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FUND FINANCE FRIDAY

Missing Persons

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When an investor chooses a private equity fund, it is a calculated gamble on that fund's general partner and more specifically its managing principals and the members of the investment team (the "Key Persons"). The Key Persons are the individuals who the investors believe are critical to sourcing, making, managing and exiting from investments to maximize the investor's return. A lender providing a subscription facility to a fund is also concerned with that fund's management. These are the individuals that the lender is partnering with to provide liquidity and the Key Persons provide stability, predictability and, most important to the lender, instill confidence to incentivize an investor to fund its capital commitment to repay obligations under a subscription facility.

Once the investors have made their choice to invest and a fund has compelled a lender to provide a subscription facility, a primary concern of investors and lenders alike is what happens if a Key Person dies, is permanently disabled or otherwise ceases to be involved in managing the fund (a "Key Person Event"). During a fund's investment period, the fund can make investments, dispose of investments, distribute proceeds from asset sales and generally function in the manner that induced the investors to choose to invest at the outset. When a Key Person Event occurs, the investment period is paused and the fund must decide on the next steps, including whether to appoint new key persons or permanently end the investment period. From a lender's standpoint, the occurrence of a Key Person Event often triggers a potential default or an event of default under a subscription facility and forces the remaining principals and the lender to engage in communication about the fund's future plans.

As a general matter, a lender is often willing to live with how the fund decides to define a Key Person Event in its partnership agreement but expects those defined events to continue throughout the life of fund or, at a minimum, through the scheduled investment period (*i.e.,* the three- or five-year period from final closing of new investors as stated in the partnership agreement). A recent trend in partnership agreements seems to frustrate that expectation. We have seen an increasing number of partnership agreements where the occurrence and ramifications of a Key Person Event end after an 18- or 24-month period beginning with the first investor closing. In other words, if a lender ties its trigger event for the occurrence of a potential default or an event of default to how the fund defines a Key Person Event in its partnership agreement, the protection it seeks is lost when the time period lapses. The lender may unknowingly lose the right to pause borrowings upon the occurrence of a Key Person Event because the partnership agreement definition of a Key Person Event disappears with simply the passage of time.

At Cadwalader, determining how a Key Person Event is defined and whether investors must continue to fund to repay debt after the occurrence of a Key Person Event has always been part of our diligence checklist. But now there is a new cautionary tale to alert lenders to in undertaking the review of a partnership agreement. Does the Key Person Event continue as expected or does the defined event unexpectedly disappear? If the latter, counsel must alert the lender to this fact and take the steps necessary to make sure parties come to the table to discuss the path forward in all instances.

Much like the aforementioned disappearing events, 2023 is coming to an end and is about to pass into the annals of history. It was a year marked by twists and turns, highs and lows and opportunities and resiliency. It did not start how I expected, but it taught us all how to navigate challenges. The fund finance industry came together in ways we never expected, and each of us has a story to tell or a reflection on the events of 2023. We are hoping the best 2023 story you can tell is the joy you experience this Holiday Season.