

CADWALDER

Backdating: What To Do ... and Not To Do

March 3, 2023 | Issue No. 213



By **Eric Starr**
Special Counsel | Fund Finance

Attorneys are regularly asked about or faced with the request to backdate a document or set of documents. We are also at times asked about the acceptableness of a document that has been backdated. This article explores the practice of backdating and sets forth a high-level framework that can guide business people and lawyers as to the acceptable use of the practice.

To many lay people, the term “backdating” has negative connotations. Ten to fifteen years ago, the practice of backdating stock options was a hot topic for journalists and the subject of many court cases, one of the more notable and press-worthy being a case involving options issued to then-Apple CEO Steve Jobs. Large public companies employed the practice of awarding options to executives that were dated on an earlier date, when the company’s stock price was lower (or much lower in some cases). The effect of such fictitious dating is that it allows the executive to then exercise the option at a steep discount to the current stock price, instantly showing a significant gain on the actual cash invested. In the case of the Apple options, Jobs stood to gain \$20 million in the arbitrage (the options were returned unexercised in the wake of the scandal that followed).

But options are just one of a myriad of documents, legal or otherwise, that might be backdated. The fact is, the practice of backdating involves a wide range of conduct and an array of different possible contracts and documents. Simply put, not all backdating is unethical or inappropriate. In fact, backdating is a common business practice that is an important and necessary tool ... if utilized appropriately.

Below we examine some of the different ways in which backdating is permissible, as well as some in which it is not.

Instances and examples in which backdating would be appropriate:

- One of the most common and innocuous uses of backdating occurs when an anticipated closing date slips by a day or two. The deal parties may determine that leaving the effective date unchanged throughout, despite the occurrence of the closing the next day, is the most desirable and commercially reasonable choice. Particularly in a complex, multi-jurisdictional transaction, with a multitude of loan documents and other deliverables, there can be potentially material amounts of time and costs associated with re-dating such a large suite of documents. This form of backdating is widely accepted and entirely legitimate. In this instance, there are two mutually-agreed business parties agreeing that a prior effective date is acceptable.
- In the case of a missing document, such as an original promissory note, both parties might agree that having a replacement note executed and dated consistent with the original transaction is appropriate. Here, the “agreement” of the parties occurred in the past, and it makes sense to have the document dated accordingly.
- Subscription agreements are sometimes not executed on the date of effectiveness. For practical reasons, it might well make sense for a fund to backdate such a document. It is worth noting that it is important that the “acceptance” by the GP cannot pre-date the “offer” made by the investor when executing commitments. However, a fund may wish to make a group of investor closings effective on a particular date in order to align a closing of capital and make adjustments among multiple rounds of funding. Similarly, we sometimes see transfers that were agreed to by a transferee and transferor backdated to the agreed date of the transfer.
- Board minutes and resolutions are frequently, and legitimately, backdated. The board minutes may be reduced to writing and executed weeks following the actual meeting being memorialized. Such minutes should reflect the date of the meeting, not the date of execution.
- Confidentiality agreements are sometimes put in place at a later date than the date they are actually drafted – thus memorializing a prior agreement. Again, backdating of such an agreement is entirely appropriate.
- This analysis is limited to New York law, and we note that in some jurisdictions this practice may be prohibited or unlawful or may have additional execution formalities that must be observed. When it comes to fund finance transactions there can be complexities due to the overlay of foreign law with certain deal documents and, as such, determinations as to backdating require a collaborative process with input from local counsel from the relevant

jurisdictions. In addition to considerations as to whether backdating is lawful there can be additional implications for other documentation in a transaction, such as conditions precedent deliverables like legal opinions.

Instances and examples in which backdating would *not* be appropriate:

- The end of a calendar year (and, to a lesser extent, the end of a quarter) presents unique pitfalls when faced with a request to backdate documents. When an agreement is executed in early January, but backdated to the previous December, red flags are raised. At issue is the *purpose* of the backdating. A Seventh Circuit Court of Appeals case from the mid-1980s (*United States v. Micke*) involved an investment made in January 1983 but with documents backdated to December 1982, improperly giving the defendant an undeserved tax deduction. Importantly, the court, in upholding the criminal fraud conviction, noted that if the documents truly memorialized an investment made in 1982 (but not documented until 1983) the backdating would have been deemed legitimate and the outcome would likely have been different.
- Similar to the prior example, backdating documents to accomplish regulatory compliance, or avoid a lack thereof, would be a very bad idea. While the issues raised by regulatory issues can be grave, committing fraud to avoid them is likely only to greatly compound the problems.
- In a 2017 wrongful termination lawsuit, the CEO of a biotech company, BioRad Laboratories, was questioned about documentation justifying the termination of the firm's general counsel, who had been at the company for 26 years. Ultimately, the CEO admitted (when faced with metadata proving the point) that he had backdated his top lawyer's performance review to a date prior to the termination; in fact, it had been written months later after a wrongful termination suit had already been filed. The court was not impressed with the fraudulent effort or persuaded by claims the CEO had intended to document his handwritten notes but had just not gotten around to it until the lawsuit was filed.
- In 2009, Scott Polakoff, then-acting director of the Office of Thrift Supervision (the regulator for institutions such as IndyMac, Countrywide and the American International Group), was relieved of his duty. His offence? Polakoff had encouraged financial institutions regulated by the OTC to backdate documentation of capital infusions, effectively obscuring the financial distress of their balance sheets by improving capital reserves for previous quarters. When institutions under the OTC's regulation, such as IndyMac, imploded, the FDIC and investors were left with multi-billion dollar losses.

So which is it?

There is no bright-line test that governs backdating. When faced with determining the appropriateness or inappropriateness of backdating a document, there are several important considerations that should be weighed.

- One should be especially cautious of backdating documents when third-party rights are implicated. Similarly, changes of calendar years should cause an attentive lawyer to inquire carefully about the purpose of backdating a document.
- Disclosure and transparency are critical. All parties should be aware of the backdating and agree that it is appropriate.
- Backdating should never be used in an effort to obscure a fact; it is best practice to assume that all documents may become public or the subject of litigation. Nor should backdating be employed in order to evade regulatory compliance, deceive a court or gain an undeserved tax benefit.

Final thoughts

Ideally, all documents would be signed simultaneously on the date of effectiveness, but that is simply not always practical, realistic or commercially reasonable in the modern world. Consequently, backdating documents, when done appropriately, can become an essential tool for today's business lawyers.

MassMutual Direct Private Investments and MassMutual Asset Finance to Transition to Barings

March 3, 2023 | Issue No. 213

Massachusetts Mutual Life Insurance Company (“MassMutual”) and Barings, one of the world’s leading investment managers and subsidiary of MassMutual, announced plans earlier this week to transition MassMutual’s Direct Private Investments (“DPI”), a leading fund finance provider, and MassMutual Asset Finance (“MMAF”), an equipment finance company, to Barings. The transition, which will occur in the second quarter of 2023, will enable the businesses to scale their investment strategies with access to additional third-party institutional investors through Barings’ global platform, while enabling Barings to provide a broadened set of complementary investment solutions to its clients. You can read the full announcement [here](#).

Look for an interview with Phil Titolo, MassMutual’s Head of Direct Private Investments, next week.

Fitch Ratings Publishes Subscription Finance Rating Criteria Exposure Draft

March 3, 2023 | Issue No. 213

Fitch Ratings has published an **exposure draft** proposing new rating criteria for subscription facilities backed by capital commitments to private capital funds.

These criteria outline Fitch's methodology for assigning ratings to funds' obligations backed by capital call commitments. Fitch evaluates both quantitative and qualitative factors when assigning ratings to SFFs. The quantitative analysis is based on the credit quality and diversification of the LP pool, and projected losses compared to the level of overcollateralization available to the SFF. The qualitative assessment considers the fund manager, the fund's characteristics, and SFF structural terms that can materially influence LPs' incentives to meet capital calls, recoveries upon LP defaults on capital calls, and other risk factors. Fitch may also cap SFF ratings in certain circumstances. The rating framework applies globally to new ratings and surveillance of existing transactions.

You can access an on-demand replay of Fitch's recent webinar here: **[Subscription Finance Criteria Exposure Draft & Webinar](#)**.

Fitch invites feedback on the proposed criteria from market participants. Comments should be sent to **criteria.feedback@fitchratings.com** by March 19, 2023. Fitch will publish on its website any written responses it receives, in full, including the names and addresses of such respondents, unless the response is clearly marked as confidential by the respondent.

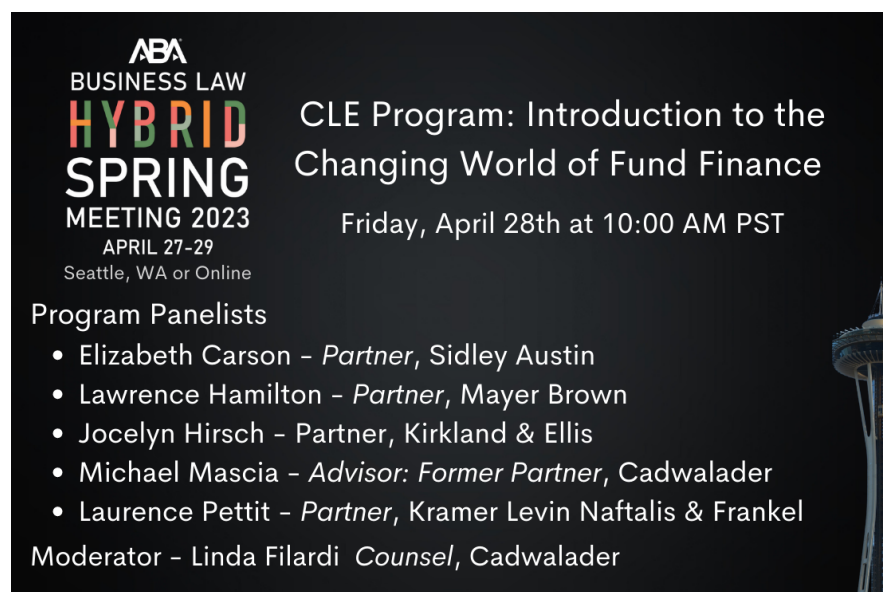
EMEA NextGen with NextGen IR: Fundraising Trends, Financing Needs and Investor Considerations

March 3, 2023 | Issue No. 213

The EMEA NextGen team will host a joint FFA NextGen and NextGen IR panel event on March 21 to discuss fundraising trends, financing needs and investor considerations. Panelists will be a mixture of GPs, lenders (bank and non-bank) and lawyers. Drinks, canapes and networking will follow.

The event, from 5:30 p.m. - 8:30 p.m. GMT, will be hosted by Allen & Overy at One Bishops Square in London.

You can register [here](#).

The image is a promotional graphic for a CLE program. It features a dark background with white and colorful text. On the left, the ABA Business Law Hybrid Spring Meeting 2023 logo is displayed, with 'HYBRID' in large, multi-colored letters. To the right of the logo, the program title 'CLE Program: Introduction to the Changing World of Fund Finance' is written in white, followed by the date and time 'Friday, April 28th at 10:00 AM PST'. Below this, the 'Program Panelists' are listed in a bulleted format. At the bottom, the moderator is named. A small image of the Space Needle is visible on the right side of the graphic.

ABA
BUSINESS LAW
HYBRID
SPRING
MEETING 2023
APRIL 27-29
Seattle, WA or Online

CLE Program: Introduction to the Changing World of Fund Finance
Friday, April 28th at 10:00 AM PST

Program Panelists

- Elizabeth Carson – *Partner*, Sidley Austin
- Lawrence Hamilton – *Partner*, Mayer Brown
- Jocelyn Hirsch – *Partner*, Kirkland & Ellis
- Michael Mascia – *Advisor: Former Partner*, Cadwalader
- Laurence Pettit – *Partner*, Kramer Levin Naftalis & Frankel

Moderator – Linda Filardi *Counsel*, Cadwalader

This April 28 CLE program, part of the ABA Business Law's Hybrid Spring Meeting 2023 in Seattle, will describe the evolution of fund finance, starting from Subscription Lending, to Net Asset Value Financing, to Collateralized Fund Obligations and various hybrid types of structures, with commentary on the changing view of insurance regulators and overall market trends. Cadwalader's Linda Filardi will moderate.

CLE attendees may participate in-person or on-line. For more information, visit [here](#).

Fund Finance Hiring

March 3, 2023 | Issue No. 213

Fund Finance Hiring

U.S. Bank is seeking an Analyst to join its Subscription Finance origination team in New York. For a description of the role, and for other information, including how to apply, please visit [here](#).