

FUND FINANCE FRIDAY

LP Givebacks Anyone?

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This article follows the considerations set out in Chad Stackhouse’s *Fund Finance Friday* article, “Getting It Right: Recallable Capital Provisions,” published on 9 July 2021.

LP Givebacks

We agree that almost all long-form partnership agreements (and the ILPA Model Limited Partnership Agreements) include a “return of distributions” provision, whereby limited partners are required to contribute capital to the partnership to cover obligations of the partnership out of distributions previously made by the partnership (the “LP Giveback”). The LP Givebacks are heavily negotiated between sponsors and seed investors and usually limited by cut-off times and/or percentage amounts of distributions or commitments. The general partner of the partnership may only exercise its right to “clawback” distributions from the limited partners under the LP Giveback where the partnership agreement explicitly authorises the general partner to do so.

LP Giveback provisions in partnership agreements can cover different things. In some cases, the limited partners’ obligations to contribute capital to the partnership as an LP Giveback is limited to fund the indemnity obligations of the partnership, whilst in other cases, the obligations are broader and the limited partners are required to fund any liability of the partnership, including indebtedness (the “Liability”). Naturally, the general partner may only operate the LP Giveback provisions where the uncalled capital commitments of the limited partners (the “Uncalled Capital Commitments”) are exhausted. The contractual obligation of the limited partners to contribute capital to the partnership under the LP Giveback provisions is distinct from the obligation to fund Uncalled Capital Commitments. Indeed, some partnership

agreements expressly establish that amounts contributed by limited partners as LP Givebacks are not treated as capital contributions.

Recallable Capital

We must distinguish LP Givebacks from recallable commitments. For the purpose of this article, recallable commitments means the unused capital contributions of the limited partners returned to them by the general partner and the recycled distributions of the partnership which are liquidity proceeds of realised investments distributed to the limited partners with a provision that they could be recalled later (the “Recallable Capital”). Recallable Capital, once it is returned to the limited partners, is added back to the limited partners’ uncalled capital commitments, thus increasing the Uncalled Capital Commitments. As set out above, the obligations of the limited partners to inject capital to fund Liabilities as an LP Giveback would not increase (nor, if paid, discharge) their Uncalled Capital Commitments.

Security considerations

Lenders of capital call financing (the “Facility”) lend against the Uncalled Capital Commitments of the limited partners. Most partnership agreements describe the Uncalled Capital Commitments of the limited partners as the capital commitments which are available to be called by the general partner, including capital commitments that have never been contributed to the partnership, as well as returned or recallable capital commitments. From this definition, it is clear that Recallable Capital is part of the Uncalled Capital Commitments.

In order to secure the obligations of the partnership under the Facility, a security interest (usually by way of an assignment) is created over the general partner’s right to call Uncalled Capital Commitments from the limited partners of the partnership. Most security assignment agreements fail to create security over the general partner’s right to demand capital contributions from the limited partners beyond the Uncalled Capital Commitments. As Uncalled Capital Commitments decline during the life of the Facility, lenders may wish to consider requesting the general partner to grant a security interest over its right to demand funds from the limited partners under LP Givebacks (and in *Shaw v Lighthouseexpress Ltd* [2010] EWCA Civ 161, the English Court of Appeal concluded that indemnities are freely assignable). If under the partnership agreement the limited partners are required to provide capital to the partnership as an LP Giveback in order to fund Liabilities of the partnership (including its obligations under the Facility), lenders may wish to be in a position to request the injection of capital under the LP Giveback provisions to fund the Liabilities of the partnership under the Facility once the Uncalled Capital Commitments are exhausted. The fact that LP Givebacks are not part of the borrowing base of the Facility should not necessarily mean that the LP Givebacks are excluded from the collateral package. Lenders would, of course, prefer to be overcollateralised for typical reasons that are beyond the scope of this article.

Practical considerations

Most partnership agreements do not expressly envisage the creation of a security interest over the general partner’s right to demand the limited partners to fund LP Givebacks. Silence does not necessarily mean that this is impossible; however, close review of the relevant provisions of the partnership agreement will be required for the smooth implementation of a security package over the right to demand LP Givebacks. In order to avoid uncertainty of interpretation (and

create a potential misalignment between the commercial interests of partners of the partnership), the partnership agreement should expressly stipulate the possibility of the general partner creating a security interest over its rights to demand the funding of the LP Givebacks, with associated mechanics such as provisions around demand notices, if that is the commercial intention. The wording can be carefully crafted to ensure that such security interest could only be granted in favour of a fund finance lender, and other provisions of the partnership agreement should also be adjusted to support this. For example, wording around limited partners honouring the demand of the lender to fund LP Givebacks without any set-off or defences would be expanded, as would certain third-party rights provisions in favour of the lender. It is also worth highlighting that LP Givebacks invariably are time-limited by applicable cut-off dates (perhaps by reference to the date of a prior distribution), thus security may be of critical importance where speed of enforcement is essential.

Fund formation and finance lawyers should be attuned to these considerations as the market moves on with pace.