

# Fund Finance Friday



## We Are Going to Need That from the Start

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In a prior [article](#), we highlighted common issues contained in side letters that are concerning to Lenders. Whenever a problematic side letter provision is included, a Lender is faced with either excluding the applicable investor from the calculation of the borrowing base or developing a workaround to allow the Fund to keep its contractual arrangement with the investor in the side letter intact while also protecting the Lender's interest. One such circumstance in a side letter is exemplified by the following provision:

"The General Partner agrees that each Capital Call notice shall be signed by an authorized officer of the General Partner (which signature may be an electronic signature on a PDF file) or come from an e-mail account of an authorized officer (including an e-mail generated by a reporting site directing the Investor to a Capital Call notice)."

In a typical subscription credit facility, the Lender, upon the occurrence and during the continuance of an event of default, may, among other things, initiate one or more capital calls in order to pay the obligations under a credit facility then due and owing. The side letter provision above has the potential to frustrate that right, as the Lender is neither an authorized officer of the General Partner nor would it have the necessary e-mail account.

To address this issue, Lenders have developed a few creative solutions, the first of which is to include a covenant in the credit agreement similar to the following:

"On or before the Closing Date, each Fund shall deliver to the Lender, Pre-executed Capital Call Notices for each Investor that has a Side Letter that either prohibits the Lender from signing or requiring only the General Partner or an officer thereof to sign any Capital Call Notice provided to such Investor. With respect to Pre-executed Capital Call Notices that have been previously delivered to the Lender pursuant to the terms hereof, amended Pre-executed Capital Call Notices for such Investors whose name or address information has changed, after the applicable Fund has knowledge of such change of name or address. In addition, the Lender shall have the right to request, and each Fund shall deliver to the Lender, additional Pre-executed Capital Call Notices if the Lender issues the original Pre-executed Capital Call Notices pursuant to the Lender's rights hereunder and, after the time for payment of the related Capital Contributions, any Obligations remain outstanding."

"'Pre-executed Capital Call Notices' means Investor Capital Call notices executed by a Fund Party in blank as to the amount of the applicable Investor Capital Call, and delivered to the Lender in accordance with the terms hereof."

Under this scenario, pre-executed notices are delivered to the Lender with blank amounts and held until such time (if ever) as the Lender needs to issue such notices to facilitate the repayment of the facility. This workaround is not without a few logistical challenges. If the notices are purely electronic, the Lender is simply tasked with maintaining appropriate electronic recordkeeping. However, if the notices are provided as original executed counterparts, the Lender must maintain proper safeguarding of the physical copies. Also, after the facility is terminated and all obligations are repaid, the Fund will likely ask for the pre-signed notices to be returned in much the same way as an original promissory note. Any bank refinancing the facility would also be concerned about a return of these notices. The Lender and the Fund must also agree on how many executed notices for each investor must be provided. Given the

potential need that more than one capital call may be issued to an investor in a default scenario, obtaining multiple pre-executed notices for each applicable investor is prudent.

There is also the consideration of whether the Lender's counsel holds the notices and assumes the safeguarding risk. In addition, the administrative burden can be extensive. The Fund will need to deliver a pre-executed notice with respect to each new investor joining the Fund with this side letter provision, and a most favored nation election by many investors in a large commingled Fund can result in two or three pens without ink after signing the necessary notices.

A second alternative is not as common and is often met with some level of scrutiny by both the Fund and the Lender. The above problematic side letter provision makes reference to the notice coming from an authorized officer of the General Partner. This poses the question as to whether individuals employed by the Lender could be appointed an officer of the General Partner for the limited purpose of issuing a capital call. Many Funds raise concerns about an individual contacting the investors with a capital call notice under the guise of an officer of the Fund. Many banks do not like the idea of being placed in a position of authority with the Fund and are unsure if this appointment imposes fiduciary risk. For these reasons, this alternative is less frequently pursued.

Like many side letter provisions, this scenario is one in which a Fund and the Lender can develop a solution through mutual consideration of the issues. In this case, the solution is likely to have pre-executed notices delivered up front, and all involved hope the same number of notices so delivered are returned to the Fund at the conclusion of a successful deployment of capital and repayment of the facility.