

ILPA RELEASES ITS MODEL LIMITED PARTNERSHIP AGREEMENT

On October 30, 2019, the International Limited Partner Association (ILPA) published a Model Limited Partnership Agreement for the private equity industry. ILPA is a global organization dedicated to advancing the interests of investors in private equity funds.

The ILPA Model LPA is available online¹ and incorporates the positions taken in ILPA Principles 3.0,² published earlier this year. The ILPA Model LPA was developed by a group of approximately 20 internal and external legal counsel that represent the investor community (and to a lesser extent the sponsor community) in fund formation transactions. ILPA has also previously published a Model Subscription Agreement.³

The ILPA Model LPA is designed for a traditional private equity buyout fund formed in Delaware with a “whole-of-fund” waterfall. It is expected that ILPA will in the future release additional versions of the ILPA Model LPA, including one for funds with a “deal-by-deal” waterfall structure. Although “whole-of-fund” waterfall structures are still generally considered the market standard in Europe, we note that most North America-based private equity buyout funds have a “deal-by-deal” waterfall, presenting a useful reminder of the continuing disconnect between ILPA and, on this issue in particular, the US sponsor community.

The ILPA Model LPA includes a number of investor-favorable provisions, most of which already appear in ILPA Principles 3.0. Some noteworthy provisions are set forth at the bottom of this newsletter.

ILPA states in the press release accompanying the ILPA Model LPA that one of the purposes of publishing a uniform and publicly available document is to reduce reliance on side letters and, as a result, optimize fundraising costs ultimately borne by all investors. By reducing the length and scope of side letters, the process of negotiating private equity fund investments can indeed be streamlined. The result, however, of limiting side letters and having a “most favored nation” right that applies to all investors regardless of size (as proposed by ILPA) is that

¹ See <https://ilpa.org/wp-content/uploads/2019/10/ILPA-Model-Limited-Partnership-Agreement-October-2019.pdf>.

² See https://ilpa.org/wp-content/uploads/2019/06/ILPA-Principles-3.0_2019.pdf.

³ See <https://ilpa.org/wp-content/uploads/2018/05/ILPA-Model-Subscription-Agreement-Final.pdf>.

fund sponsors will have less ability to offer large or strategically important investors better or bespoke terms, which may make the cost of offering some of those terms too high to offer them at all.

The ILPA Model LPA may be helpful as a benchmark to emerging fund sponsors who are seeking to adopt terms that have been vetted by members of the limited partner community. More established fund sponsors, on the other hand, are unlikely to adopt this form. Such sponsors may also have fund terms, including specific language in their LPAs, that on balance are more investor-favorable than the ILPA Model LPA as a result of prior negotiations.

In its press release ILPA acknowledges that the ILPA Model LPA is designed for private equity buyout funds. Sponsors raising funds across other strategies should be mindful that even ILPA may not think that certain terms in the ILPA Model LPA would be appropriate for such other funds. In addition, a number of arrangements proposed by ILPA may not work for sponsors running multiple funds and accounts across different investment strategies or for sponsors affiliated with investment banks, insurance companies or other financial institutions.

As the private equity industry has experienced since the release of the three prior rounds of ILPA Principles, we expect investors to use the ILPA Model LPA as a guide to fund terms, and sponsors may not choose to adopt this form or its terms but would be well-advised to be aware of the views expressed in the ILPA Model LPA.

Noteworthy investor-favorable terms included in the ILPA Model LPA:

- In addition to featuring a "whole-of-fund" waterfall and clawback at the end of the fund's life, there is a requirement to establish an escrow account for carried interest distributions and calculate the clawback at various interim stages during the fund life.
- The general partner must make decisions, including investment decisions, reasonably and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and any exercise of its discretionary authority under the LPA (including "sole discretion") must be exercised in a manner consistent with this standard of care. This standard of care applies in addition to any fiduciary duties applicable under applicable law or the relevant regulatory framework.
- The preferred return begins accruing upon a drawdown on a subscription facility.
- The authority to enter into side letters is limited to the general partner's reasonable discretion.
- Side letters with individual investors are treated as a part of the LPA for certain purposes, e.g. non-compliance with side letters results in consequences identical to non-compliance with the LPA.
- Disclosure of conflicts to fund investors prior to their investment in a fund does not waive the conflict or otherwise reduce or eliminate the requirement for the investor advisory committee to consent to a conflict of interest.

- "For cause" removal includes a breach of the standard of care, does not always require a material breach of an obligation and does not require the fund to suffer any financial loss, and it is optional whether a court must make the finding of cause (and a final determination is not required). In addition, a "for cause" removal results in an immediate and full forfeiture of carried interest.
- "For cause" removal includes a key person's misdemeanor criminal offense (even if only punishable with a fine) and the conduct need not be related to or material to its duties to the fund.
- No management fee is payable during the liquidation period, any extensions to the fund's term or any key person suspension period.
- Investors have multiple no-fault remedies, including termination of the investment period, general partner removal and fund termination.
- Investors have relatively broad rights to be excused from investments.
- As is customary, organizational expenses are subject to a cap; however, the cap is the lower of a percentage of fund commitments and a fixed amount.
- There is no flexibility to form supplemental capital vehicles such as managed accounts or overflow funds.
- All side letter provisions must be disclosed to all investors and the "most favored nation" provision is included in the LPA, as is more common outside the US, making it available to all investors. The "most favored nation" right is not size-based and has limited exceptions, and operates automatically (*i.e.*, without elections required by investors).

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