

Model LPA Provisions for Subscription Credit Facilities

The first step in determining if a subscription credit facility, often called a capital call facility (a “Subscription Facility”), is a viable option for a private equity or similar investment fund (a “Fund”) is to diligence the limited partnership agreement or other organizational document of the Fund (the “LPA”). Subscription Facility lenders usually require that specific concepts and language be included in an LPA in order to provide a Subscription Facility without additional credit support, such as investor consent letters. Below, we provide model LPA Subscription Facility language, examine some of the most important LPA provisions that lenders may require and discuss certain obstacles that may arise depending on the language included in LPAs.

Subscription Facility Provisions and Model Language

An ideal LPA from a Subscription Facility perspective will include the following:¹

- Explicitly permit the incurrence of indebtedness by the Fund in connection with a Subscription Facility as a borrower and/or guarantor.
- Specifically contemplate a Subscription Facility and the related pledge of collateral and corresponding acknowledgments from the Fund’s limited partners (the “Investors”) of the Fund’s pledge to a lender of the uncalled capital commitments to the Fund, the general partner’s related right to call capital and the collateral account.
- Authorize the joint and several borrowings (or cross-collateralization) with alternative investment vehicles and parallel funds. This is key in order to provide one Subscription Facility to an entire Fund complex.
- Acknowledge that Investors will be obligated to fund their capital contributions into a collateral account of the Fund that will be pledged to the lenders as security under the Subscription Facility loan documents.
- Include an explicit agreement by the Investors to fund their capital contributions without setoff, counterclaim or defense, including certain defenses under bankruptcy. This is a key provision for lenders because their underwrite is primarily based on the creditworthiness of the Fund’s Investors—and thus disputes between Investors and the general partner should not be a risk that is allocated to the Subscription Facility lender.
- Acknowledge that the lenders are relying on the capital contributions as their primary source of repayment. This language is important to lender analysis, as such language was referenced by one of the key court decisions that has examined Subscription Facilities.²
- Acknowledgement by the Investors that their capital contribution obligations are legal, valid, binding and enforceable.
- ¹²Subordinate any claim an Investor might have against the Fund to the lenders.

¹ NTD: Duplicative of the 4th bullet point.

² NTD: Reservation of sovereign immunity is investor-specific and included in side letters rather than LPA so any language with respect to immunity is addressed in the side letter or investor consent letter (if applicable).

- Provide for an Investor's delivery of financial information, confirmation of uncalled capital commitments, an investor consent letter and, with respect to certain pension plan Investors, certain representations or confirmations relating to ERISA requirements.
- Specifically carve out any overcall limitations in the LPA relating to management fees, defaulting Investors or excused Investors with respect to the Subscription Facility. Note that such debt carve-outs should also be included in the overcall provision directly in order for the LPA not to internally conflict.
- Provide that any Investor transfer or withdrawal from the Fund may result in a capital contribution to repay obligations under the Subscription Facility.
- Establish that the lenders are third-party beneficiaries of the LPA, and if there is "no third-party beneficiary" language in the LPA, the lenders should be adequately carved out of such limitation.

Below is model language addressing each of these points:

The Fund and General Partner shall be authorized to incur Indebtedness under such terms as they may elect, including, but not limited to, on a joint and several basis with Parallel Funds, Alternative Investment Vehicles and other affiliates of the Fund. In connection therewith, the Fund and General Partner shall be authorized to pledge, charge, mortgage, assign, transfer and grant security interests to a lender in (i) all Capital Commitments of the Partners, the General Partner's right to initiate Capital Calls and collect the Capital Contributions of the Limited Partners and to enforce their obligations to make Capital Contributions to the Fund; (ii) the Subscription Agreements and in the Partners' obligations to make Capital Contributions thereunder; and (iii) a Fund collateral account (the "Collateral Account") into which the payment by the Limited Partners of their uncalled Capital Commitments are to be made (any such financing, a "Subscription Facility").

Each Limited Partner understands, acknowledges and agrees, in connection with any Subscription Facility, that (i) it shall remain absolutely and unconditionally obligated to fund Capital Contributions duly called by the General Partner or by the lender (as collateral assignee) under a Subscription Facility (including, without limitation, those required as a result of the failure of any other Limited Partner to advance funds with respect to a call for a Capital Contribution), without setoff, counterclaim or defense, including without limitation any defense of fraud or mistake, or any defense under any bankruptcy or insolvency law, including Section 365 of the Bankruptcy Code, subject in all cases to the Limited Partners' rights to assert such claims against the Fund in one or more separate actions; provided that, any such claims shall be subordinate to all payments due to the lenders under a Subscription Facility; (ii) its Subscription Agreement and this Partnership Agreement constitute such Limited Partner's legal, valid and binding obligation, enforceable against such Limited Partner in accordance with their terms, subject to applicable bankruptcy, insolvency, reorganization, moratorium or other laws affecting creditors' rights generally and to general principles of equity; (iii) the

lender under the Subscription Facility is extending credit to the Fund in reliance on such Limited Partner's funding of its Capital Contributions as such lender's primary source of repayment; (iv) so long as the Subscription Facility or obligations thereunder remain outstanding, all payments made by such Limited Partner pursuant to this Partnership Agreement or its Subscription Agreement shall be made to the Collateral Account, and any payments not made to the Collateral Account will not satisfy such Limited Partner's obligation to fund its Capital Commitment; (v) the making and performance of the obligations under the Partnership Agreement and the Subscription Agreement constitute private and commercial acts rather than governmental or public acts; (vi) neither it nor any of its properties or revenues has any right of immunity from suit, court jurisdiction, execution of a judgment or from any other legal process with respect to its obligations under the Partnership Agreement or the Subscription Agreement, including the obligation to make Capital Contributions; (vii) any termination, reduction or release of its Capital Commitment may require the consent of the lenders under and pursuant to a Subscription Facility; and (viii) all claims it may have against the Fund, the General Partner or any affiliate thereof shall be subordinate to all payments due to the lenders under a Subscription Facility.

Each Limited Partner hereby represents and warrants that (i) it has the power and requisite authority to execute, deliver and perform its respective obligations (including the Capital Contribution obligations) under this Partnership Agreement and its Subscription Agreement and (ii) its Subscription Agreement and this Partnership Agreement (including the Capital Contribution obligations) constitute such Partner's legal, valid and binding obligation, enforceable against such Partner in accordance with their terms, subject to applicable bankruptcy, insolvency, reorganization, moratorium or other laws affecting creditors' rights generally and to general principles of equity.

Each Limited Partner further agrees to deliver, if requested by the General Partner for provision to the third-party lender, (i) its most recent financials; (ii) a certificate confirming the remaining amount of its uncalled Capital Commitment; and (iii) an investor letter and/or authority documentation relating to its entry into its Subscription Agreement and this Partnership Agreement, and such other instruments as the General Partner or such lender may reasonably require in order to effect any such borrowings by the Fund or any of its Subsidiaries. In addition, in connection with any Subscription Facility, each ERISA Partner confirms that a fiduciary of such ERISA Partner has confirmed that (A) it made its own determination that such ERISA Partner's investment in the Fund and execution of this Partnership Agreement were made on terms that are no less favorable to such ERISA Partner than those that could be obtained in arm's-length transactions with unrelated parties; (B) the decision to invest in the Fund and to execute and deliver this Partnership Agreement was made by such fiduciary; (C) such ERISA Partner (or commingled funds of related plans): (x) has no less than \$100,000,000 of assets

and (y) not more than five percent (5%) of the assets of such ERISA Partner (or commingled fund) have been invested in the Fund; and (D) no Subscription Facility lender (1) has had any influence, authority or control over such ERISA Partner's investment in the Fund or (2) has rendered investment advice with respect to such ERISA Partner's investment in the Fund.

Notwithstanding anything in this Partnership Agreement, its Subscription Agreement or any Side Letter to the contrary, each Limited Partner acknowledges and agrees that (i) any excuse right or other limitation with respect to any Capital Contribution (including the payment of any management fee) shall not be applicable with respect to any Capital Call the purpose of which is to repay amounts due under the Subscription Facility, regardless of whether the related Capital Call is issued by the General Partner or the lender (as collateral assignee) under the Subscription Facility; and (ii) in the event such Limited Partner is entitled to transfer its interest or withdraw from the Fund pursuant to any provision of this Partnership Agreement, its Subscription Agreement or its Side Letter, prior to the effectiveness of such transfer or withdrawal, as applicable, such Partner shall be obligated to fund such Capital Contributions as may be required under the terms of the Subscription Facility as a result of such transfer or withdrawal; *provided*, that in no event shall any amounts funded by such Limited Partner exceed its uncalled Capital Commitment.

Notwithstanding anything herein to the contrary, including Section [Insert Third Party Beneficiary Provision], each lender and other secured party under a Subscription Facility shall be an express and intended third-party beneficiary.

Commitment Period and Key Person Events

In addition to the foregoing Subscription Facility provisions, lenders will examine the Fund's commitment period to determine whether capital calls for the purpose of repaying indebtedness (including principal, interest and fees) are explicitly authorized during the commitment period, any suspension (i.e., after a key person event) or after the termination of the commitment period. Many LPAs will explicitly address interest and fees through the definition of "Partnership Expenses" but will not explicitly address principal. Clarifying this ambiguity or otherwise providing that Subscription Facility indebtedness may be repaid following any suspension or termination of the commitment period will provide the most flexible terms under the Subscription Facility.

Debt Limitations

Of course any limitations on the incurrence of indebtedness are scrutinized by lenders, including any limits on the amount of debt and/or guarantees that may be incurred and the amount of time debt may remain outstanding (commonly known as "clean-down" provisions). Many LPAs carve out Subscription Facility debt from their debt limitations, especially if the

debt is short term, in order to give the Fund maximum flexibility in using the Subscription Facility to bridge asset purchases quickly and effectively.

Remedies

Subscription Facility lenders will also look to see if the LPA provides adequate predefined remedies if an Investor fails to comply with the terms of the LPA, including failing to make capital contributions. Market remedies include, among other things, an ability to charge default interest, reduce the Investor's capital account and sell the Investor's interest in the Fund at a reduced price. Additionally, as noted above, it is key that the LPA explicitly provides that non-defaulting investors may be called on (up to their uncalled capital commitments) to make up any deficiency caused by a defaulting Investor.

Adequately addressing the foregoing concepts directly in the LPA will help a Fund obtain more competitive bids that provide the greatest amount of flexibility for its Subscription Facility needs and most likely avoid the need for investor consent letters.³

Endnotes

- ¹ While some of these provisions may not be necessary in order to authorize and/or structure a Subscription Facility, they provide Subscription Facility lenders desired clarity and comfort on key points. Accordingly, even though a Fund might be authorized to incur indebtedness and pledge assets generally via the broad authorizing terms of the LPA and/or by virtue of relevant governing law, adding specific Subscription Facility provisions will assist the Fund in obtaining the most advantageous structures and pricing.
- ² See *In re LJM2 Co.-Investment, L.P.*, 866 A.2d 762 (Del. Super. Ct. 2004).
- ³ Investor consent letters are typically required by the market for highly concentrated investor pools (including single-investor Subscription Facilities) even with ideal LPA provisions.

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