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FUND FINANCE FRIDAY

Some Key Considerations When Lending to a Master-Series Fund

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Master-series funds are definitely not on our desks on a daily basis; however, they do arise from time to time, and certainly as transactions are becoming more and more bespoke. Care should be taken by lenders when lending to these types of funds and in particular when putting the relevant loan documentation (including the security package) in place. Before delving into that, we thought it would be helpful to first take a look at what master-series funds are and why they are employed. We will then take a closer look at some of the key considerations to take into account when advancing credit to these entities, and when taking a security interest in respect of their investor capital commitments in a subscription credit facility.

- What is a Series Fund?

Various states such as Delaware allow for the formation of master-series limited liability companies and limited partnerships ("Series Funds"), which consist of a parent or master fund (the "Umbrella Fund") with one or more subunits or series (each, a "Series") that are established under the Umbrella Fund. The defining feature of a Series Fund is that, in addition to being able to create multiple Series under one Umbrella Fund, each Series can have characteristics that are separate from the Series Fund itself and every other Series. For example, each Series is permitted to have its own business purpose, assets, liabilities, partners/members, general partner/investment manager and partner/member rights, powers and duties.

- Why use a Series Fund?
- **Administrative Ease**. A key advantage in using a Series Fund is the more efficient management of multiple separate business activities within one single legal entity.
- **Cost savings**. A Series Fund is required to be formed by filing a certificate of formation or certificate or limited partnership (as applicable) with the relevant Secretary of State. This saves on filing fees since the Umbrella Fund is able to set up as many Series as the members see fit under only one filing. Series Funds generally also require only one annual franchise tax filing per Umbrella Fund.
- **Legal Separateness**. If structured accordingly, the debts, liabilities, obligations and expenses of one Series cannot be enforced against another Series of the Series Fund or against the Series Fund as a whole. This can be attractive to investors as it insulates the activities of a Series from another, providing liability protection. It is worth pointing out that this is distinct to a traditional limited liability company ("LLC") or limited partnership ("LP") with separate classes of members/partners since, while the members/partners in different classes may have different rights or obligations within the relevant class, unlike a Series Fund, the internal organizational structure doesn't impact the obligations and liability of the LLC/LP as against creditors and counterparties.
- Key Considerations for lenders when lending to a Series Fund:
- ***Organizational Documents***

As with any fund finance transaction, the organizational documents of the fund should be thoroughly diligenced in order to determine whether the fund is in fact "bankable", and of course to determine the structure of the deal. With a Series Fund, extra scrutiny should be taken with respect to the liability segregation of the Series within the Series Fund. For example, it's essential to understand whether liability amongst the Series is *in fact* entirely segregated. It's also important to understand what capital commitments are callable by what Series and whether there are any differing restrictions on debt depending on the Series. All of this information will help determine the structure of the deal. For example, the parties may employ an umbrella credit facility if there is complete liability segregation as between the

Series; if there is no liability segregation between the Series, then the Series borrowers may be jointly and severally liable for the obligations under the facility. Depending on how the Series Fund is set up, it may also make sense to have separate borrowing bases for each Series.

- ***State Law Considerations***

Lenders should understand whether the Series Fund state of formation in addition to the governing law of the facility agreement recognizes a Series Fund structure. Some states formally recognize Series Funds, such as Delaware, and have relevant statutes associated therewith, which makes it easier, for example, to determine whether or not that state will recognize the assets and liabilities of the Series as distinct. Certain states have different conditions to be complied with in order to recognize the assets and liabilities of the Series as distinct, and it's essential to ascertain whether or not the legal formalities of the specific state have been complied with when structuring the facility. Consideration will also need to be given as to whether any state law specific covenants should be included in the loan documentation.

- ***Security Interest***

When putting the security documentation in place it's essential to understand what entity holds the capital commitments comprising the collateral and what entity can call on the uncalled capital commitments in order to ultimately repay the facility. Lenders need to ensure that they are taking a security interest over the correct entity.

Care also needs to be taken with respect to the name of the Series, since sometimes it is not always clear. Lenders can't simply look up the name of the Series on a certificate of formation or certificate of limited partnership. Sometimes the organizational documents of the Series Fund may refer to a Series in multiple ways. For example, "X, a Series of Umbrella Fund Y" or "Series X, a series of Umbrella Fund Y" etc. Careful legal analysis should be carried out in order to determine the correct name of the Series.

The state law governing formation of the Series Fund should also be taken into account when putting the relevant security documentation in place. Certain states do not grant a Series separate legal personality, meaning that the Series can't be a "debtor" under Article 9 of the Uniform Commercial Code. In such a scenario, the Umbrella Fund would likely need to be included as a grantor and pledgor under the related security documentation in addition to the borrower Series.

- ***Perfection of Security Interest***

State law governing formation of the Series Fund is also an important factor to consider when determining perfection requirements of the related security interest. This will inform where the UCC-1 filing should be made. The principal place of business should also be considered for Series funds since sometimes a filing may be required in a separate jurisdiction if the principal place of business is different from the jurisdiction in which the Series Fund was formed. The name of the Series is also an important factor when perfecting the security interests, and sometimes it is advisable to use multiple naming conventions if the name of the Series is unclear. It is highly advisable to seek guidance from specialist counsel when determining the perfection requirements with respect to a Series Fund security interest, since it can be quite nuanced.

- ***Judicial Treatment of Series Funds***

A potential downside to employing Series Funds is that case law supporting their judicial treatment hasn't been widely developed, and so there is still some degree of uncertainty related to their usage. This is more of a concern in states that do not formally recognize Series Funds.

- ***Treatment of Series Funds under the U.S. Bankruptcy Code***

Treatment of Series Funds under the U.S. Bankruptcy Code is also uncertain as it's not fully clear that a Series would constitute a "debtor" thereunder, and hence whether a bankruptcy court would uphold the assets and liabilities of one Series as separate and distinct from another. It is advisable to consult a bankruptcy specialist when documenting the loan, and to build certain mitigating language into the loan documentation where applicable.

Summary

While Series Funds are attractive vehicles to sponsors given the various administrative benefits and cost savings associated therewith, care should be taken by lenders when lending to them. The foregoing is just a general overview of some of the main issues to be aware of when lending to a Series Fund. The Cadwalader team is happy to answer any specific questions with respect to Series Funds, and we remain available to advise lenders as to how they can best structure their deal documents when transacting with a Series Fund.