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Fundraising: When should finance counsel be involved?

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When entering into a subscription line facility agreement both the fund manager and lender have the same common goal: the successful fund raising and closing of the fund with an optimal borrowing base under a subscription facility. However, a lender's requirements are often not considered until later in the fundraising stage, which can lead to requested amendments to fund documents, resulting in additional investor approval and sometimes causing a delay, or a suboptimal borrowing base. In order to avoid such a scenario, we take a high-level look at when it is best to engage finance counsel in the fund-launch process, and also remind funds of the ongoing obligations that they will be under regarding amending their fund documents during the lifetime of a financing. Ultimately, it's beneficial to all involved to provide lender's counsel with the opportunity to review and comment on draft fund documentation as soon as possible.

STAGE 1: The manager appoints advisers (including lawyers, accountants and fund administrators), chooses the jurisdiction(s) where the fund will be domiciled, and starts to finalise the structuring of the various fund entities.

Lender's counsel are unlikely to be involved in the early stages of a fund formation, although providing a copy of the structure chart to prospective lenders and their counsel as soon as possible is advisable. Any tendered term sheets can then take the fund structure into account, including whether the collateral package needs to be structured as cascading to make allowances for feeder funds put in place for tax or ERISA purposes.

STAGE 2: The fund's lawyers prepare the fund documentation, including initial limited partnership agreements ("Initial LPAs") in order to establish the fund vehicles. This sets out initial details such as name of the partnership, registered office and general partner, but doesn't include fund operational mechanics. Draft amended and restated limited partnership agreements ("A&R LPAs") are prepared, which contain more detail around, among other things, when the fund can call capital from the investors, the investors' obligations in relation to meeting capital calls, and the investors' rights to distributions. A draft prospectus, private placement or offering memorandum may also be prepared, which will summarise the provisions in the A&R LPAs (as well as including any necessary regulatory disclosures), as well as form subscription agreements and a master side letter (if any).

The Initial LPAs will not contain any of the detail around capital call mechanics that lenders will need to review, but this is the stage where the draft A&R LPAs should be provided to lender's counsel so as to ensure that these contain the necessary 'bankable provisions'. Provisions that a lender will require include, among others, (i) power to borrow and grant security over the right to issue capital calls and related rights, (ii) investor obligation to fund in full whilst waiving any rights to set-off, counterclaim or defence, and (iii) clarification as to whether the fund can call capital from investors after the end of the investment period in order to repay debt. Lender's counsel is typically able to provide precise comments to a few provisions, all with generally acceptable market language, thereby protecting the lender's position..

STAGE 3: The draft fund documentation and any marketing material (including any investor presentation) is sent to prospective investors for their review and comment. A fund may also employ a placement agent to approach investors.

Note that some investors may be subject to certain anti-solicitation laws or regulations which restrict using placement agents to "pay to play". Lender's counsel should take note of any provisions in an investor's side letter which would allow it to cease funding if certain representations that are given by the fund around the use of placement agent are found to be incorrect.

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STAGE 4: Comments received from lender's counsel and investors on the draft A&R LPAs and other fund documentation and any agreed amendments incorporated.

It is important that lender's counsel also review the comments that the investors have on the draft A&R LPA before these changes are incorporated in case any of these comments could have overlooked adverse effects on the secured parties. It is also important that any amendments that a lender requires are made before the A&R LPAs are signed in order to avoid having to obtain investor consent to amend them again.

STAGE 5: After reviewing the draft A&R LPA, investors may request certain derogations and/or personalised provisions due to their status by way of side letters.

Any lender will want to review the side letters to look for any provisions which may allow an investor to not fully fund a capital call or otherwise cease funding, or provisions which require unusual requirements relating to the drawdown procedure. If a "master side letter" which includes all possible side letter terms for the investors' election is available then this should be provided to finance counsel, along with confirmation of which investors have elected to incorporate which side letter provisions. A lender is unlikely to request amendments to an investor side letter unless there is a need for mitigating language. Depending on the content of the side letter and whether the investor is to be included in the borrowing base, if a lender does not have an opportunity to comment on mitigating language before a side letter is signed, the lender may request that an investor address certain omissions from the side letter in a 'comfort letter' to be provided by the investor to the lender directly. An example of a common investor right included in side letters which may need to be addressed in a comfort letter is the right to sovereign immunity. Review of these side letters will help the lender determine the eligibility for inclusion in the borrowing base.

ONGOING OBLIGATION: Following the first close of the fund and during the lifetime of the financing, the fund parties will be subject to certain restrictions in relation to future amendments of the fund documents. These restrictions will typically require a borrower to provide a copy of any proposed material amendment to an A&R LPA to the lenders prior to making such amendment, with the lenders then having a consent right in relation to the amendment. Funds should be aware that they will still be under an obligation to provide copies of any immaterial amendments to fund documents to the lenders too.

Fund parties will also be under an obligation to provide copies of any new investor documents following subsequent closes to the lenders, as well as any amendments to existing side letters (including by way of exercising any 'most favoured nation' right). Any amendments to existing side letters which are adverse to the secured parties could result in that investor being excluded from the borrowing base.