

ILPA Publishes Model Limited Partnership Agreement Applying Principles 3.0

November 19, 2019

On October 30, the Institutional Limited Partners Association (ILPA) published a comprehensive, Delaware-law based European style “fund as a whole” waterfall Model Limited Partnership Agreement (LPA) that can be used to assist in structuring investments into a traditional private equity buyout fund. The Model LPA is ILPA’s first model limited partnership agreement and is the latest development in ILPA’s ongoing effort to promote the alignment of interests between general partners (GPs) and limited partners (LPs) in the context of private equity funds and gives concrete expression to the concepts set forth in the third edition of the ILPA Principles (Principles 3.0) published earlier this year. For more information regarding Principles 3.0, please see Katten’s Investment Management Advisory, “[ILPA Principles 3.0: Focusing on Enhancing Transparency in Private Equity Funds and Alternative Investments](#).”

The Model LPA also addresses what ILPA perceives to be the persistent need within the industry to simplify the negotiation of LPAs and reduce the often significant cost, time and complexity of negotiating the terms of investment in private equity funds. One of ILPA’s stated purposes in publishing the Model LPA is to advance the interests of GPs to reduce the length of side letter agreements, provide fundraising certainty and lower their fund formation costs, and of LPs to have balanced and transparent terms that explain rights and obligations while also lowering their legal negotiation costs. Although ILPA represents the interests of the investor community, in preparing the Model LPA it sought input from lawyers in the industry representing both GPs and LPs. The full text of the Model LPA is available [here](#).

ILPA expects the Model LPA will provide significant value to the private equity marketplace. We expect that its value will vary among different market participants. Apart from LPs, emerging fund sponsors are the most likely beneficiaries of ILPA’s efforts. Using the more investor-friendly ILPA-approved terms of the Model LPA can facilitate the marketing efforts of an emerging fund sponsor and reduce its legal costs. Established fund sponsors are, in our view, less likely to rely on the Model LPA in their fund raising efforts; however, even established fund sponsors could benefit from becoming familiar with the Model LPA as LPs may seek to discuss the provisions in the Model LPA with fund sponsors and, in some cases, may attempt to include provisions from the Model LPA in side letters and successor fund LPAs.

Notable provisions of the Model LPA

Waterfall Structure. Net investment proceeds are distributed 100 percent to LPs until they receive cumulative distributions equal to the sum of their aggregate capital contributions plus the preferred return amount (i.e., the hurdle), with the preferred return being calculated from the date each capital contribution is drawn (including drawn on a subscription credit facility) down and not the date it is invested. This “fund as a whole” waterfall is more common in Europe than in the United States, where a “deal-by-deal” waterfall is still generally the market standard.

Carried Interest Calculation and GP Clawback. The GP's carried interest is calculated based on net profits (i.e., after deduction of fund-level expenses), and a portion of each carried interest distribution made to the GP is deposited in an escrow account to be used to satisfy any clawback obligation of the GP. A clawback calculation is made on the first anniversary of the end of the commitment period, upon the removal of the GP, at the time of the fund's final liquidating distribution, and when any distributions are required to be returned by the LPs.

Management Fee. The management fee is not paid during any extension of the fund's initial term or during the winding up and liquidation of the fund.

Enhanced Role and Enhanced Disclosure of the Advisory Committee. The Model LPA expands the traditional role of the Limited Partner Advisory Committee (LPAC). The LPAC must approve the fund's auditor, consent to an extension of the commitment period or the term of the fund, consent to various types of investments and transactions, and approve the establishment of any reserves for fund expenses during the fund's winding up. The GP is required to disclose to the LPAC all valuations and all actual and material potential conflicts of interest (whether or not they are disclosed in the fund's offering documents); however, the commentary to the Model LPA notes that a strict prohibition on conflict transactions will be impractical for some funds. In addition, the GP must disclose all fee income received by the GP, the investment manager, any key person, or any of their respective affiliates, and the calculations and a list of the management fees, carried interest, and fund expenses, and must notify the LPAC of all proceedings, changes of control, claims of indemnification, and co-investment opportunities offered by the GP to any person.

Standard of Care. The General Partner and investment manager must act reasonably and in good faith and are required to use the care that an ordinarily prudent person in a like position would exercise under similar circumstances. This standard supplements, and does not replace, the fiduciary duties applicable to the GP or investment manager under applicable law and applies to all investment decisions, delegations of authority, exercises of discretion, and all other acts or omissions of the GP or the investment manager under the Model LPA, the subscription agreement, each side letter, the investment management agreement, and any other agreements or understandings relating to or otherwise affecting the fund (collectively, the Fund Documents). In the event of any inconsistency between the Model LPA standard of care and any provision of any Fund Document, the Model LPA standard of care governs.

Exculpation and Indemnification. The GP, the investment manager, and their respective affiliates, partners, members, employees, directors and officers, including key persons (collectively, GP Covered Persons), are not liable to the fund and its partners for any losses, claims or damages unless such losses, claims or damages arise from their fraud, bad faith or wilful misconduct, gross negligence or reckless disregard, a breach of the LPA (including the standard of care) or any other Fund Document (which includes side letters), the violation of any law or regulation, or a proceeding between or among a GP Covered Person or an interested person. A finding by a court that such conduct has occurred is not a predicate for imposing liability on a GP Covered Person. Established funds have historically followed a different approach, for example, requiring a court finding that such conduct has occurred.

GP Covered Persons are indemnified and held harmless by the fund for any losses, claims or damages they may suffer or incur as a result of their conduct on behalf of the fund unless such losses, claims or damages arise from conduct described above or from the GP Covered Person's insolvency, administration, dissolution, liquidation or bankruptcy.

Removal of the GP. The GP can be removed without cause by the vote of investors representing 75 percent of the commitments (including commitments to any parallel investment vehicle) and for "cause" by vote of investors representing a majority of such commitments. Cause for removal of the GP includes the fraud, bad faith or wilful misconduct of the GP, the investment manager, any of the key persons and any of their respective affiliates; the

gross negligence or reckless disregard of any such person in relation to activities of the fund, a breach by any such person of the standard of care described above, a material breach of any other term of the LPA or of any other Fund Document (which as noted above includes all side letters); and misdemeanour criminal conduct by a key person even if not related and material to his duties to the fund and punishable by only a fine.

Upon removal for cause, the GP forfeits all right to receive further distributions of its carried interest and any amounts retained in the clawback escrow account referred to above are returned to the fund and distributed to the LPs.

MFN Rights. The GP is required to give notice to each LP of the terms of all side letters and, with limited exceptions, the LPA extends to all LPs, regardless of the amount of their commitment, any more favourable rights granted to any other LP in a side letter. This approach addresses a long standing source of tension between GPs and LPs, particularly in relation to the disclosure of special rights given to certain LPs. However, if the approach proposed by the Model LPA is adopted it would limit the ability to provide a strategically important LP with more favourable terms as compared to other investors.

Amendment Thresholds. Amendments generally require approval of LPs holding 75 percent of the partnership interests. However, certain amendments, including amendments to the fund's investment objectives, investment policy, maximum fund size and investment restrictions, will require approval of LPs holding 90 percent of the interests.

In addition to the Model LPA, ILPA has produced a number of model documents and templates, including a model subscription agreement, due diligence questionnaire and a reporting template. ILPA has indicated that it plans to produce additional versions of the Model LPA, including one based on a "deal-by-deal" waterfall. We will continue to monitor the ILPA's efforts in this space.

Conclusion

LPs should bear in mind that, although the Model LPA can serve as a reference point for the negotiations of fund terms, each fund's terms should be considered on their own merits. Although ILPA acknowledges that the provisions in the Model LPA will not be appropriate for every fund, GPs should be prepared to have discussions with LPs regarding the features of the Model LPA.

CONTACTS

For more information, please contact your Katten relationship lawyer or one of the authors.



Jack P. Governale
+1.212.940.8525
jack.governale@katten.com



Edward A. Tran
+44 20 7770 5254
edward.tran@katten.co.uk



David A. Brennand
+44 20 7776 7643
david.brennand@katten.co.uk



Henry Bregstein
+1.212.940.6615
henry.bregstein@katten.com



Allison C. Yacker
+1.212.940.6328
allison.yacker@katten.com



Cathleen A. Booth
+1.312.902.5336
cathleen.booth@katten.com



Walter S. Weinberg
+1.312.902.5405
walter.weinberg@katten.com

Katten

katten.com

CENTURY CITY | CHARLOTTE | CHICAGO | DALLAS | HOUSTON | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SHANGHAI | WASHINGTON, DC

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2019 Katten Muchin Rosenman LLP. All rights reserved.

Katten refers to Katten Muchin Rosenman LLP and the affiliated partnership as explained at kattenlaw.com/disclaimer.

11/15/19