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The Involuntary Bankruptcy Exclusion Event

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By Michael Mascia
Partner | Fund Finance

The standard U.S. subscription credit facility exclusion event related to an investor's involuntary bankruptcy has for ages included a 60-day cure period. This is consistent with the typical event of default cure period; that is, a borrower typically has 60 days to have an involuntary insolvency proceeding stayed or dismissed before it matures into a capital "E" event of default.

But the two circumstances differ materially. In the vast majority of credit agreements, a condition precedent to a new borrowing is that the borrower is not subject to a potential default related to an involuntary bankruptcy. Thus, while the borrower has 60 days before an event of default occurs allowing the lender to accelerate the obligations, the lender has no obligation to advance new loans during the 60-day period. However, the historical subscription credit facility exclusion event has no such "potential exclusion event" concept that protects the lender from having to make new loans based on the applicable investor's uncalled capital during the 60-day period. Thus, lenders could be asked to lend new money against a potentially insolvent investor.

Perhaps that was one thing in the market's infancy where all funds were comingled, only rated investors were included in borrowing bases and the fund's partnership agreements rarely included overcall limitations. But in these days of separately managed accounts, tighter overcall limitations, more aggressive borrowing bases, etc., query if this is a risk that should appropriately be allocated to the lender. Perhaps a more equitable structure would involve the investor remaining in the borrowing base for the 60-day period with respect to existing loans, but being excluded with respect to new borrowings until the involuntary bankruptcy is dismissed.