CADWALADER

Joint and Several Liability

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Rose Capital, a Greenwich, Connecticut-based private equity firm, last week announced the closing of a $55 million fund focused on the cannabis industry. While a decision to lend to this fund would be an intended transaction, it reminded us of questions that will hit the fund finance market sooner rather than later: What if a fund borrows under a subscription line to acquire a portfolio company in the cannabis space? Or what if a fund seeks to join a cannabis-oriented portfolio company as a qualified borrower under a facility? Getting the munchies???

First, let's get into the weeds with respect to the legal aspects. Here is the state of play on the legalities of lending to the cannabis industry in the United States:

- Marijuana is illegal under federal law, regardless of varying degrees of legalization in most states.
- The Justice Department has revoked guidance protecting state marijuana laws. Conducting financial transactions with the proceeds of cannabis sales — such as repayment of loans — could violate anti-money laundering statutes.
- Lending directly to cannabis companies, or perhaps even cannabis funds, could conceivably be tantamount to aiding and abetting illegal marijuana trafficking if the government could prove that was the intent of the finance scheme.
- FinCEN has created a suspicious activity report ("SAR") regime to address banking state-legal cannabis businesses, requiring financial institutions that knowingly bank "marijuana related businesses" to file SARs for its clients' banking activities in this space.
- Yet, many banks have filed SARs and have lent money to the cannabis industry, while federal law is black and white. How it is applied and whether there is true prosecutorial and regulatory risk is a fact-specific, case by case assessment.

Fortunately, as federal law currently stands, most subscription facility documentation in the U.S. will give lenders strong protections from adding a cannabis company as a qualified borrower based on the compliance with law and "know your customer" compliance provisions. We also believe the compliance with law sections, with particular focus on the Controlled Substances Act, would give lenders ample right to prevent a fund from using a facility to invest in a cannabis company.

Of course, the conflict between federal law and state law begs for reconciliation, and the smoke seems to be blowing in the direction of legality. Leaving, of course, franchise risk. We could see certain banks being comfortable with the franchise risk of lending to the cannabis industry, particularly indirectly under a subscription line. But others would clearly prefer to avoid the

space. On the documents side, not all lender form credit agreements contain relevant use of proceeds restrictions or restrictions on qualified borrower joinders based solely on franchise risk. We have been encouraging lenders for several years to consider general consent rights around a qualified borrower (even though the underwrite is the fund) because a lender should never be obligated to lend to a company that it is not comfortable with from a franchise risk perspective. Just say no. Going forward, and not to stir the pot, but perhaps banks want to prohibit the space by contract and not just by reliance on current law. We see these issues getting more attention in the future.

If you have cannabis lending questions, we recommend talking with Cadwalader partner Jodi Avergun (Jodi.avergun@cwt.com).

Waiving Goodbye to Sovereign Immunity in the European Market?

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Financial institutions operating in the European fund finance market are increasingly having to familiarize themselves with sovereign or state immunity laws and how these interact across multiple jurisdictions.

Lenders advancing funds against the uncalled capital commitments of “sovereign” or “state” entities (such as public pension plans or sovereign wealth funds, for example) may have serious difficulty bringing a contractual claim for payment in circumstances where that investor is in default and is able to claim immunity. Equally, a fund will want to ensure that all investors are contractually “on the hook.” For this reason, funds will typically look to obtain a waiver of immunity from the investor in question. However, the solution is not always quite so simple.

A sovereign or state entity may have immunity from both adjudication (immunity from suit) and enforcement. This gives rise to two important issues. First, can proceedings be brought against the investor in the relevant courts? And second, having obtained a judgment against that investor, can it be enforced in the jurisdiction in which that investor holds its assets? Clearly, it is of limited benefit obtaining a favorable judgment against a defaulting investor from the courts in one jurisdiction only to be restricted from enforcing that judgment in another.

Where sovereign immunity is a concern, the laws of many countries will often provide some comfort by exempting from immunity any contracts or agreements entered into by the “sovereign” or “state” entity which are entered into purely for commercial purposes.

In the U.S., for example, the Foreign Sovereign Immunities Act of 1976 (the “FSIA”) generally shields certain foreign governments and international organizations of a quasi-governmental nature, such as the United Nations, against claims in the U.S. courts. However, while the “commercial activity” exception is a major caveat to the general premise of the FSIA that a foreign government has immunity and cannot be sued in the U.S. Under the commercial activity exception, a claimant may sue a foreign government in a U.S. court when the claim is based on (i) a commercial activity carried on in the U.S. by the foreign government, (ii) an act by a foreign government that is performed in the U.S. in connection with a commercial activity outside the U.S., or (iii) an act by a foreign government that is performed outside the U.S. in connection with commercial activity that occurs outside the U.S., if such action “causes a direct effect” in the U.S. Judicial precedent in the U.S. suggests that a valid submission to jurisdiction in the

U.S. or an agreement to binding arbitration should fall into the commercial activity exception in the context of a non-U.S. governmental investor in connection with a subscription facility.

Alongside statutory protections (or in addition to them) specific waivers of immunity will often be included in a side letter. Waivers of sovereign immunity, while helpful, are not always perfect. Increasingly, as the length of investor side letters continues to grow, we are seeing side letter provisions which seek to muddy the contractual waters. For example, a waiver of sovereign immunity provision might include a requirement that all issues of law relating to sovereign immunity must be resolved and enforced according to the laws of the jurisdiction of that investor. Unless familiar with the sovereign immunity laws in which the investor is domiciled, the fund and/or lender will be unable to determine if the waiver is enforceable. Waivers also tend to deal more with adjudication than enforcement.

Happily, funds and lenders alike may take comfort from the fact that there are various statutory exemptions and additional commercial factors at play which may prevent a sovereign investor from relying on any rights of immunity (or defaulting on their commitments). However, issues surrounding sovereign immunity are often complex, and parties would be wise to discuss these with legal counsel at the outset of any transaction.

Divide and Conquer: New Delaware 'Division' Law Creates Potential Issues for Fund Finance Lenders

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The State of Delaware recently amended the Delaware Limited Liability Company Act (the "Act") to create a new form of transaction called a "Division." Newly enacted Section 18-217 of the Act (the "Amendments") allows an existing limited liability company (a "Dividing LLC") to divide into two or more separate and distinct LLCs (each, a "Resulting LLC"), with a Dividing LLC allocating its assets, rights and liabilities among the two or more Resulting LLCs, with the further option of either terminating or continuing its own existence. The Amendments allow a Dividing LLC to separate pools of assets among Resulting LLCs without the procedural burden of a traditional asset transfer or other familiar form of reorganization.

It is important to distinguish a Dividing LLC from a Delaware Series LLC. A Series LLC is treated as a single "umbrella" LLC with a collection of individual series operating under the same umbrella LLC. Resulting LLCs, on the other hand, are separate and distinct entities from the Dividing LLC. Each series in a Series LLC is formed under a single Certificate of Formation, while Resulting LLCs each file individual Certificates of Formation. Additionally, a Series LLC survives after the creation of individual series, while (as mentioned above) a Dividing LLC can choose to terminate or continue its existence after a Division.

From an organizational document perspective, a Dividing LLC's operating agreement drives whether or not such LLC can be divided. If the operating agreement is silent, under the Amendments, a Division is permitted to the extent a Plan of Division is approved by the Dividing LLC's members owning 50 percent or more of the Dividing LLC. If the operating agreement contemplates a Division, it would be adopted as specified in the operating agreement.

Implications for Fund Finance

The impact of Divisions presents lenders making loans to Delaware LLCs with several new challenges. First, loan documents generally restrict or condition mergers, consolidations, transfers and other similar transactions, but most do not contemplate a Division. As a result, credit parties that are Delaware LLCs could, theoretically, divide and allocate assets and liabilities to Resulting LLCs that are not party to the loan documents without violating restrictive covenants or triggering any mandatory prepayments thereunder. Fortunately, the Amendments

contain a safe harbor for loan documents with Delaware LLCs that were in effect prior to the August 1, 2018 effective date, which provides that any restrictions on mergers, consolidations, transfers and other similar transactions in agreements entered into before August 1, 2018 will be deemed to also apply to any Division.

Further, while the Amendments provide for the preservation of liens against the Dividing LLC, the language is not explicit as to whether such liens apply to the Resulting LLCs ("all liens upon any property of the dividing company shall be preserved unimpaired, and all debts, liabilities and duties of the dividing company shall remain attached to the division company to which such debts, liabilities and duties have been allocated in the plan of division, and may be enforced against such division company to the same extent as if said debts, liabilities and duties had originally been incurred or contracted by it in its capacity as a domestic limited liability company." Section 18-217(l)(4)). Thus, while the lien against a Dividing LLC remains intact, if the assets securing that lien are allocated to a Resulting LLC, the lender will not have a security interest in the Resulting LLC's assets unless the lender obtains a security interest from the Resulting LLC.

Considerations for Loan Documents

The impact of the Amendments on Delaware LLCs deserve attention from practitioners, credit parties, banks and other lenders in the fund finance space. On the front end, practitioners should carefully review the operating agreements of credit parties that are Delaware LLCs to (i) determine whether a Division is contemplated and, if necessary, address the concerns at that stage and (ii) restrict Divisions in the operating agreements if not contemplated ("A limited liability company agreement may provide that a domestic limited liability company shall not have the power to divide as set forth in this section." Section 18-217(k)). Further, in conjunction with such restriction, loan documents entered into on or after August 1, 2018 should expand negative covenants relating to mergers and transfers to restrict a Division unless the Resulting LLC(s) that are allocated the assets/collateral become a party to the loan documents. Finally, the affirmative covenants should be expanded to require the credit parties to procure the pledge of the assets of any Resulting LLC in the same manner as a Dividing LLC.

Limited Partnership Agreements

The majority of U.S. fund finance transactions involve Delaware limited partnerships. They are not impacted – there is no corresponding legislation with respect to partnerships. This issue only impacts those fund credit parties formed as Delaware limited liability companies. But this could evolve – so stay tuned.

Conclusion

The Amendments create some interesting but solvable considerations for parties entering into loan facilities that include (or have the potential to include) Delaware LLCs as credit parties. Lenders should consider incorporating language addressing a Division in all new facilities in which a Delaware LLC is a loan party (or likely to become a loan party), or adding such language at any time such loan documents are being amended or renewed.

Link to the Amendments:

Fund Finance Association Updates

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The Fund Finance Association has made several recent announcements of interest. Most importantly, the dates of the 2019 conference line up have been adjusted. The European Symposium, historically in October, will be moved to June 20, 2019, remaining at the Landmark Hotel in London. The Asia Pacific Symposium now shifts to September 24, 2019, again remaining in Hong Kong. Both changes were initiated based on feedback from market participants. The 9th Annual Global Symposium remains March 24-26 at the Fontainebleau Hotel in Miami. *Fund Finance Friday* will now maintain a Fund Finance Calendar going forward to help market participants keep up with key dates.

The FFA also requested nominations for the 2019 Julian Black Contribution to the Industry Award and the 2019 Dee Dee Sklar Women in Fund Finance Award. Nominations are due by February 11, 2019. To request a nomination form, email: info@fundfinanceassociation.com or visit the FFA's website at www.fundfinancessociation.com.

On the Move—Fund Finance Tidbits

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On the Move

- Partner Samantha Hutchinson, along with senior attorney Tom Armstrong and associate James Hoggett, joined Cadwalader's Fund Finance practice in London this week. The arrival of two additional team members is imminent. Hutchinson, previously the leader of the Global Fund Finance practice at Dentons, will now co-lead Cadwalader's European Fund Finance team along with partner Jeremy Cross. The team is now nine lawyers deep in London. A copy of the press release is available here.
- If you have a personnel update that you would like included in *Fund Finance Friday*, email us at fund-finance-friday@cwt.com.

Fund Finance Hiring

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- Silicon Valley Bank is in the market to fill a number of positions in its expanding Global Fund Banking division. These include two associate openings (one in Denver/Chicago and one in Menlo Park) as well as an opening for a Vice President in New York. These and other current openings are posted at https://www.svb.com/careers/.
- First Republic Bank is looking for a Credit Analyst to join its Business Banking Department in the bank's Palo Alto office to work on venture capital and private equity loan facilities. The job posting is available here.
- Validus Risk Management is looking for an Associate/Vice President (2-6 years experience) to join its team, focusing on Fund Finance Advisory for Alternative Investment Funds across Europe. The scope of transactions include: a wide range of financing solutions to private equity, credit funds, secondaries, real estate and infrastructure funds. If interested, email Sarah Lobbardi, Head of Funds Finance Advisory, at sarah.lobbardi@validusrm.com.
- Cadwalader is looking for fund finance associates in New York and Charlotte. To apply, contact Sally Licandro at sally.licandro@cwt.com.
- If you have a job posting that you would like included in *Fund Finance Friday*, email us at fund-finance-friday@cwt.com.