

Standstill Provisions in Subscription Facilities

A Practical Guidance® Practice Note by
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This article discusses standstill provisions in subscription facilities. In recent years, private equity fund (Fund) requests for “standstill” provisions in subscription credit facilities have become more commonplace. A standstill provision offers a Fund the first opportunity to issue a capital call to repay the subscription facility after an event of default has occurred. This right is conditioned upon satisfaction of certain conditions and the existence of certain circumstances, but if exercised, results in lenders being temporarily precluded from exercising one of their most powerful remedies under a subscription facility – the right to directly issue a capital call to the Fund’s investors. After outlining the historical evolution and competing concerns related to standstill provisions, this article will examine a number of considerations for parties to consider during negotiations.

For more information on subscription facilities, see [Subscription Facilities](#). For information on subscription facility exclusion events, see [Subscription Facility Exclusion Events](#). For a discussion of the mechanisms available to a lender to protect its rights in collateral under a subscription-secured finance facility, see [Subscription-Secured Financings: Enforcement vs. Perfection](#).

Overview and History

Standstill provisions are not unique to subscription credit facilities. Other financing transactions may include similar provisions restricting a lender’s enforcement rights under specific circumstances for a prescribed period of time. Within subscription lending, this has taken on a specific connotation of applying to the initial capital call following an event of default. Historically, these facilities did not include such provisions, but as the market evolved, certain Funds began requesting them. Although many large Funds regularly insist on having a standstill provision, their inclusion in the broader market is uneven and varies based on the Fund’s risk profile, the lender’s credit policy, the overarching relationship and history between the lender and Fund, and broader market considerations.

Impact of Standstill Provisions

Funds began requesting standstill provisions to remain in control of the relationship with their investors and to issue capital calls consistent with the ordinary course of business. Although, an event of default under a subscription facility would likely have to be disclosed to the investors, having such capital call come from the Fund is less disruptive to the Fund and presumably less worrying to investors.

From a lender’s perspective, it could be a significant administrative undertaking to gather and organize all of the information needed to make a capital call on its own, especially for Funds with large investor pools. Accordingly, permitting the Fund to issue the capital call could result in quicker repayment. Delays could be compounded by a lender-issued capital call as it may raise red flags for an investor and prompt them to delay contributing capital until they get more information. In light of these possible issues, there are practical reasons why a lender may have a defaulting Fund

issue an initial capital call, regardless of whether a standstill is in the subscription facility documentation. That said, in an enforcement scenario, lenders want flexibility to assess all of the circumstances at the time and decide on the best course of action. They may elect to permit the Fund to issue a capital call, but if the relationship is contentious, they may prefer to issue it themselves.

Considerations

Almost all standstill provisions have the same general structure. That is, they are triggered after an event of default has occurred and allow the Fund the first opportunity to issue a capital call within a specified time period and, if such call is made, the lender is temporarily precluded from exercising its right to call capital. Against this backdrop of competing concerns and motivating factors, the specific parameters of the standstill will vary and parties negotiating such provisions should keep the following in mind.

Event of Default Triggers

The purpose of issuing a capital call is to receive payment. Therefore, standstill provisions should only be seen as an effective remedy for a payment default or another event of default upon which the administrative agent and the lenders have accelerated the obligations. However, there are certain events of default that lenders may carve out from the standstill provision despite meeting such parameters:

- **Bankruptcy events of default.** All lender remedies should apply without a standstill if a bankruptcy-related event of default has occurred. Lenders may consider at such time, on a case-by-case basis and after consultation with counsel, the risks and benefits in allowing the Fund to issue the first capital call. Although lenders are subject to the automatic stay, a Fund may be able to call and receive capital contributions into a “locked” collateral account. This would result in the Fund having cash in the collateral account, and such cash would be cash collateral of the lenders (as opposed to just having the right to call capital). The lenders can request authority from the bankruptcy court to have the cash released. The bankruptcy court, however, may not permit such cash to be released and/or condition release on having the Fund retain and utilize some amount of cash for operational purposes.
- **Failure to repay the obligations at scheduled maturity.** Funds should plan for payment at the stated maturity, and, if necessary, should have called capital for timely repayment. Lenders may be reluctant to permit a Fund the opportunity, under a standstill provision, to make a post-maturity capital call if it failed to plan appropriately.
- **Failure to make mandatory prepayment.** If the Fund has not made a payment in accordance with the mandatory

prepayment requirements and timeframe, lenders may be hesitant to allow a standstill and an additional grace period for the Fund to call capital (i.e., from the time the mandatory prepayment amount is due, the lenders have to wait through the mandatory prepayment period and then again through the Standstill Period (as defined below)).

- **Indicators of Fund level issues.** There are several other events of default that lenders may carve out from the standstill, including a certain percentage of investors failing to timely pay capital contributions, removal of the general partner, failure by the general partner or other affiliated investors to make timely capital contributions or other events of default that would undercut a lender’s faith in the Fund (for example, fraud or willful misconduct by the Fund). Each of these events of default may indicate serious issues between the Fund and its investors, and the typical rationale for allowing the Fund the first chance to call capital may no longer be appropriate.

Timing

Generally, there are two time periods to consider in a standstill provision, the “notice period” and the “payment period”.

The notice period (Notice Period) is typically a 3 to 7 business day window during which the Fund must issue a capital call in order to utilize the standstill provision. This window is almost always triggered by the Fund receiving notice from the lender that it intends to exercise its rights and call capital. The standstill provision should include a requirement that the Fund deliver evidence of the capital calls being made to ensure all parties can confirm that the standstill should go into effect.

The payment period (Payment Period) begins after the Notice Period and can range from 7 to 15 business days (which will change depending on the underlying timing for investors to respond to capital calls under the limited partnership agreement). That is, the Fund has 7 to 15 business days after issuing the capital call to collect the capital contributions from the investors and repay the outstanding obligations. Depending on the drafting, the Payment Period may begin after the Notice Period has expired or after the capital call is issued during the Notice Period.

This means that, in total, lenders may be “standing still” for anywhere from 10 to 22 business days (Standstill Period) after providing notice of their intent to call capital. As discussed below, there are several other features to be included in the standstill provision to protect the lenders during this waiting period. As a practical matter, lenders can use this time to request information from the Fund and begin preparing their own capital call notices in the event the obligations are not fully repaid.

Rights Impacted

In most facilities, lenders have an immediate right to make capital calls and exercise other remedies upon an event of default. When drafting standstill provisions, lenders must be explicit that the only right impacted is the right to call capital from the investors. No other rights and remedies available to the lenders under the subscription facility are affected. Some provisions go further and specifically note that lender rights with respect to the collateral accounts and/or protecting their rights in bankruptcy proceeds are not impacted.

Requirements for Calling Capital

Standstill provisions typically include a list of requirements that have to be satisfied in order for the provision to apply. These include:

- The Fund providing evidence during the Notice Period that a capital call was issued in an amount sufficient to repay all obligations
- The capital call requiring investor capital contributions must be delivered within the Payment Period described above
- The capital call must direct that the capital contributions be deposited into the collateral account
- The Fund will direct the depository bank to withdraw and apply capital contributions to the subscription facility obligations –and–
- There may be a limit on how many capital calls the Fund can make during the Notice Period (e.g., “Borrower shall be permitted to make [a *single* Capital Call] [one or more Capital Calls] ...”)

“Cure”

Some standstill provisions use the word “cure” throughout. Lenders should carefully consider whether using “cure” might incorrectly imply that the triggering event of default can be cured by the calling of capital and repayment of the obligations. Once an event of default has occurred the standstill provision simply gives the Fund the opportunity to call capital first. A subsequent payment is not generally understood to actually cure the event of default, and the lender should continue to have sole discretion over what further actions it may pursue (e.g., waiver and reinstatement of commitments versus termination of the subscription facility).

Sample Standstill Provision

A basic sample standstill provision is included below, but as noted earlier, there is no “one-size-fits-all” approach with this provision. Lenders will have different standards on the event of default carve outs, payment windows and other conditions, assuming the lender permits a standstill at all.

Standstill. Notwithstanding anything to the contrary herein or in any other Loan Document, upon the occurrence and during the continuance of an Event of Default [(other than an Event of Default under Sections [])], for a period of [three-seven (3-7)] Business Days following notice from Administrative Agent that it intends to exercise its right to call capital as a result of such Event of Default (the “**Notice Period**”), General Partner shall have the initial right to issue a Capital Call, and Administrative Agent will refrain from issuing Capital Calls until the expiration of the Payment Period (as defined below); provided, that: (a) such Capital Call is in an amount sufficient to repay all outstanding Obligations; (b) such Capital Call is issued by General Partner during the Notice Period and General Partner has delivered evidence thereof to Administrative Agent during the Notice Period, (c) such Capital Call issued by General Partner must require the funding of the related Capital Contributions within [seven-fifteen (7-15)] Business Days after the date of such Capital Call (such “**Payment Period**” beginning on the date such Capital Call was issued and ending [seven-fifteen (7-15)] Business Days later); (d) the Capital Contributions and all other amounts paid in respect of such Capital Call shall be deposited into the Collateral Account(s); and (e) Borrower shall direct the applicable depository bank that such Capital Contributions, together with any other funds held in such Collateral Accounts, shall be withdrawn and paid to Administrative Agent in an amount necessary to repay all outstanding Obligations; provided, further that nothing in this Section shall prohibit Administrative Agent or any Lender from exercising any other remedies it may have herein or in any other Loan Document.

Conclusion

As outlined above, where parties have agreed to include a standstill provision, there are several important factors to consider when negotiating and drafting such provision. In the rare event a lender needed to exercise its remedies, the requirements and application of any standstill provision must be as narrow and clearly outlined as possible to ensure that while the lender may be standing still, it is by no means caught sleeping.

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Her practice focuses on structuring, negotiating, and documenting multi-jurisdictional subscription-secured credit facilities. Kinne takes a practical and collegial approach to her work in order to achieve optimal results for her clients. She believes that building an effective working relationship with all parties to a transaction is the most effective means of securing her clients' goals.

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