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Fund Finance Friday

Subscription Finance Loan Agreement Series, Part 18: Conditions Precedent

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Perhaps a strange place to finish this series, and more to do with the order in which an LMA-based Subscription/Capital Call Facility is set out than the actual timing, but in this last article in our Subscription Finance Loan Agreement Series we look at the documentary and other conditions that lenders will need to see completed before any utilisations under facilities can be made. As with the other articles, the focus is very much on those items in the conditions precedent that are unique to subscription/capital call facilities or where there is a particular "twist" to think about in relation to these facilities.

We start with the constitutional documents of the fund and any other fund-related parties to the facility agreement. It is worth noting here that these documents should include all relevant documents that go to form part of the fund's powers to operate (so they should include, for example, any side letters from investors as well as the subscription agreements of those investors, in addition to the relevant limited partnership agreement and any prospectus or equivalent). As we have stressed in previous articles in this series, all of these documents can in one way or another impact the relevant powers of the fund and its related parties in respect of the transaction. In contrast to corporate transactions, lenders will have limited or no protection if there has been a breach of those powers, so it is important that all documents are provided and reviewed. Depending on the relevant jurisdictions involved, there may be requirements for additional documents (for example, documents registered on public registries) also to be provided.

Next come approvals for the transaction and the transaction documents. These will generally be approvals provided by the general partner or manager of the fund (acting on behalf of the fund), but it is also important to include approvals from these entities in their own right. As with other loan facilities, there should also be a requirement for a certification that no borrowing or other limits in the constitutional documents will be breached by the transaction. As we have noted, this is particularly important in a fund context (and should form a specific part of the due diligence) as, in contrast to a corporate loan, there are generally no overriding legal protections which might save a lender if these restrictions are breached. We would also expect to see conditions precedent requiring specimen signatures and certification of constitutional and other documents (in common with similar conditions in most other loan agreements).

Then come the finance documents making up the transaction – so, including the facility agreement, any security and any other related items. We have covered this in previous articles in this series, but particularly important here is to ensure that any notices of security are completed and that delivery of these notices to investors (and to any account bank) is included as a condition if not to signing the facility agreement at least to any utilisation under it. As also discussed previously, acknowledgments of such notices, while always desirable, are usually not required from investors, although where there is only one or a small group of investors, acknowledgments should also be considered.

After that, we would expect to see legal opinions covering the transaction. These will be a mix of enforceability opinions and capacity opinions. In the UK and Europe, it is market practice for the lender counsel to provide enforceability opinions but for fund counsel to provide any capacity opinions. Because of the nature of a fund, it is almost impossible for a lender's counsel to have sufficient information to provide a capacity opinion, which is why this important condition is almost always left for fund counsel to provide.

Finally, at least in respect of documents specific to conditions for subscription/capital call facilities, we would expect to see relevant documentation and information on the investors and the investors' commitments. This may take the form of an opening "borrowing base" certificate or something less "formal" but should always be required. Alongside this, consideration should be given to requiring some reassurance or certification to the effect that these documents are valid, binding and enforceable, or at the very least that there are no disputes with investors ongoing as to the liability of the investors to satisfy commitments. Depending on the circumstances, lenders may also consider whether to extend this to cover information on disputes in other related (or even unrelated) funds with the general partner or manager.

As said at the beginning of this article, the above is not intended to cover every condition required but just those where there is a particular issue with (or which are particularly relevant to) subscription/capital call facilities. Repeating an overarching theme of all of these articles, getting the conditions precedent right, and ensuring that all relevant documentary and other angles are covered, is, of course, important in any finance transaction. However, given the nature of funds and the limited protections available to lenders where there are “gaps” or “breaches,” it is particularly vital to have all angles covered in a subscription/capital call facility context, and it is hoped that this final article in the series will help parties to achieve this.