

Private Equity Technical Update

Analysis of legal and tax developments which affect
European private equity
12 January 2011

ILPA Private Equity Principles 2.0

Yesterday, the Institutional Limited Partners Association (ILPA) released a revised and updated version of its Private Equity Principles, together with the first of what is intended to be a series of recommended standard form reporting templates.

During 2010 ILPA sought feedback and suggestions from GPs and LPs for potential improvements and refinements to the first version of the Principles (released in September 2009). The resulting "version 2.0" is a restatement of the Principles that seeks to clarify and expand on certain issues, whilst acknowledging more deliberately than the first version that "a single set of terms cannot provide for the broad flexibility of the market".

The core components of the revised Principles include:

- A new appendix containing amended proposals on GP Carry Clawback.
- A substantially redrafted appendix on the Best Practices of the Limited Partner Advisory Committee (LPAC).
- Amendments and clarification to the existing guiding Principles.

ILPA has also committed to providing a set of five "Standardised Reporting Templates", the first of which (covering capital call and distribution notices) is available on the ILPA website (click [here](#)). Further templates covering annual and quarterly reporting are currently in development.

Carry Clawback

ILPA has expanded its guidelines on GP clawbacks, apparently acknowledging the increased importance of this topic on the list of GP/LP negotiation points, largely following the effect of the financial crisis on funds part way through their lifecycle, where over-payments of carry were made in a fund's early years.

ILPA retains its "strong" recommendation that the individual members of the GP commit to joint and several liability for payment of GP clawback amounts, but adds a new alternative where this is not possible. Where joint and several liability is not provided, the Principles acknowledge that a potential substitution would be a creditworthy guarantee of the clawback amount by:

- a substantial parent company; or
- an individual GP member; or
- a subset of GP members.

In addition, and perhaps the most substantial amendment to the carry clawback provisions (following "extensive discussions with GPs"), is ILPA's reversal of its original recommendation that GPs should bear the cost of tax incurred on any carry amounts distributed and then returned.

The initial release of the Principles stated that all carry clawbacks should be gross of tax. Although this position has been reconsidered, and ILPA now seems satisfied that GP carry may be returned with the tax netted off, they recommend that "instead of assuming the highest hypothetical marginal tax rate in a designated location, the rate should be based on the actual tax situation of the individual GP member". This is designed to encourage GPs to reduce the overall tax burden, and prevent them from making a profit from the LPs' willingness to bear the tax.

LPAC best practice

Though the appendix on LPAC formation, constitution and best practices has been substantially redrafted, the powers recommended in the first version of the Principles largely remain. Specific amendments include:

- An ability for the LPAC to vote on matters using written consent (particularly for time-sensitive matters).
- A recommendation that each LPAC member should consider their own potential conflicts of interests, both at LPAC meetings and prior to voting.

Critics of the original Principles argued that they gave the LPAC too much power, and that what was being recommended removed important decision making powers from the investor body as a whole. Although the revised Principles recognise that the "role of the LPAC is not to directly govern, nor to audit, but to provide a sounding board for guidance to the GP and a voice for LPs when appropriate", for all intents and purposes, the broad powers of the LPAC are retained.

Amendments and clarifications to the Principles

Although the majority of the original suggestions in the first release of the Principles remain, in many instances the language in respect of these provisions has been changed (and often softened). Key amendments and additions to the Principles include:

- A recognition that the size of the majority required to implement amendments to a fund's limited partnership agreement will vary depending on the amendments proposed. Whilst the original text stated only that any amendment would require the approval of a supermajority, the revised Principles acknowledge that amendments may require consents ranging from a majority to unanimity depending on the circumstances.
- The softening of the original requirement that the LPAC be required to review partnership expenses annually to a recommendation that the LPAC should engage with the GP with regard to the "allocation of partnership expenses".
- The condition that fund extensions should "be approved by a majority of the LPAC or LPs" and that, absent such consent, the GP should liquidate the fund within one year.
- Changes to key-man provisions to be approved by a majority of the LPAC or LPs.
- The addition of an explicit statement that the "GP should not be allowed to co-invest in select underlying deals but rather its whole equity interest shall be via a pooled fund vehicle".
- A recommendation that the GP should provide estimates of quarterly projections on capital calls and distributions as well as the additional requirements that the GP should immediately disclose to LP's upon occurrence:
 - any material contingency or liability arising during the fund's life; and
 - any breach of the LPA or other fund document.
- A recommendation that the annual reports include "portfolio company and fund information on material risks" and how those risks are managed.

For further information on the impact of the ILPA principles, please call your usual point of contact in SJ Berwin's private funds team.

[VIEW ARCHIVE >>](#)

[SJ BERWIN.COM >>](#)

WOULD YOU LIKE TO RECEIVE PRIVATE EQUITY TECHNICAL UPDATE?

SUBMIT YOUR DETAILS TO SUBSCRIBE

Warning! This bulletin is not intended to offer professional advice and you should not act upon the matters referred to in it without taking specific advice. These regular bulletins provide legal and tax developments that affect the European private equity and venture capital community. The views expressed in this bulletin are those of its author and not necessarily those of SJ Berwin LLP.

If you have any comments on the bulletin, or would like to receive further details on the subject matter, please send an email to bulletins@sjberwin.com or call your usual point of contact at SJ Berwin. If you would like to republish this bulletin or link to it from your website, please contact bulletins@sjberwin.com.

SJ Berwin LLP is a limited liability partnership registered in England no OC313176. It is regulated by the Solicitors Regulation Authority. A list of the members of SJ Berwin LLP and of the non-members who are designated as partners is open to inspection at 10 Queen Street Place, London EC4R 1BE, its principal place of business and registered office. Any reference to a partner in relation to SJ Berwin LLP is to a member of SJ Berwin LLP or to an employee or consultant with equivalent standing. SJ Berwin LLP or an affiliated undertaking has an office in Berlin, Brussels, Dubai, Frankfurt, Hong Kong, London, Madrid, Milan, Munich, Paris and Shanghai. Although not authorised under the Financial Services and Markets Act 2000, SJ Berwin LLP can provide services relating to investments which are limited to those incidental to its legal services or excluded from regulation under the Financial Services and Markets Act 2000.

While SJ Berwin LLP has taken steps to control the spread of viruses on its systems, it cannot guarantee that this email and any files transmitted with it are virus free. No liability is accepted for any errors, omissions, interceptions, corrupted mail, lost communications or late delivery arising as a result of receiving this message via the Internet or for any virus that may be contained in it.

© SJ Berwin LLP 2011. All rights reserved.

[Berlin](#) [Brussels](#) [Dubai](#) [Frankfurt](#) [Hong Kong](#) [London](#) [Madrid](#) [Milan](#) [Munich](#) [Paris](#) [Shanghai](#)