

FUND FINANCE FRIDAY

Investor Letters: Key Provisions

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Even though the market practice has shifted away from obtaining investor letters (“Investor Letters”) for many subscription-based credit facilities (“Facility”), Investor Letters continue to be an effective option to provide additional credit support for certain types of Facilities with single managed accounts and challenging lender provisions in side letters. One of the reasons for this change is that Limited Partnership Agreements (“Partnership Agreements”) have become much more lender-friendly, provide more robust secured Facility provisions, and include many of the important Investor Letter provisions. Investor Letters have historically supplemented the standard loan and security documents and fund formation documents to provide direct assurances from a limited partner (“Fund Investor”) to a lender that the Fund Investor unconditionally stands by its capital commitment to a fund (“Fund”). In this article, we will explore a few of the key provisions contained in Investor Letters and the significance of each to a lender in a subscription facility.

An Investor Letter is an acknowledgement and agreement made by a Fund Investor for the sole purpose and benefit of a lender extending credit to a Fund in a Facility. The Investor Letter provides for certain representations, acknowledgements, and covenants by the Fund Investor to a lender that the Fund Investor will honor its capital commitment to the Fund and make capital contributions when called by the Fund to repay any outstanding credit extensions made by such lender to the Fund. The lender will rely on these representations, acknowledgements, and covenants to provide the extension of credit to the Fund. An Investor Letter is usually appropriate and required by a lender in a Facility when there is (a) a single managed Fund Investor, (b) a public institution or agency such as a state pension plan absent a statutory waiver, (c) a capital commitment concentration that exceeds a certain percentage of the overall Fund commitment (usually between 25% and 35%), or (d) a Fund Investor side letter provision that would limit or impair a lender’s security or provide for the termination or withdrawal by the Fund Investor of its capital commitment to the Fund. Best practices would recommend an Investor Letter for the above-mentioned circumstances.

When preparing an Investor Letter there are a few key provisions that should be included as condition precedent to the Fund Investor being included in the Facility borrowing base. The following is by no means intended to be an exhaustive list, and lender's counsel should conduct the necessary diligence with respect to each Fund Investor and customize the provisions of the Investor Letter accordingly.

Fund Documents. The first few paragraphs of the Investor Letter should clearly identify the purpose of the Investor Letter and describe the documents governing the subscription made by the Fund Investor to the Fund. The purpose of the Investor Letter is to create a written agreement between the Fund Investor and lender placing the two parties in contractual privity in which the Fund Investor acknowledges the lender's Facility to the Fund and that it might be called upon to make a capital contribution to repay the outstanding obligations of the Facility. The documents governing the Fund Investor's subscription are typically a subscription agreement ("Subscription Agreement") and a Partnership Agreement pursuant to which the Fund Investor has agreed to (a) purchase a limited partnership interest in the Fund and (b) fund capital calls of the Fund up to its commitment amount ("Commitment"). The Investor Letter should specifically set forth the aggregate Commitment, the dollar amount of the Commitment that has been called by the Fund to date, the dollar amount that has been funded to date by the Fund Investor, and the dollar amount of the remaining unfunded Commitment ("Unfunded Commitment") that may be drawn upon the delivery of one or more written requests pursuant to and in accordance with the Partnership Agreement ("Capital Call Notice").

Unconditionally Obligated. It is critical that the Investor Letter contain a provision in which the Fund Investor acknowledges and confirms to the lender that, under the terms of the Partnership Agreement, the Fund Investor (a) is and shall remain absolutely and unconditionally obligated to fund its Unfunded Commitment in accordance with the Partnership Agreement and (b) agrees to fund capital calls without setoff, counterclaim, or defense, including without limitation, any defense under Section 365 of the U.S. Bankruptcy Code. The agreement by the Fund Investor to unconditionally fund a Capital Call and to waive defenses is the heart of the Investor Letter. It provides the lender with assurances that the Fund Investor is committed to the ongoing capital funding and helps mitigate against the potential risk of the Fund Investor failing or refusing to fund a capital call to repay any outstanding obligations under a Facility. Additionally, these contractual waivers create an estoppel that would preclude the Fund Investor from asserting a defense to funding a capital call under the Partnership Agreement.

Facility Acknowledgement. The Investor Letter should contain a paragraph that provides for the acknowledgment and consent by the Fund Investor of the Facility. This paragraph would include some or all of the following: (a) acknowledge the Facility is a subscription line of credit or similar term as contemplated under the Partnership Agreement; (b) consent to the direct pledge and assignment by the Fund and general partner of the Commitment and the right to issue Capital Call Notices and receive all capital call contribution proceeds in order to secure the payment and performance of the obligations of the Fund under the Facility; (c) represent that no default or event of default has occurred, which would constitute a defense to, or right of offset against, the Fund Investor's obligation to fund its Commitment or otherwise reduce the Commitment and no defense to or right of offset exists against the Fund Investor's obligation to fund its Commitment; (d) represent that the Subscription Agreement, the Partnership Agreement, and the Investor Letter constitute valid and binding obligations, enforceable against the Fund Investor; (e) acknowledge that for so long as the Facility is in place, the General

Partner and the Fund have agreed with the lender not to amend, terminate, reduce, or suspend any of the Fund Investor's obligations under the Subscription Agreement or Partnership Agreement; (f) acknowledge and confirm that, for so long as the Facility is in place, all payments made by the Fund Investor under the Partnership Agreement will be made by wire transfer to an account maintained with the lender and which the Fund has also pledged to the lender as security for the Facility; and (g) agree to honor any Capital Call Notice delivered to the Fund Investor in the name of the lender, without setoff, counterclaim or defense. These acknowledgements are an important part of the Investor Letter because it puts the Fund Investor on notice of the Facility, removes any ambiguity as to whether the Facility is permitted under the Partnership Agreement, creates an effective estoppel, and establishes the consideration by the Fund Investor to make the Investor Letter an enforceable contract. Moreover, these acknowledgements and agreements by the Fund Investor, together with the collateral pledged by the Fund under the security documents evidencing the Facility, collectively form the basis to which a lender may seek recovery for the repayment of its Facility.

Sovereign Immunity. The Eleventh Amendment extends the doctrine of sovereign immunity to state governments and agencies and protects them from being sued in federal or state court without their consent. Many state constitutions and legislations have provided for exceptions to the sovereign immunity protections, such as when a state entity enters into a commercial contract with a private individual or company. When a Fund Investor is a public institution or a state agency, it is important to know if a statutory or common law waiver applies under state law. In our experience, most state laws do and would obviate a separate consent to suit in writing via an Investor Letter. However, if a statutory waiver of the sovereign immunity protection doesn't apply or if the Fund Investor is also a single managed Fund, including an express consent to such waiver in an Investor Letter would be prudent and will have the same effect as a statutory waiver of the doctrine of sovereign immunity against the Fund Investor. A typical waiver of sovereign immunity paragraph in an Investor Letter will include an acknowledgment by the Fund Investor that (a) it is subject to commercial law with respect to its obligations under the Partnership Agreement, the Subscription Agreement, and the Investor Letter; (b) entering into and performance of the Partnership Agreement, the Subscription Agreement, and the Investor Letter constitute private and commercial acts rather than governmental or public acts; and (c) any sovereign immunity shall not relieve the Fund Investor from any of its obligations under this Letter, the Subscription Agreement or the Partnership Agreement, including, but not limited to, the obligation to fund the Commitment.

Conclusion. While the prevalence of Investor Letters has faded over the past few years, we still see Investor Letters being a valuable tool for lenders to rely on when considering a Facility to one of the above-mentioned Fund structures. Investor Letters can be very effective tools to mitigate against potential risk to a lender by having contractual privity with the Fund Investor, an agreement by the Fund Investor to unconditionally fund capital contributions for the purpose of repaying the Facility without defense, setoff, or counterclaim, and an affirmative consent to the Fund entering into the Facility with the lender.