

Heard on the Listserve

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Capital Call Lines of Credit / Capital Call Bridge Facilities

Once again, our Listserve has been very active over the last few months – with vigorous discussions taking place on a number of topics. These have included offshore jurisdictions, Patriot Act issues in M&A and capital call lines of credit, which is the topic of this summary.

I began the discussion on January 4, 2008 with the following query:

“I would appreciate any input from the committee on common terms and structure for lending facilities extended to VC and PE funds in order to bridge some or all of their funding obligations at the closing of an investment or acquisition and pending receipt of capital calls from LPs.

In particular, what security are lenders obtaining?

Would the security extend to liens on the fund's right to make capital calls from LPs? If so, are lenders obtaining any acknowledgement from LPs regarding enforceability of the capital call right?

Would the security include a pledge of the applicable portfolio company's securities acquired by the fund or any other securities in the fund's portfolio?”

In all, I received 16 written responses and a number of direct telephone calls from Committee members offering information. An impressive response and a good example of the working spirit of our Committee. The written responses are summarized below (the telephone responses were consistent with these).

General Terms / Frequency of Capital Call Lines of Credit

Almost all of the responses indicated that these facilities are generally referred to as “capital call lines of credit” and have become very common. Richard Starling’s response below provides a good summary of these facilities and is representative of many of the replies:

“It is quite common for funds to obtain these sorts of credit facilities, which are often referred to as “capital call lines of credit.” They are usually set up as revolving secured credit facilities that can be used repeatedly over an extended period of time, with a cap on borrowing set at some percentage of unfunded commitments to the fund. That cap varies, but 50% would be typical. The security is usually the right of the GP to make capital calls from the LPs, as the lender isn’t interested in foreclosing on illiquid securities it is ill-suited to manage or dispose of. The partnership agreement of the fund usually contains a provision expressly contemplating this pledge by the GP of its right to make capital calls, so no further acknowledgement from the LPs is really needed. We usually give the GP the right to require the LPs to make such acknowledgements anyway if required by the lender, but in our experience lenders rarely require them as long as the partnership agreement clearly

allows the pledge. Lenders usually don't take a security interest in the fund's other assets."

Liens on Proceeds of Capital Calls / Acknowledgment by LPs

The consensus was that lenders do require liens on the proceeds of capital calls by the funds, and will also frequently require the right to make a capital call on behalf of the fund in the event of a default. However, most responses indicated that lenders typically do not require an acknowledgement by the fund's LPs. Nevertheless, the responses also indicated that some lenders will require acknowledgments or other information from LPs – including due to syndication requirements. Margaret Paradis' e-mail below discusses this point.

"Certain lenders have particular documentation requirements to meet the documentation requirements for syndication, including acknowledgement, opinions and ongoing information from each investor. It is helpful if the lender can be identified while drafting so the documentation can be obtained as a part of the closing package."

The responses also noted that a lender's willingness not to seek acknowledgments may be due in part to provisions in fund documents that acknowledge in advance the GPs right to grant the capital call lien. In the below excerpt from Samantha Horn's response, she notes the need to contemplate this in fund documents:

"If you are drafting a new LPA, it is probably best to provide that the LPs would provide an acknowledgement, and any other information or confirmations the lender may reasonably require."

Pledge of Portfolio Company Securities or Other Assets and Related Issues

All responses agreed that lenders do not take security interests in any of the funds other assets. For example, Samantha indicated that "Typically, the lender takes an assignment of the capital call but does not take a security against the assets of the fund . . ."

In response to Samantha's e-mail, Michael Rosenthal pointed out a potential issue involved in these facilities – UBTI (unrelated business taxable income):

"I concur [with Samantha's response]. As to the pledging of other Fund assets, that can be quite dangerous from a tax perspective, as it may result in the recognition of UBTI by tax exempt investors in the Fund."

Michael's point regarding UBTI may have broader implications for capital call lines of credit. Some that I spoke to directly indicated that if the facility and borrowings are not structured properly, there is a risk of UBTI based solely on the borrowing – an important point to consider in these transactions.
