Subscription Agreements

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We have said it before – the "credit cornerstone" of a subscription credit facility is the limited partnership agreement (the "LPA") – it is the primary contract, together with any side letters, governing the relationship between a fund and its investors. But does the LPA really mean anything if there are no investors subscribed to the fund? Enter the LPA's most important sidekick, the subscription agreement.

While the LPA outlines the details of the relationship between a fund and its investors, the subscription agreement *creates* the relationship, i.e., the subscription agreement is the document that actually evidences: (1) the subscription of an investor to the fund for a limited partnership interest, (2) the investor's capital commitment amount, and (3) the investor's agreement to be bound by the terms of the LPA.

Contents of the Subscription Agreement

In its most simple form, a subscription agreement should always include the following key components: a page setting forth the investor's identity and signature, pursuant to which the investor agrees to subscribe for a limited partnership interest in the fund for a specified capital commitment amount, and which is typically followed by a separate page with the general partner's countersignature, evidencing acceptance of the investor's subscription to the fund and its capital commitment amount. While the form of subscription agreement varies from fund to fund, the principal terms and the supporting disclosure documents found in subscription agreements tend to be similar and often include the following provisions:

- the "subscription agreement", i.e., several pages of contractual language which outlines: (1) the terms and conditions by which the investor agrees to become an investor in the fund, (2) the agreement of the investor to be bound by the terms of the LPA, and (3) the agreement by the investor to make cash contributions to the capital of the fund, up to its capital commitment amount;
- an investor questionnaire, to be completed by the investor that provides, among other things, contact and notice details of the investor, wiring instructions, and other regulatory/legal information necessary for the fund to confirm compliance with the regulatory/legal regimes to which it is subject;
- a power of attorney, whereby the investor grants to the general partner a limited power of attorney to act on behalf of the investor with respect to its subscription in the fund; and
- numerous representations and warranties by the investor, including, without limitation, representations and warranties relating to the investor's power and authority to enter in to the fund documents, the accuracy and completeness of the information provided in the subscription agreement, anti-money laundering and other regulatory compliance, and beneficial ownership.

Diligently "Diligencing" the Subscription Agreement

When "diligencing" a subscription agreement, the reviewing attorney is focused on: (1) who is subscribing to the fund and for what amount, and (2) confirming that the subscription agreement itself, on its face, is an enforceable contract. The investor signature page and investor questionnaire tells us what we need to know about the identity of the investor and its capital commitment amount. But confirming whether the subscription agreement itself is an enforceable contract takes us lawyers back to Contracts 101 – in order for any contract to be enforceable, there must be an offer and acceptance. The "offer" is evidenced by the investor's signature page with its capital commitment amount, and the “acceptance” is evidenced by the general partner’s countersignature accepting the investor’s capital commitment to the fund. Diligence attorneys review to confirm that signature pages are in fact signed, dated and include a capital commitment amount. They also look to determine whether the subscription agreement sets forth any specific requirements for proper execution – this is oftentimes set forth in an introductory section outlining instructions for completion. If the introductory section specifies that ***all*** attachments must be properly completed and attached in order for the investor’s subscription to be accepted, the reviewing attorney will generally expect to see all completed attachments included.

Common Issues, From a Diligence Attorney’s Perspective

A diligence attorney’s review of subscription agreements is a critical component of any subscription facility. Oftentimes such reviews can be voluminous and time intensive, which means that the reviewer must be attentive to details and mindful of any curveballs that do come up during the review. A few common examples that reviewing attorneys should be aware of are briefly described below:

- *Proper Execution*. A diligence attorney does not investigate whether the investor signing a subscription agreement is in fact who they say they are, or whether they have the power and authority to enter in to the contract. However, the reviewer does review to determine that the subscription agreement is “properly executed”. This means confirming that the investor’s signature page is signed, dated and includes the proposed commitment amount, and that the general partner’s acceptance page is likewise signed, dated and includes an accepted commitment amount. A common issue that we see, occurs when the general partner’s acceptance page is dated *prior* to the investor’s signature page. One of the cardinal rules of contracts is that an offer must come before the acceptance (logically, you cannot accept something before it is offered). In these cases, the fund must provide updated signature pages showing the proper order of execution.
- *Complete Subscription Agreement*. As previewed above, it is the diligence attorney’s job to determine that the subscription agreement is *on its face* enforceable, which necessitates an understanding of what attachments are required in order for the subscription agreement to be considered fully executed and complete. For example, we sometimes see subscription agreements that require the investor’s signature page or power of attorney form to be notarized and/or witnessed. However, especially during the COVID-19 era, investors faced difficulties in completing these formalities and as a result, sponsors were waiving these requirements. In this scenario, a conversation is necessary between the diligence attorney and fund’s counsel to confirm that this formality was in fact, waived, and to further understand the impact (if any) on the enforceability of the subscription agreement.
- *Open for negotiation?* For ease of execution, funds typically have the same “form” subscription agreement that is provided to all investors. The form may differ slightly between different “types” of investors (i.e. U.S. vs foreign), but the idea is that this document generally is not up for material negotiation. Every once in a while, we will see hand-marked changes to the subscription agreement form. More often than not these kinds of changes are immaterial, but nonetheless, any changes must be reviewed and considered on a case-by-case basis to determine the impact on the subscription credit facility.
- *Which Fund?* Imagine this scene: its Friday night, and a team of diligence attorneys are tasked with over 1000 subscription agreements that need to be reviewed by Monday for a subscription credit facility closing that week. The team comes up with an organized plan to divide and conquer the review, and eagerly gets to work. About an hour into the review, one of the diligence attorneys makes an astounding discovery – some of the subscription agreements are to a fund that is not party to the credit facility as a borrower, guarantor, or pledgor. This is never a good scenario - the issue is that for an investor to be included in the borrowing base, rights to that investor’s capital commitment must be pledged to the subscription lender. If the fund is not party to the facility in some capacity (as a borrower, guarantor, or pledgor), there is no pledge. In this scenario, you will likely find a frantic fund’s counsel facing a subscription lender with two choices – not include the investor’s commitment in the borrowing base, or require the fund in question to join the credit facility.
- *E-Signatures*. Another post-COVID phenomenon is that more and more investors are executing their subscription agreements electronically. E-signatures are becoming generally accepted, but diligence attorneys run into issues when investors use e-signature platforms that omit the typical information required to confirm enforceability (i.e., a date and signature). Platforms like DocuSign are usually non-problematic, as the program typically populates a signature with the date provided next to it, or there is a separate signature certification page at the end of the document stating when and by whom it was signed. However, some e-signature platforms do not include a signature or date – they may just state “e-Signed by [Investor Name].” In cases like these, we can typically get comfortable if there is a separate certification page providing the signature date. If no such page is included, the subscription lender will likely require an updated signature page including the date. On a related note, we have also

recently run into issues with e-signature platforms that provide a signature certification page, but in a foreign language, preventing the diligence attorney from confirming the execution date. We attempt to resolve this issue by requesting a translated page, or requesting the fund and investor to reopen and re-date the applicable signature pages. Ultimately, the issue of the acceptability of e-signatures generally turns on the subscription lender's comfort level with e-signatures generally, the information provided by the e-signature platform, and whether e-signatures are permissible under the subscription agreement itself.

Conclusion

The good news is that more often than not, the discussion around and review of subscription agreements for purposes of a subscription credit facility is pretty uneventful. With that said, the subscription agreement's function for the fund (and in turn, the subscription credit facility), should not be minimized – each is obsolete without the other and should be considered carefully.

ILPA Releases NAV Guidance

July 26, 2024

Yesterday, the Institutional Limited Partners Association (“ILPA”) issued guidance for Limited Partners (LPs) and General Partners ("GPs") around the use of Net Asset Value (NAV-)based financing facilities by private equity funds (the “Guidance” - see link at end of article). While ILPA recognizes that “NAV-based facilities can be a useful tool for capital structuring or to provide financing to support assets”, ILPA is issuing the Guidance in response to LP concerns regarding the use of NAV-bases facilities today, including (i) limited transparency around their use, which inhibits LPs understanding of the impacts of these facilities, (ii) differing approaches among GPs in engaging LPs around their use (where LPAs are otherwise silent as to whether NAV-based facilities are permitted, which is often the case for existing funds), and (iii) a spectrum of approaches to reporting by GPs with respect to the impact of NAV-based facilities. ILPA advises that the Guidance is intended to provide general parameters for transparency and dialogue between LPs and GPs around the use of NAV-based facilities for private equity funds (*i.e.*, is not intended to address the use of NAV-based facilities in other contexts, *e.g.*, secondaries, private credit, or closed-end real estate funds). Notably, the Guidance does not (a) oppose the use of NAV-based facilities generally, (b) set out a subset of permissible use cases, or (c) seek to impose specific leverage limitations tied to the use of NAV-based facilities. It instead emphasizes a push for communication and transparency by GPs in their use of NAV-based financing. See below for a summary of ILPA’s recommendations included in the Guidance and stay tuned for further analysis from the Cadwalader Fund Finance Team.

1. <u>LPAC Consent</u>. Unless a fund’s LPA explicitly permits the use of NAV-based facilities or a fund’s GP has received prior consent to utilize a NAV facility, the Guidance recommends that GPs seek LPAC consent prior to implementing a NAV-based facility. The Guidance recommends that as part of the LPAC consent process, GPs should provide a detailed disclosure of the following:
    a. rationale and use of proceeds for the NAV-based facility, including details on alternatives considered;
    b. size, structure, and controls relevant to the NAV-based facility (*e.g.*, whether the facility is secured or unsecured, revolving or term credit, and any key covenants – including cash sweep and mandatory repayment requirements);
    c. key economic terms (*e.g.*, interest rate, maturity date, PIK interest, etc.); and
    d. additional obligations of LPs imposed in connection with the NAV-based facility (*e.g.*, are any distributions of loan proceeds to LPs recallable).

2. <u>LP/LPAC Engagement – Specific Use Cases</u>. In addition to the above, the Guidance differentiates its recommended level of engagement by GPs with LPs based on the proposed use of proceeds for a NAV-based facility (*i.e.*, whether the facility will be used to generate distributions to investors or to support the fund’s investment portfolio). See below:
    a. *Proceeds used to support the fund’s portfolio*: Assuming that the GP has otherwise received prior consent to use a NAV facility (whether in the LPA or through prior LPAC approval), GPs should not be required to return to the LPAC for consent to use a NAV facility to support the portfolio.
    b. *Proceeds used to generate distributions to investors*: The Guidance highlights heightened LP concerns regarding the use of NAV-based facilities to generate early distributions, including the impact on IRR/DPI, interest expenses associated with these facilities, and the fact that resulting distributions may be recallable. Accordingly, prior to a NAV facility being put in place, even if a GP has received prior approval to enter into NAV facilities generally (whether in the LPA or through prior LPAC approval), the Guidance recommends that GPs should still seek LPAC approval if they intend to use any of the loan proceeds to generate a distribution to investors.
    c. Regardless of use case and whether a GP has received consent to enter into NAV-based facilities, ILPA recommends that GPs seek LPAC and/or LP approval to address any conflicts of interest that could be perceived arising from the transaction (*e.g.*, is the lender a related entity?).

3. <u>Addressing NAV Based Facilities in LPAs</u>
    a. *Treatment of NAV-Based Facilities in Older LPAs*: For existing funds where LPAs do not specifically contemplate the use of NAV-based facilities, the Guidance recommends that LPs should (i) review the LPA borrowing leverage provisions and (ii) proactively discuss NAV-based facilities with their GPs to understand whether GPs have interpreted these provisions such that NAV-based facilities that utilize an SPV/master holding company structure beneath the fund are excluded from fund-level leverage provisions. Note: It is ILPA’s position that NAV-based facilities constitute fund-level leverage and, as such, should be included in fund-level borrowing limitations.

b. *Addressing NAV-Based Facilities in Newer LPAs*: Moving forward, the Guidance recommends that newer LPAs should explicitly address NAV-based facilities, including:
   i. delineating the reporting expectations around NAV-based facilities;
   ii. clearly defining limits to the amount of leverage that a GP is able to incur through NAV-based facilities throughout the life of the fund; and
   iii. defining the term "NAV-based facility" (to differentiate between portfolio-level or fund-level leverage that uses an SPV/master holding company structure v. SPVs or borrowing structures utilized for other forms of debt, such as single company portfolio debt).

Link to ILPA NAV-Based Facilities Guidance: https://ilpa.org/resource/nav-based-facilities-guidance/

What We're Reading

July 26, 2024

Teacher Retirement System of Texas **plans to reduce** its private equity target allocation to 12% from a current exposure of 16.7% starting in October. The planned reduction, which may be implemented over a number of years. For now, the change in target allocation likely means reduced new commitments, while some of the rebalancing could be accomplished by fund AUM growth.

Florida State Board of Administration (FSB), which has occasionally conducted secondaries sales in the past, is **considering adding CFOs and NAV** to the private equity portfolio management toolkit, subject to state legislative approval. Looking farther ahead, FSB expects GP turnover in the portfolio to increase relative to the past decade as more value creation is expected to rely more on portfolio company operational improvement rather than multiple expansion.

“The bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seek to discharge claims against a nondebtor without the consent of affected claimants,” according to the Supreme Court in its recent ***Harrington v. Purdue Pharma L.P.*** opinion. At issue was the power of the bankruptcy court to release the Sackler family’s from civil liabilities even though the family had not filed for bankruptcy and a minority of the opioid victims rejected the plan. Naturally, the court’s decision that limits nonconsensual third-party releases has some observers questioning its potential significance **in private equity land** since GPs are interested in releases when portfolio companies restructure in court.

In Our Golf Era

July 26, 2024

Cadwalader was delighted to co-sponsor this week's second annual golf outing at Dyker Beach Golf Course in Brooklyn, New York. The event was conceived of, planned and orchestrated by Kristin Castellanos, head of fund finance at TriState Capital Bank, and was sponsored by TriState Capital, Assured Guaranty, Cadwalader and Women in Fund Finance.

After last year's super successful inaugural outing (which sold out in less than 10 minutes), we doubled the size this year and had 63 golfers in attendance with 50 of them being true beginners, some of whom had never held a club before. The event was open to golfers of all experience levels and was an opportunity to get women out on the golf course to try their hand at golf in a fun, supportive and friendly environment. Kudos to our pro and the experienced golfers in the group – who were all fund finance bankers and lawyers – for helping and encouraging the newer golfers and making the day such a fun one.

It was truly fun to see so many women out there getting comfortable – and even a little competitive – out on the course. Some amazing connections were forged as the expert golfers supported the beginners and the beginners cheered one another on.

This feels like the start of a tradition and team CWT couldn't be prouder. Thanks to Kristin for organizing and to our co-sponsors for supporting this fun and awesome event.

Enjoy the photos from the event!

Fund Finance Hiring

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Fund Finance Hiring

Here is who's hiring in Fund Finance:

Churchill is seeking a highly motivated, detail-oriented team player to join as an Analyst or Associate in the growing Fund Finance vertical. If you are interested in this opportunity you can learn more **here** and submit your resume to **ben.love@churchillam.com** and **ryan.wydra@churchillam.com**.