

Current Traps for the Unwary in Alternative Investments

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Introduction

- Our presentation will focus on recent developments in alternative investment documents that make it difficult for investors to parse through potentially undesirable terms
- We are not trying to discuss all alternative investment document issues

Consents

- ❑ Deemed consent if no response (negative consent)
 - Failure to respond within the specified time period will be a vote in favor of and consent to the proposed amendment

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Consents

- ❑ Short timelines applied to negative consent
 - Limited Partners may not have sufficient time to review, receive any required advice or recommendation from a consultant and respond to a request for consent
 - Consent or amendment requests are often sent before holidays and popular vacation times, leaving even less time for review and response

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Consents

- ❑ Counting only those who vote
 - Excludes commitments of those Limited Partners who do not participate in a vote
 - Included in definition of “Majority in Interest,” which can drastically affect a vote

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Consents

- ❑ General Partner and affiliates not excluded from the voting pool
 - General Partner and affiliate votes not excluded at all
 - General Partner and affiliate votes excluded selectively but may vote on critical issues where it is not appropriate (such as removal of the General Partner)

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Voting

- Limited Partner v. Limited Partner Advisory Committee
 - Commitment size of Limited Partner
 - Total commitments of Partnership
 - Percentage of vote
 - Override provisions
 - Membership of LPAC

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Amendment

- Amendments to key economic terms
 - Permitted by general amendment standard
 - Without requirement of obtaining the consent of affected Limited Partners

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Amendment

- ❑ Increasingly broad amendments permitted without Limited Partner consent
 - No consent required as long as amendment does not materially adversely affect the interests of the Limited Partners as a whole
 - No consent required as long as amendment addresses change in applicable law, regulation or accounting practice
 - No consent required for amendments negotiated with Limited Partners in subsequent closings
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Amendment

- ❑ Amendments permitted so long as do not disproportionately alter or affect the rights of a Limited Partner (including economic rights)
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Buried Substantive Provisions in Subscription Documents

- ❑ Broad and continuing representation on accuracy of information
 - All information that the Investor has provided is true, correct and complete as of each date that the Investor is required to make a capital contribution or receives a distribution

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Buried Substantive Provisions in Subscription Documents

- ❑ Broad representation regarding applicability of laws to the Partnership

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Buried Substantive Provisions in Subscription Documents

- If Subscriber is an “employee benefit plan” as defined in Section 3(3) of ERISA that is not subject to either Title I of ERISA or Section 4975 of the Code (including a governmental plan or foreign plan), the Subscriber represents and warrants that neither the Partnership nor any person who manages the assets of the Partnership will be subject to any laws, rules or regulations applicable to such Subscriber solely as a result of the investment in the Partnership by such Subscriber

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Buried Substantive Provisions in Subscription Documents

- If the investment in the Interest is being made on behalf of a plan established and maintained by any U.S. state, its political subdivisions, or any agency or instrumentality of such a state or its political subdivisions, for the benefit of its employees, there is no provision in the instruments governing such plan or any U.S. federal, state or local or non-U.S. law, rule, regulation, or constitutional provision applicable to the plan that could in any

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Buried Substantive Provisions in Subscription Documents

respect affect the operation of the Partnership by the General Partner or prohibit any action contemplated by the operational documents and related disclosure of the Partnership, including, without limitation, the investments that may be made pursuant to the Partnership's investment strategies, the concentration of investments for the Partnership and the payment by the plan of incentive or other fees

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Buried Substantive Provisions in Subscription Documents

- Breadth of the representation could be read to include securities laws or any state law applicable to any investor, not just a public pension plan

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Buried Substantive Provisions in Subscription Documents

- ❑ Broad representation regarding applicability of registration or filing requirements
 - Each Limited Partner represents and warrants that there are no governmental orders, consents, or authorizations that are required to be obtained, and no registrations or other filings are required to be made in connection with the Investor's status as a Limited Partner

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Buried Substantive Provisions in Subscription Documents

- ❑ Broad power of attorney
 - Any misstatement or breach of any of the representations, warranties, acknowledgements and confirmations by a Limited Partner in the Subscription Agreement may entitle the General Partner to transfer such Limited Partner's commitment

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Buried Substantive Provisions in Subscription Documents

- ❑ Confidentiality provisions that vary from the Partnership Agreement

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Buried Substantive Provisions in Partnership Agreements

- ❑ Waivers or limitations of fiduciary duties hidden in unusual places
 - Included in section regarding management and control of the Partnership: Actions taken by the General Partner are considered binding and conclusive and are not subject to question or review by Limited Partners in any suit or proceeding, with limited exception

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Buried Substantive Provisions in Partnership Agreements

- Included in key man, removal, conflicts and amendment sections of a Partnership Agreement: Actions taken by a General Partner pursuant to such sections will not constitute a breach of any duty owed by the General Partner

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Buried Substantive Provisions in Partnership Agreements

- Default to sole and absolute discretion
 - Every power vested in the General Partner will be construed as a power to act in its sole and absolute discretion

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Buried Substantive Provisions in Other Documents

- ❑ Examples of provisions found in subscription documents and private placement memoranda but not in the Partnership Agreement (where they would typically be):
 - Waiver of right to trial by jury
 - Consent to jurisdiction and venue
 - Broader power of attorney

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Buried Substantive Provisions in Other Documents

- ❑ Waiver of conflicts
 - By acquiring an interest in the Partnership, a Limited Partner will be deemed to have acknowledged the existence of any conflicts of interest and to have waived any claim with respect to such conflict of interest

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Early Closing Discounts

- ❑ Early closing discounts
 - Enticing Limited Partners with reduced management fee if participate in first close
 - Pressures agreement on business terms or risk losing the discount
 - Provides General Partners a benefit to publicize large first close and resist changes from subsequent closing partners

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Expenses

- ❑ More expenses explicitly included in Partnership Expenses
 - Travel expenses “including, where appropriate, the chartering of private aircraft”
 - Research expenses
 - Expenses incurred in obtaining systems, research and other information utilized for portfolio management purposes

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Expenses

- Costs and expenses associated with outsourcing of certain services to affiliated and unaffiliated service providers
- Internal legal costs

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Deal Fees and Fee Sharing

- Deal Fees and Fee Sharing
 - SEC issues
 - Types of fees shared should be broadly defined
 - Recipients of fees

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Offsets to Management Fee

- ❑ End of Partnership
 - Distribution of excess fees should be to fee-paying Limited Partners
 - Distribution through waterfall
 - Carry over to successor or related partnerships

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Recycling and Termination of Commitment Period

- ❑ Recycling
 - Returned capital or all proceeds
 - Unrestrained by termination of commitment period
 - Unrestrained after cause event or key person event
 - Failure to clearly define termination of commitment period

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Side Letters

- Carve outs expanding (agreements excluded from a side letter for purposes of the MFN)
 - New:
 - Reporting
 - Withdrawal rights
 - Excuse
 - Regulatory rights
 - Transfer rights

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Side Letters

- Limited MFN Packets (e.g., General Partner selects side letter provisions applicable to Investor's MFN)
- Side Letter provision v. Partnership Agreement provision
 - Enforceability issues
 - Other concerns

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Due Diligence Letter in Lieu of Side Letter

- ❑ General Partners provide a separate disclosure letter “in response to the due diligence inquiry” from a Limited Partner covering provisions typically included in a side letter
 - Interest in co-investment opportunities
 - Representations regarding litigation
 - Information to be provided at the request of the Limited Partner

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Due Diligence Letter in Lieu of Side Letter

- Confirmations regarding intended interpretation of Partnership Agreement provisions
- ❑ Questions regarding enforceability

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Opinions

- Previous opinion vs. subsequent fund opinion
 - Disclosure by law
 - Documents being opined on
 - Provide different opinion or no opinion to some Limited Partners

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Parallel Funds

- Different economic terms may be permitted (either explicitly or implicitly) for Parallel Funds
 - Different terms may not be disclosed to Limited Partners as a matter of course
 - Different terms may not be subject to the MFN

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Subscription Line Financing

- ❑ Subscription line financing more prevalent in private equity funds
 - Financing has been permitted in the past, but Limited Partners were generally not required to deliver confirmation letters and opinions that are more typical in real estate

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Subscription Line Financing

- ❑ Documents requested by General Partners and lenders are becoming more expansive and may include agreements and substantive terms that were not agreed to in the Partnership Agreement
- ❑ Financing may now require security interests in the Limited Partners' interests in the Partnership

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Moderator and Presenters



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