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FUND FINANCE FRIDAY

Subscription Finance Loan Agreement Series, Part 17: Events of Default

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We are nearing the end of this series of articles (and making good progress through the clauses of particular interest in the fund finance market, which we are examining). This week we turn our attention to the Events of Default contained in an LMA-based subscription/capital call facility.

As one would expect, in general, Events of Default in subscription/capital call facilities have many features in common with Events of Default contained in other LMA-based loan facilities. We will spend a little time looking at some of those, where there may be some things to think about when adapting these for subscription/capital call facilities, along with a look at some Events of Default which would typically be included only in these types of facilities. We will finish up with some thoughts on other Events of Default which might be relevant in the context of recent events in the market.

As with most discussions on these (and other) facilities, where exactly the balance is struck on a number of these issues depends in large part on the commercial intent and priorities of the parties. For example, as with any other facility, these facilities will include right at the top a "non-payment" Event of Default, and this will generally be drafted in a very similar way to any other LMA-based facility, with any non-payment causing an immediate Event of Default (with some very limited exceptions). For any fund, it is important not to get tripped up by this, so while it is hard to pull back the "non-payment" Event of Default itself, it is important to consider throughout the document where and when obligations to pay arise and to ensure that the fund has sufficient time to access cash (or its investors) to honour such payments.

Following on from "non-payment" are a set of Events of Default for which, if they occur, no grace period (or perhaps a very limited grace period) will apply. In almost all LMA-based facilities, these include a breach of financial covenants, and the subscription/capital call facility is no exception. However, there are other events particular to subscription/capital call facilities which lenders may consider including here. Without providing an exhaustive list, examples would include non-compliance by the fund or its representatives with their LPA and/or the investment policy set out in the limited partnership agreement, or a failure to provide certain information (*e.g.,* financial statements or compliance certificates on time). Compliance and information are both crucial parts of any subscription/capital call financing, hence their inclusion.

Then come a series of Events of Default which also have much in common with those in other LMA-based facilities, including a breach of any other obligations (*i.e.,* other than those specified in the clauses we just considered above or otherwise specified as Events of Default separately) and any misrepresentation. Generally, these Events of Default will only occur if they are “capable of remedy” and are not “remedied” within a set period (often called a “cure period” and set somewhere between 15 and 20 days or business days). The question of what breaches of a facility agreement may be “capable of remedy” and, in what circumstances, is for a separate article. However, a point to note here (and often the subject of discussion) is how the concepts of Events of Default being “capable of remedy” and “cure periods” in this section interact with one of the “standard” interpretation provisions contained at the front end of the facility. That interpretation provision also references “Events of Default” and “remedies” but does not include any concept of whether an Event of Default is “capable of remedy.” For now, suffice it to say that it is worth ensuring there is some consistency between the two.

To wrap up, on Events of Default which (with very few changes) are common to most or all LMA facilities, these will also include (and this is not intended to be an exhaustive list): (i) cross default or cross acceleration of any other financial indebtedness incurred by the fund or related parties in other facilities; (ii) “insolvency” or ”bankruptcy”-related events; (iii) invalidity or repudiation of the obligations under the facility or other finance documents, and (iv) cessation of business.

Then there are a series of Events of Default that are specific to subscription/capital call facilities, and these are in many respects as important to include for lenders as are “non-payment” and other Events of Default in any other LMA-based facility. These are Events of Default focused particularly on the fund, its investors and the relevant constitutional documents of the fund. Again, without providing an exhaustive list, the events that lenders should consider here will include: (a) non-payment of obligations by withdrawal of or excuse of a material proportion of investors; and (b) in some but not all facilities, transfers by a material proportion of the original investors. What constitutes a “material proportion” for these Events of Default is a matter of negotiation but generally will be set somewhere between 10 and 20 per cent. Other specific Events of Default in this general group will include (i) the invalidity or unenforceability of the fund’s constitutional documents, including any limited partnership agreement; (ii) any termination of a general partner or manager in respect of the fund (often limited so that it only occurs if that general partner or manager is not replaced by a suitable person); (iii) the occurrence and continuation for a defined period (often 90-plus days but depending on the underlying constitutional documentation) of any suspension period caused, for example, by the resignation of “key persons” to the fund; and (iv) any termination of the fund (or possibly and depending on the potential impact on the financing) any earlier termination or ending of an investment period. Lenders may well want to include other “fund-related” Events of Default, and it is always important to ensure that these follow and reflect the due diligence done on the fund documents.

Finally, a brief word on other (or expanded) Events of Default that may be considered in the context of the fallout from the reported elements of the Abraaj case. While in many respects this is the Goldsboro incident of the fund finance world, with the impact being significantly less disastrous than could have been the case, lenders may want to consider the extent to which (subject to commercial and competitive considerations) they might seek additional or expanded Events of Default to add to their protections against the type of reported events in that case.

These may include (and again this is not an exhaustive list) the addition of, for example, significant disputes between investors and the fund or its general partner or manager (even in the case of the latter, in relation to funds other than the borrower) and the expansion of “insolvency”-type Events of Default to other holding or affiliate entities in the same group as the general partner or manager.