

ILPA EUROPEAN FORUM

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Board Governance: LPAC Best Practices

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Agenda

- LP Advisory Committee (“LPAC”) Basics
- Fiduciary Duties of Members of LPAC
- Why Should LPs Serve on LPACs?
- Governance Role of LPACs
- Advantage of LPACs for GPs
- LPAC Structuring Issues and Questions
- Legal Protections for LPACs / Comparison of the LPAC to other Governing Bodies
- Expanded (or Contracted) Role for the LPAC
- Appendix

LPAC Basics

- Product of the Limited Partnership Agreement – not statutorily defined
- Bare bones description in most Limited Partnership Agreements
- Members chosen by General Partner, partly through one-off negotiations with select Limited Partners
- Mostly passive activities (e.g. valuations, conflicts, investments outside LPA parameters)

LPAC Basics

- Fiduciary Duties of LPAC Members
 - More power equals greater duties
- Jurisdiction of Fund's organization is very important especially liability to third parties
 - Delaware vs. Cayman Islands vs. other jurisdictions
- Focus on Delaware
 - Bias to freedom of contract
 - Fiduciary Duties may be eliminated by contract
 - Good Faith and fair dealing are the minimum

Fiduciary Duties of Members of LPAC

- No caselaw addressing LPACs
- Bias to impose fiduciary duties when accepting responsibilities
- The greater the responsibility the more likely fiduciary duties will be imposed
- LP liable for action of its LPAC Member under agency principles

Fiduciary Duties of Members of LPAC

- Delaware Revised Uniform Limited Partnership Act (“DRULPA”)
 - Section 17-1101(c) states “It is the policy of [DRUPLA] to give ***maximum effect to the principle of freedom of contract*** and the enforceability of partnership agreements”
 - Section 17-1101(d) states “To the extent that...a partner or other person has duties (including fiduciary duties) to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, the partner’s or other person’s ***duties may be expanded or restricted or eliminated by the provisions in the partnership agreement; provided that the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing***”

Fiduciary Duties of Members of LPAC

- Limitation of liability – Section 17-1101(f) states “A partnership agreement ***may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties)*** of a partner or other person to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement; ***provided, that a partnership agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing***”

Why Should LPs Serve on LPACs?

- Enhanced information flow
 - Access to information in an “unstaged” setting
- Unscripted dialogue with GPs
 - “Peeling back the onion”
 - Opportunity to influence GPs
- Superior fulfilment of fiduciary obligations
 - Improved monitoring
 - Continuity of due diligence
 - Leads to better informed long-term decisions
 - More powerful leverage as an LP

Governance Role of LPACs

- Routine “housekeeping”
 - Review and approval of valuations
 - Approval of term extensions
 - Requests for additional information
 - Enhanced transparency
 - Sharing best practices with GP
- Resolution of conflicts and alignment of interests
 - Approval of cross-fund investments
 - Waiver of various LPA provisions
 - Ad hoc “firefighting”
- Enhanced role in case of partnership crisis
 - Case example #1: end of life restructuring of economics
 - Case example #2: civil lawsuit threatens financial solvency of GP entity
 - Case example #3: criminal fraud alleged against one of GPs

Advantage of LPACs for GPs

- Seal of “good housekeeping”
- Sounding board and feedback mechanism
 - Genuine interest or device to “divide and conquer”?
- Marketing tool to attract and retain larger LPs
 - Where do GPs draw the line?
- Streamlining of governance process
 - Fewer small cats to herd

LPAC Structuring Issues and Best Practices

- What is “critical mass”?
- Proper balance of constituencies
 - Diversity of investor groups by type and size
- Need for experienced LPs
 - LPAC should not be a “training ground” for “green” LPs
- Frequency and format of meetings
 - Semi-annual or quarterly?
 - In-person or telephonic?
 - Attendance monitored and substitutions discouraged
- Disclosure of potential conflicts
 - Is LP compensation structure an issue?
- Increasing use of “in camera” sessions
 - Example of ILPA “best practices”

Legal Protections for LPACs

- More robust rules and procedures provide greater protection (see ILPA Principles)
 - Meeting protocols, including votes taken at a meeting rather than one-off phone call with GP
 - Disclosure of names and affiliation of each LPAC member
 - Minutes of LPAC meetings
- Define duties of care of LPAC members in the Limited Partnership Agreement
 - No duties “to the maximum extent permitted by applicable law”
 - No duties “other than the implied contractual covenant of good faith and fair dealing”

Legal Protections for LPACs

- Well-crafted exculpation and indemnification provisions
 - No liability if act in good faith
 - Indemnification whether sued by third party, another partner, or the partnership
 - Advancement of expenses
 - Consider separate agreement so no amendment without LPAC member consent and for enforceability purposes
- Insurance
 - Highly negotiated
 - LPAC should control negotiation
 - Suits by affiliated parties (e.g. another partner) may be disallowed

Comparison of LPAC with Other Governing Bodies

➤ Major Differences with LPAC

- Control of membership in hands of stakeholders
- Formal processes
- Ultimate control held by governing body, not management
- Fiduciary duties

➤ Differences LPAC might borrow

- Use of experts: professional LPAC members
- Ability to select own counsel
- Ability to control non-investment management functions like fund's independent public accountants

Expanded (or Contracted) Role for the LPAC

- LPAC involvement increasing
- Is there a role for LPACs in smaller institutional funds?
 - Should all waivers and amendments be voted on by all Limited Partners?
- Are powerful LPACs more appropriate for larger funds?
- Does geography of the fund manager make a difference?

Expanded (or Contracted) Role for the LPAC

➤ Possible Expansion of LPAC Powers

- Approve GP Operating Budget
- Determine Key Persons
- Removal of GP and Determination of GP Replacement
- Appointment of Fund Liquidator
- Broader Powers to Approve Certain Investments
- Approve LPA Amendments
- Approve Default Remedies

Questions?



Appendix

Comparison of LPAC with Other Governing Bodies

- Delaware Corporation Board of Directors
- U.S. Mutual Fund Board of Directors

Comparison of LPAC with Other Governing Bodies

➤ Delaware Board of Directors

- Rules and Procedures in statute and corporate by-laws
- Manages the business and affairs of the corporation
- Appoints officers / sets compensation
- Decides on fundamental corporate matters
- Elected annually by shareholders
- Fiduciary Duties
 - Duty of Loyalty: act in best interests of the corporation
 - Duty of Care: act in an informed and deliberate manner
 - Indemnification available if act in good faith in a manner not opposed to best interests of the corporation

Comparison of LPAC with Other Governing Bodies

➤ Mutual Fund Board of Directors

- At least 50% of directors are independent of management; remainder consist of management
- Independent directors consist typically of experts including an audit expert
- Most actions require approval of majority of board, including majority of independent directors
- Negotiates contractual arrangements with investment manager, including compensation
- Selects fund's independent public accountants
- Approves conflict transactions
- Represented by own legal counsel

THANK YOU

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