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ILPA Model LPA: ILPA 3.0 Was Only the Beginning

Will a New Model LPA Shape the Future of Private Equity?

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The Institutional Limited Partners Association (ILPA) has released a Model Limited Partnership Agreement ([Model LPA](#)) following its publication of the third version of its principles of industry best practices ([ILPA 3.0](#)) earlier this year. The Model LPA reflects ILPA 3.0 and is part of ILPA's broader "LPA Simplification Initiative" that began in 2018. Although it is too soon to know how broadly the Model LPA will be adopted by the industry, private equity fund sponsors would be well-advised to familiarize themselves with the terms of the Model LPA in advance of their next fundraise.

ILPA describes the Model LPA as a comprehensive, Delaware law-based "whole of fund" waterfall limited partnership agreement that "represents a foundational component of an LP-friendly fundraise." ILPA believes that the Model LPA will benefit fund sponsors and investors by reducing the length of side letter agreements, increasing fundraising certainty and lowering fund formation costs. ILPA has indicated that it expects to release additional versions of the Model LPA in the future, including one based on a more traditional North American style "deal-by-deal" waterfall.

Although we do not expect fund sponsors to abandon their existing partnership agreements in favour of the Model LPA, some investors may ask them to consider adopting some of its provisions. In addition, some institutional investors who support the adoption of ILPA 3.0 may request new or emerging fund sponsors to adopt agreements that are based on the Model LPA.

Key Takeaways

The Model LPA conforms to ILPA 3.0 (read our [key takeaways](#) from ILPA 3.0) and contains the following LP-friendly terms:

- **European-Style Waterfall.** The Model LPA includes a European style "whole of fund" waterfall and an optional escrow provision that requires a specified portion of carried interest distributions to be held in escrow pending receipt by investors of distributions equal to the investors' capital commitments and any required preferred return. As a result of this approach, depending on the portion of the carried interest that is subject to the escrow provision, fund sponsors may not receive any carried interest until close to the end of the life of the fund. Escrow provisions such as the one set forth in the Model LPA could reduce the effectiveness of carried interest as an incentive for investment professionals, given the length of time that they would be required to wait to receive distributions.
- **Management Fees.** Management fees are payable only until the end of the initial term of the fund and not in respect of any extension terms or during any period in which the commitment period has been suspended. The Model LPA includes a 100% fee offset without any exception for amounts paid to operating partners (i.e., employees of the general partner who have a dedicated role at portfolio companies) and without the possibility of allocating offsets to non-management fee-paying partners. While a full fee offset is typical, it has become increasingly common to permit exceptions with respect to amounts paid to operating partners in recognition of the value that they provide.
- **Removal for Cause.** The standard of care in the Model LPA reflects a fiduciary standard and would be in addition to any statutorily imposed fiduciary duties. Under the Model LPA, a general partner may be removed with the approval of a majority in interest of the limited partners for, among other things, any breach of the standard of care, whether or not the breach is material. A general partner that is removed for cause would forfeit 100% of any future entitlements to carried interest and any carried interest that has been deposited into escrow.

- **No-Fault Remedies.** Limited partners would have a range of remedies available to them regardless of fault on the part of the general partner or manager, including suspension of the commitment period, removal of the general partner or termination of the fund without cause if the removal or termination is approved by 75% in interest of the limited partners. In some cases, such as for a small or emerging manager, the Model LPA permits removal without cause only after the first one or two years of the fund and provides that the management fee may continue at the pre-removal rate for a 6- to 18-month period. However, a no-fault removal generally would be permitted at any time and without compensation to the manager. The Model LPA also provides for the option to reduce the carried interest in the event of a no-fault removal or termination.
- **Governance, Control and LPAC.** Consistent with trends we have been seeing in the market, the Model LPA expressly permits the limited partner advisory committee (LPAC) to meet in camera and to appoint advisers, whose reasonable expenses would be borne by the fund. LPAC members would be entitled to call meetings of the LPAC and would be entitled to the benefit of insurance policies that the fund is required to maintain to address potential claims against LPAC members (such as for breach of trust or negligence).

Anticipated Impact

While the Model LPA is likely to generate continued dialogue and discussion within and between the sponsor and investor communities, it is unlikely to result in a significant shift in fund terms in the near term. ILPA itself describes the Model LPA as a component of an “LP-friendly” fundraise rather than a precedent that should be used in each instance. In addition, sponsors and investors alike should bear in mind that the Model LPA is based on ILPA 3.0, which is itself a set of guiding principles that are not intended to function as a checklist. As ILPA indicates in its commentary in ILPA 3.0, “each partnership should be considered separately and holistically. A single set of preferred terms and practices cannot provide for the broad variability of products, strategies and investor preferences across the market at any given time, nor account for every individual circumstance.” The Model LPA is a helpful example of an LP-friendly limited partnership agreement, but it does not negate the need to develop and maintain key relationships and to come to the negotiating table armed with a clear understanding of the facts and circumstances that will influence key fund terms in any given context.

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