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Blockers and Tackling

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Blocker entities are a common part of private equity fund structures. In many cases, blockers are used to insulate foreign and tax-exempt investors from direct tax liability in the fund's home jurisdiction. Blockers are generally intermediate entities that receive capital contributions from a feeder fund and then contribute those funds to a master fund. While blockers may be one of several intermediate entities between a feeder fund and a master fund or an aggregator vehicle, for simplicity this article assumes that the blocker is the only entity between a feeder fund and a master fund.

Some lenders are not concerned about blockers in facilities in which the master fund, as a borrower, and the feeder fund, as a guarantor, each provide a direct pledge of collateral to the lender (or to the administrative agent, in a syndicated facility). Given that the primary source of repayment of a subscription facility is the unfunded commitments of limited partners, such lenders reason that the ability to take control of the feeder fund (and master fund) collateral account and trap funds in such account is sufficient protection.

Other lenders take a more conservative view and want direct access to any cash that may be in a blocker account upon a cash control event or event of default. One way to accomplish this is through a blocker acknowledgment which provides that the blocker has a contractual obligation to contribute any capital contributions received by such blocker to a master fund collateral account within a short period of time. A blocker acknowledgment gives the lender direct recourse against the blocker for failure to make the required contribution to the master fund. However, it does not give the lender a security interest in the account of the blocker into which feeder funds deposit capital contributions or the ability to take control of that account. Therefore, a lender may require the blocker to pledge the applicable account to the lender and

enter into any necessary control agreements to perfect the lender’s security interest in such account.

Fund borrowers often argue that the pledge of the blocker’s account is unnecessary if the lender has the ability to trap capital contributions made to a feeder fund and the blocker has executed an acknowledgment that requires any capital contributions to the blocker be deposited in a master fund collateral account. However, a lender may want to enter into a pledge and control agreement with respect to a blocker account in order to be able to take direct action with respect to that account rather than having to enforce under a blocker acknowledgment and therefore rely upon a potentially uncooperative sponsor.

If the facility provides for a cascading pledge structure, lenders may want to consider reviewing the underlying fund documents with respect to blockers. Blocker acknowledgments may be appropriate if the feeder fund has a direct commitment to the master fund, and may therefore make capital contributions directly to the master fund rather than through a blocker. However, if there is no such direct commitment and capital contributions *must* flow through the blocker, the blocker should be included in the cascading pledge.

If a blocker is incorporated into a cascade, amendments to the underlying fund documents of the blocker are often required, given that such documents may not contemplate a pledge of capital commitments or a subscription facility. Such amendments may include changes with respect to capital commitments, rights associated with making capital calls, and remedies related to defaults by limited partners. Such rights should be clearly spelled out and pledged indirectly to the lender through the cascade.

In sum, while it is easy to assume that blockers are inconsequential or can easily be dealt with, the structure of the fund, the constituent documents of the credit parties, and the collateral structure of the facility should all be carefully considered when blockers are present.