



**PRIVATE EQUITY
INTERNATIONAL**

THE LPA ANATOMISED

SECOND EDITION

A practical guide to negotiating private fund terms to
create GP/LP alignment of interests

Edited by
Nigel van Zyl and Edward Lee, Proskauer



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About the editors

Nigel van Zyl is a partner and head of Proskauer's European Private Funds Group. He specialises in advising asset managers, institutional investors and investment advisors across the full spectrum of private investment fund matters. Praised for his keen business sense and practical approach, Nigel advises leading international fund managers on all aspects of their private investment fund business, including the formation, raising, maintenance and ongoing operation and compliance of their investment funds. He also advises on internal governance, compliance and organisation, carried interest and co-investment arrangements, spinouts, reorganisations and restructurings.

Nigel represents institutional investors, including funds of funds, sovereign wealth funds, and global asset managers, with respect to their investments into private equity and other alternative asset funds. He also advises buyers and sellers of secondary fund interests and the structures used for these transactions, including synthetic secondary and co-investment structures, and fund restructurings and liquidity solutions.

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About Proskauer

Proskauer's Private Funds Group offers a complete package of services to private investment funds and institutional investors globally. With a team including specialists in tax, ERISA, regulation, employment, litigation and risk management, we understand the business objectives and dynamics of fund sponsors, limited partners and the private fund business as a whole.

We advise across the asset class on the full range of matters, going beyond fund formations, fundraisings and secondaries, and acting as true business partners with our clients. We counsel general partners on internal governance, compliance and organisation, carried interest and co-investment arrangements, spinouts, reorganisations and fund restructurings. We also represent a range of institutional investors on their alternative investment programmes.

We have particular expertise with the complexities involved in structuring and negotiating secondary transactions and fund restructurings, and advise a significant segment of the secondary market. We have experience acquiring and selling portfolios of partnership interests, including some of the largest bulk sales of interests in securities on the secondary market.

Introduction

A limited partnership agreement (LPA) is the legal foundation upon which the 10- to 15-year investment relationship between general partners (GPs) and limited partners (LPs) in the private investment funds industry is based. A well-crafted LPA regulates, with clarity, key fund terms, and the legal and economic relationship between GPs and LPs. This helps to foster meaningful long-term partnerships, create an alignment of interests and avoid conflicts, disputes and possible regulatory censure. There is a broad consensus among all industry participants that the relationship and the alignment of interests between GPs and LPs is fundamental to the success of the industry. As Invest Europe notes in its Professional Standards Handbook:

“...the nature of the longer-term partnership formed through negotiations between GPs and LPs is fundamental to how the industry operates and is what sets it apart from other asset classes.”

Drafting and negotiating a document that caters clearly for all eventualities in such a long-term relationship is a challenge that private investment funds lawyers must consider and grapple with on a daily basis as they advise their clients, whether GPs or LPs, on raising or investing in private investment funds.

The first edition of *The LPA Anatomised* was published in 2012, at a time when the fall out from the global financial crisis was still impacting the industry; there was a contraction in the amount of capital being raised for private investment funds, and fundraisings were taking longer and were more challenging. LPs used this environment to reassess key terms in LPAs and consider whether these terms actually facilitated an alignment of interest between them, their fellow LPs and the GP. The relationship between LPs and GPs is often, unhelpfully, described at any time to a point on the arc of a pendulum and in 2012 the ‘pendulum’ had clearly swung in favour of LPs. Now, in 2017–18, fundraising is at an all-time high, funds are being raised quickly and are often oversubscribed as investors scramble to meet accelerated timetables and get allocations to the in-demand funds. For those in-demand GPs, the ‘pendulum’ has clearly swung back in their favour, which leads to a more general market shift in favour of the GPs.

Our industry is defined and succeeds because of its willingness to innovate, and the ambition, intelligence and drive of the people who lead and participate in it. GPs and LPs are continually searching for new ways to achieve greater returns and deliver

outperformance to their stakeholders, exploiting opportunities as they arise. LPAs need to be structured and drafted to facilitate, and not hinder, this innovation while ensuring that the key principles of alignment, accountability and transparency are maintained. Finding the right combination of flexibility for the GPs, and certainty for the LPs, is therefore vital.

It would be remiss of us not to note the impact and influence that regulation and regulators have had on the industry in recent years and specifically on the terms of LPAs. Of particular note are the changes being made to LPAs as a result of various enforcement actions taken by the US Securities and Exchange Commission (SEC). These actions are not only relevant to GPs based in the US but GPs globally, given the volume of capital available from US investors and because there is greater awareness among institutional investors of the issues flagged by the SEC. The SEC has censured a number of GPs for falling short on transparency and disclosure – often referring to the provisions in LPAs as lacking clarity – and the industry has responded accordingly by seeking to address these points more clearly in LPAs.

The European Union's Alternative Investment Fund Managers Directive (AIFMD) has also had an impact on the content in LPAs but in comparison to the SEC it is less certain that the AIFMD has been helpful in creating and facilitating an alignment of interest between GPs and LPs.

In Europe we are also starting to see the impact of Brexit on fund structures and LPA terms. While the details of any future agreement between the UK and the European Union remain unclear, some GPs are already taking steps to ensure their funds will continue to be regarded as EU alternative investment funds (AIFs) for AIFMD purposes after March 2019 whatever deal is agreed, particularly where they have LPs that require, or prefer, funds to be EU AIFs. Luxembourg, with its special limited partnership (or SCSp), is becoming a particular focus for such GPs as a result. Other GPs are holding fire on structural changes and instead are looking to include more flexibility in the LPA to permit post-closing adjustments. LPs may well be sympathetic to the reasons for the inclusion of this additional flexibility, provided suitable protections are built in. These provisions often look similar to those that were added at the time AIFMD was coming into force, including, for example, giving GPs the ability to form parallel funds even after final closing so that LPs can be placed into a newly formed vehicle that qualifies as an EU AIF once the post-March 2019 environment becomes clearer.

Outside legal and regulatory changes, industry bodies such as the Institutional Limited Partners Association (ILPA) continue to promote principles and standards that their members would like the GPs they invest with to adhere to, and are seeking to standardise certain key provisions in LPAs and ancillary documents with the stated objective of streamlining the fundraising process. To this extent, ILPA recently published a model subscription agreement. In giving LPs a starting point for discussions, organisations such as ILPA and the principles they promote have had, and continue to have, an influence on the key terms in LPAs that regulate economics, governance, investor protections, and reporting and transparency with the objective of creating and maintaining an alignment of interest between GPs and LPs.

This second edition of *The LPA Anatomised* features the insight and views of leading legal practitioners and industry experts on how an alignment of interests between GPs and LPs is created, how the long-term relationship between them is fostered through the LPA and how recent regulation, regulatory censure and litigation have influenced LPA terms.

Private fund formation lawyers provide their insights into and analysis of all the main terms in private equity fund LPAs, detailing their specific purpose and pinpointing key issues that GPs and LPs care about when negotiating and agreeing these terms. This unique publication also considers why there are differences in terms between funds located across regions and provides practical suggestions on how operative provisions should be drafted from those who have the task of implementing the LPA terms in practice.

The publication has been meticulously crafted to feature meaningful insight, guidance and views on key LPA terms, how and why they are negotiated and how and why they evolve in response to internal and external influences. It also serves as a practical guide to those in the industry who make decisions on or advise on fund terms and those who draft and negotiate LPAs.

We would like to thank all the distinguished authors who, in spite of busy professional schedules, have contributed their detailed and thought-provoking chapters and analyses.

**Nigel van Zyl and Edward Lee
Proskauer**