CADWALADER

Investors, We're Relying on You

May 31, 2024

By Tim Hicks
Partner | Fund Finance

Delaware remains the most popular jurisdiction for the domestic formation of private equity and venture capital funds (a "Fund") as either a limited partnership or limited liability company. In fact, 54.8% of the deals closed by Cadwalader in 2023 had a Delaware component. A myriad of reasons could be cited as the basis for this fact, but lenders are generally fine with this choice based on specific protections a lender is afforded under Delaware statutory law related to the obligations of an investor to a Fund. In particular, Title 6, Section 17-502(a)(1) of the Delaware Code provides "Except as provided in the partnership agreement, a partner is obligated to the limited partnership to perform any promise to contribute cash or property or to perform services, even if that partner is unable to perform because of death, disability or any other reason." Even more important, an Investor's obligation to honor its promise to make capital contributions expressly extends for the benefit of creditors and Delaware law provides a statutory basis for a lender to assert a reliance claim to avoid a financial loss.

6 Del. C. §17-502(b)(1) provides:

Unless otherwise provided in the partnership agreement, the obligation of a partner to make a contribution or return money or other property paid or distributed in violation of this chapter may be compromised only by consent of all the partners. Notwithstanding the compromise, a creditor of a limited partnership who extends credit, after the entering into of a partnership agreement or an amendment thereto which, in either case, reflects the obligation, and before the amendment thereof to reflect the compromise, may enforce the original obligation to the extent that, in extending credit, the creditor reasonably relied on the obligation of a partner to make a contribution or return.

In its most simplistic terms, the practical effect of the above is to confer the benefit of the obligations of investors to a Fund on a lender who has reasonably relied upon the capital call rights contained in the partnership agreement as a source of repayment. To put is another way, a lender can argue reliance based on an assertion that it would not have extended credit to a Fund but for the Fund's right to call capital from its investors. What constitutes a lender's demonstration of reasonable reliance is somewhat based in theory and academic debate, as the case law on the point is limited. Fund finance practitioners often suggest that evidence of reliance may include one or more of the following:

- express provisions in the credit agreement that the lender is relying on the obligations of the investors to fund their respective capital commitments, such as the following:

Reliance. The Borrowers agree that the Administrative Agent, the Letter of Credit Issuer and each Lender has entered into this Credit Agreement, extended credit hereunder and at the time of each Loan or each issuance of a Letter of Credit, will make such Loan or issue such Letter of Credit in reasonable reliance on the obligations of the Investors to fund their respective Capital Commitments and accordingly, it is the intent of the parties that such Capital Commitments may

be enforced by the Administrative Agent, on behalf of the Secured Parties, pursuant to the terms of the Loan Documents, directly against the Investors without further action by any Credit Parties and notwithstanding any compromise of any such Capital Commitment by any Credit Party after the Closing Date as provided in 6 Del. C. §17-502(b)(1).

- references in the lender's underwriting materials to the capital contribution obligations of investors as a source of repayment of any credit extensions;
- maintain records of communications with the general partner and limited partners of a Fund regarding the basis on which any credit extensions will be repaid; and
- obtain an investor letter whereby an investor acknowledges the lender's reliance on it to fund capital and agrees to make capital contributions to repay the debt (preferably expressly stating such obligation to fund is without counterclaim, setoff or defense).

The leading caselaw in this area is *In re LJM2 Co-Investment, L.P. Ltd. Partners Litig.*, 866 A.2d 762 (Del. Ch. 2004), whereby the Delaware Court of Chancery held that the bankruptcy trustee of the limited partnership adequately demonstrated that the lenders reasonably relied, for purposes of 6 Del. C. §17-502(b)(1), on the limited partners' representations that they would honor their capital commitments, and the court allowed the lenders to enforce the capital commitments.

LJM2 Co-Investment, L.P. ("LJM2") was a Delaware limited partnership formed by Andrew Fastow, the then-CFO of Enron, for the purpose of investing in energy and communications businesses related to Enron. The Fund raised approximately $400 million in capital commitments and entered into a $120 million unsecured subscription facility with language that if the Fund defaulted, the lenders could issue capital calls to cure any payment default. When Enron went bankrupt, the Fund defaulted and the Investors declined to fund capital calls issued by both the general partner and subsequently by the lenders. The investors also amended the Fund's partnership agreement, in violation of the subscription facility terms, to compromise and rescind the capital calls. Without additional capital contributions, the Fund could not meet its obligations and also filed for bankruptcy. The bankruptcy trustee issued an additional capital call, which the investors did not fund, and litigation against the investors ensued.

The bankruptcy trustee argued that the lenders reasonably relied on the Fund's partnership agreement to extend credit to LJM2 because: (i) under that the Fund's partnership agreement, the limited partners were obligated to contribute capital only when called for by the general partner and (ii) the lenders, through the credit agreement and a separate contractual general partner "undertaking" to issue drawdown notices to the limited partners to the extent necessary to cure payment defaults under the subscription facility, compelled the general partner to make capital calls if LJM2 defaulted.

The investors raised a number of unsuccessful arguments in an effort to have the statutory cause of action under 6 Del. C. §17-502(b)(1) dismissed, including that the lenders could not demonstrate reliance on their capital commitments as required by the statute. The court denied the investors' motion to dismiss and ruled that the lenders claim for relief under Section 17-502(b)(1) could continue because the lenders adequately alleged reliance on the capital commitments and investors obligation to fund capital contributions. Unfortunately for those hoping for additional case law on the topic, the case presumably settled without the issuance of

any further court opinions. However, the court's rationale for denying the motion to dismiss is frequently cited as a "win" for creditors and a framework for how a Delaware court would decide similar arguments.

In conclusion, Delaware statutory law provides a basis for a lender to preserve a claim by demonstrating reliance on the investors to fund capital contributions. Whether it is a reference in the credit agreement, inclusion of provisions in the bank's underwriting materials, communications with a general partner or a combination thereof, establishing indicators of reliance is important for any lender extending credit on the basis that investors will fund capital for its repayment if the Fund experiences distress. If litigation were to ensue, a lender's claim of reliance would seem to be a respected by the Delaware courts, but establishing the claim starts with preliminary planning and credit agreement terms that matter when they matter.

The Dynamics of Insurers as Lenders in the NAV Market

May 31, 2024

Cadwalader partner **Angie Batterson** authored an article, "The Dynamics of Insurers as Lenders in the NAV Market," which appeared in the May 2024 edition of *Butterworth's Journal of International Banking and Financial Law*, a LexisNexis publication.

The article explores the factors attracting insurance companies to the NAV financing space and some typical deal terms. Read it **here** (subscription required).

Diversity in Fund Finance Boundary Breaker Speaker Series with Henry Tang

May 31, 2024

By Bryan Barreras
Counsel | Fund Finance

By Natasha Puri
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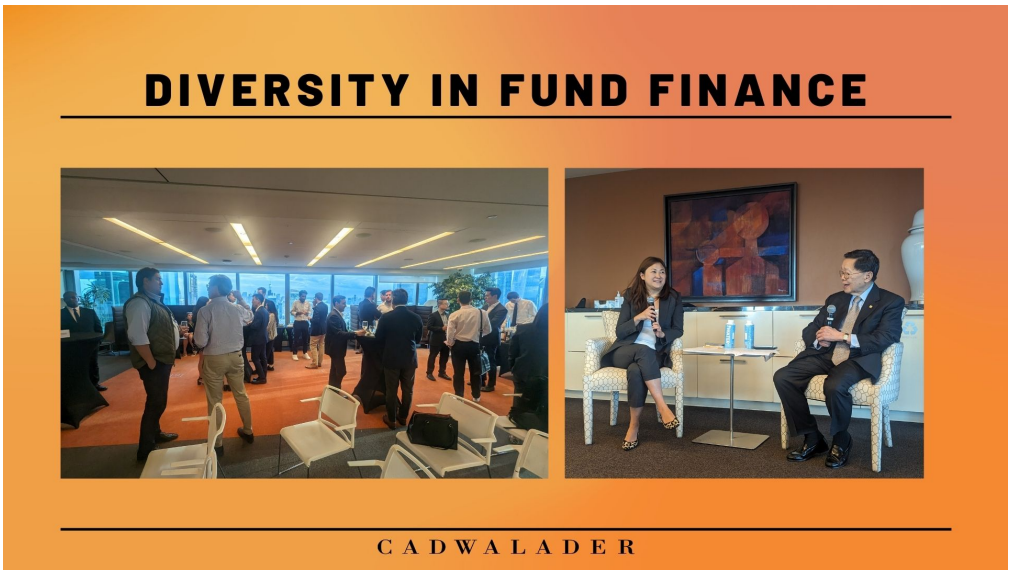

The US Diversity in Fund Finance Committee of the Fund Finance Association held the latest event in their *Boundary Breaker* speaker series this week. The event, co-sponsored by Haynes Boone and Standard Chartered, was a great success with ~40 attendees to hear an insightful conversation with Henry Tang, Co-Founder of the Committee of 100, and Vicky Du, Global Head of Fund Finance at Standard Chartered Bank. Henry and Vicky discussed Henry's long and storied career. Henry was one of the first Asian-Americans on Wall Street, and he spent time working across the largest Wall Street investment banks including Salomon Brothers, Lehman Brothers, and Prudential.

While Henry represents someone who is a true pioneer and Boundary Breaker at his core, the beginning was not without its challenges and true adversity and discrimination. Henry shared the vulnerable truth of his stories – remembering that at his first day at Prudential, a senior executive asking him *"Why are you here?"* -- everyone else was there because of the rolodexes of relationships that they had already established – and *"Who do you know?"* It is a lesson that he took to his core and preaches of **building trust and relationships** which he still carries with him today.

Building relationships with others led Henry to become a co-founder of the Committee of 100. When he first met I. M. Pei, the world famous architect (known for his designs across the world including the John F Kennedy Library in Boston and the Grand Louvre in Paris), they bonded over their shared experience of facing discrimination within their fields. In recognizing their

shared experiences, they knew there were likely more stories like their own and eventually co-founded (along with four others) the Committee of 100, seeking to bring together prominent Chinese-Americans to foster community.

Henry seeks to pass along his experience (so that it doesn't go to waste) by continuing to build trust and relationships – and to stress the importance of Diversity, Equity & Inclusion. Henry shared stories of other prominent Asian individuals, including Morris Chang, who is known as the semiconductor industry founder of Taiwan. Mr. Chang founded Taiwan Semiconductor Manufacturing after leaving the U.S. when he was passed over as CEO for Texas Instruments. It is only in his later years that he shared that he was passed over for this role because he was told no Chinese person would be CEO of the company – and thus left – illustrating the lost potential and opportunity that is a result of actions in opposition to fostering inclusion and the advancement for all.

Henry noted that there is still much work to be done, and that from his early days on Wall Street to today he wishes that there had been more progress and minds changed towards inclusivity. The discussion ended with a call for action from Henry -- through DE&I efforts there is a path to a collective sense of unity amongst people of all backgrounds, and without opening doors for diverse individuals there will continue to be lost opportunities for all organizations.

If you are interested in learning more about the Diversity in Fund Finance Committee or getting involved, please reach out to Natasha Puri at **Natasha.puri@lbusa.com**.

Fund Finance: Past, Present and Future

May 31, 2024

Cadwalader partners **Samantha Hutchinson** and **Wes Misson** co-authored "Fund Finance: Past, Present and Future," which appeared as a chapter in the 2024 edition of *Lending & Secured Finance*, published on May 28.

Now in its 12th edition, the annual guide, produced by the Global Legal Group's International Comparative Legal Guides division, offers insights into laws and regulations impacting global finance. In their chapter, Sam and Wes discuss how the events of 2023 have influenced the reshaping of the fund finance market, and what these changes will mean for 2024 and beyond.

Read it **here**.

WFF America Toronto: Join the 1st WFF Gathering

May 31, 2024

Register to save your spot for an evening of networking with your fellow industry participants. The event includes a panel discussion spanning industry viewpoints, all while enjoying light beverages and bites.

This event is open to all genders and current & prospective members of Women in Fund Finance, the Fund Finance Association, Diversity in Fund Finance and NextGen.

We hope you will be able to join us for what promises to be a wonderful evening!

Event Details:

Location: CIBC Square 49th floor (81 Bay Street, Toronto, Ontario M5J 1E6)

Date: Thursday, June 27th, 2024

Time: 5:00PM - 7:30PM EDT (doors open at 5:00pm, panel starts promptly at 5:30pm, followed by reception)

Contact **info@womeninfundfinance.com** if you have any questions

Register **here**.

Fund Finance Hiring

May 24, 2024

Fund Finance Hiring

Here is who's hiring in Fund Finance:

KBRA (Kroll Bond Ratings Agency, LLC) is seeking an experienced attorney to join the Ratings Legal team, in support of the Funds and ABS units. Position can be based in New York or Chicago. Interested candidates can find more information **here**.