



# **Center for Private Equity and Entrepreneurship**

**Tuck School of Business at Dartmouth**

## **Limited Partnership Agreement Project**

*Results of GP and LP Surveys*

**July 2004**

# Center for Private Equity and Entrepreneurship

---

## Survey Regarding Limited Partnership Agreements

<b>Contents</b>	<b>Slides</b>
• Executive Summary	3-4
• LP Demographics	5
• GP Demographics	6
• Cost of the LPA	7
• Opinions surrounding a model LPA	8-9
• Potential value of model LPA	10
• Challenges in development	11
• Industry interest	12
• LPA Clauses	13-14
• LPA as governance structure	15-16
• Conclusions	17
• About the Center	18
• Acknowledgements	19

# Executive Summary (1)

---

## The Study

- Two separate surveys were administered to limited partners and general partners, with the goal of canvassing opinions of the cost of the limited partnership agreement (LPA), its role as a governance document, and the value to the industry of a guideline or model LPA.
- 97 respondents completed the survey for Limited Partners (36% response rate).
- 125 respondents completed the survey for General Partners (23% response rate).

## Importance of a Model Agreement

- In preparing the LPA, GPs incur legal preparation costs on average in excess of \$250,000, and LPs of nearly \$20,000 for each LPA negotiated.
- There is some agreement in the industry that a model LPA agreement is important. Over 90% of LPs and 50% of GPs agree that such a model is at least somewhat important, and also could be a useful starting point for LPA negotiations.
- However, there is a substantial difference in the assessment of the degree of importance of a model agreement. Nearly 50% of LPs see this as an issue that definitely needs attention, but nearly 50% of GPs see this as of no importance at all.
- There is substantial GP/LP agreement on the important challenges to developing a model agreement. The greatest challenges are seen as:
  1. Top-tier GP resistance
  2. Differences between VC and buyout sectors, and
  3. Low likelihood of GP-LP agreement

## Executive Summary (2)

---

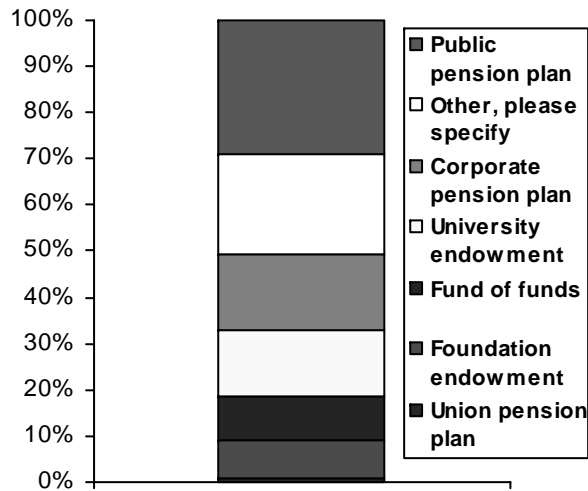
### Importance of Specific Clauses

- GPs and LPs largely agree on which clauses are most important to the success of their fund interest.
- Four of the top six “most important” clauses cited are the same.
- These highest priority provisions address the economic terms of the LPA.
- The greatest points of disagreement between GPs and LPs involve LPA provisions addressing governance, with LPs ascribing greater importance to these provisions than do GPs.
- But GPs and LPs do agree on the relative importance of the different governance mechanisms
- They also agree on the relative effectiveness of the different governance mechanisms
- Notwithstanding this, there is reasonable interest from communities in both GP and LP groups in a public dialogue (such as a conference) on the merits of a guideline LPA.

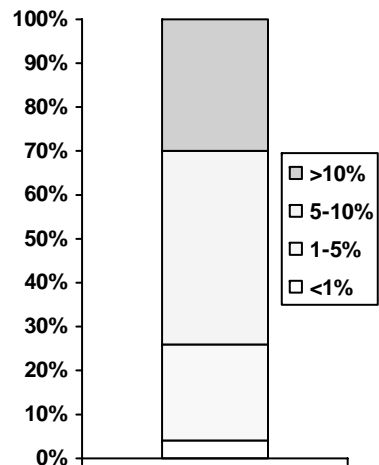
# Limited Partner Respondent Demographics

- Limited partner respondents ranged in type from family offices to large corporate pension plans
- Respondents were significant players in the private equity asset class, as measured by their overall asset allocations, and the absolute size of assets under management
- Respondents represented a broad range of investor sizes

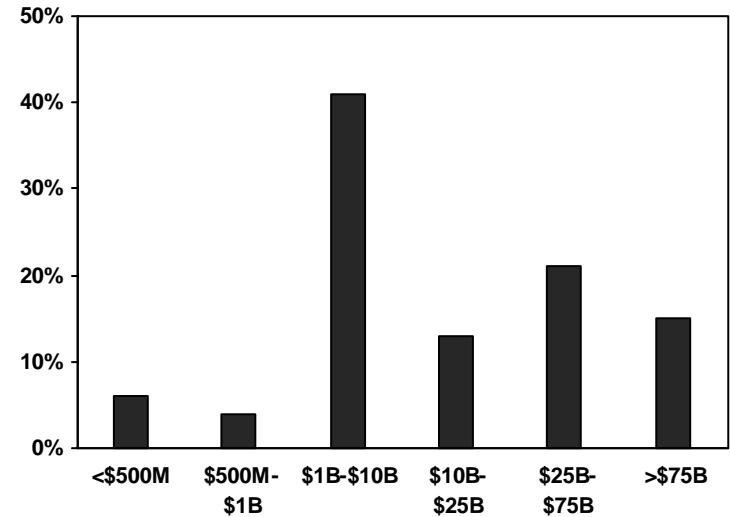
*"What is the most appropriate description of you as an institutional investor?" (n=97)*



*"What is your overall allocation to private equity?" (n=96)*



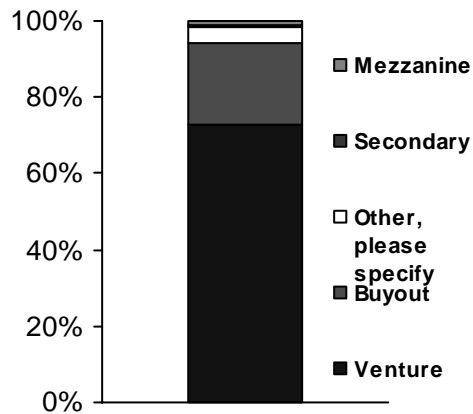
*"What is the total amount of assets your institution has under management?" (n=95)*



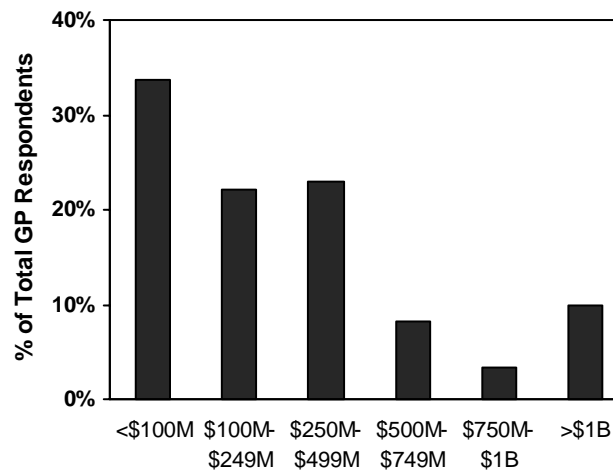
# General Partner Respondent Demographics

- GP respondents were predominantly VC, but buyout funds were well represented
- Most funds were below \$500M in total committed capital, but large funds were also captured in the survey of GPs
- The respondent pool has extensive experience with LPAs, as measured by the number of funds under management

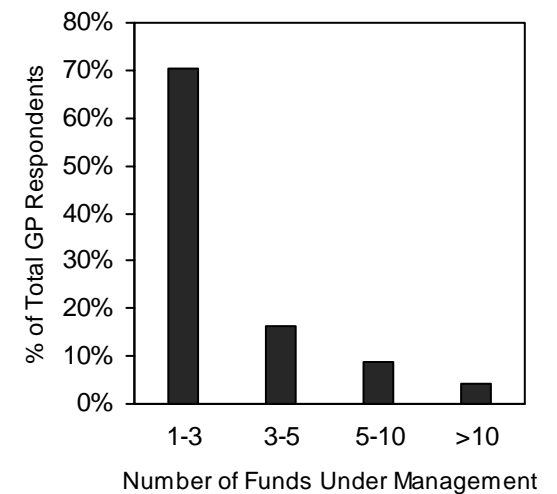
*"How would you characterize the majority of your funds under investment?" (n=117)*



*"What is the total committed capital of your most recent fund?" (n=122)*



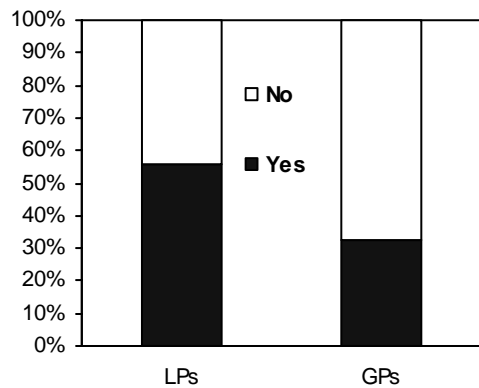
*"How many funds does your firm (or partnership) presently manage?" (n=122)*



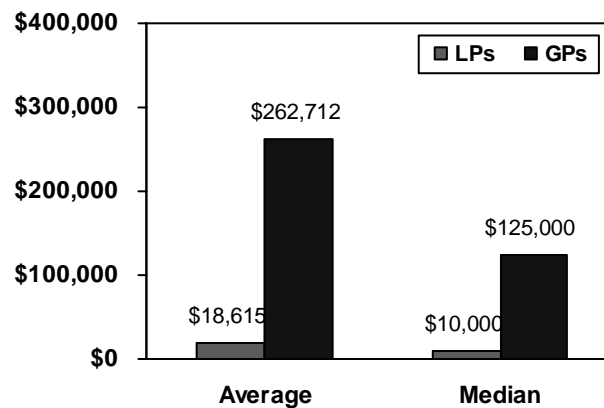
# Cost of LPA Preparation

- Both LPs and GPs incur meaningful costs to prepare the LPA and structure an investment for a private equity fund
- Overwhelmingly, the LPA is prepared by the GP, which explains the significantly larger costs incurred – as high as \$1-2MM reportedly, for some funds

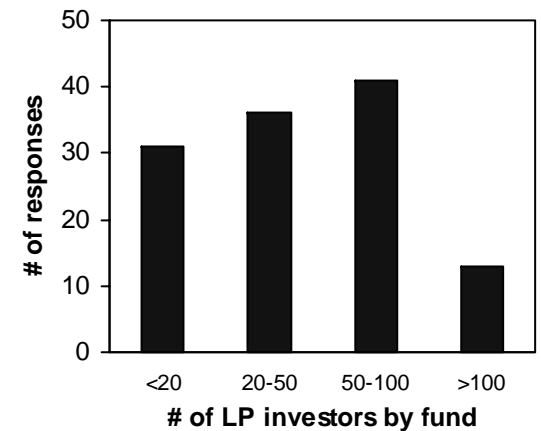
*“Do you have inside counsel participate in the process?”  
(LPs n=97, GPs n=123)*



*“On average, how much do you spend on outside legal services for negotiating the LPA?”  
(LPs n= 74, GPs n=103)*



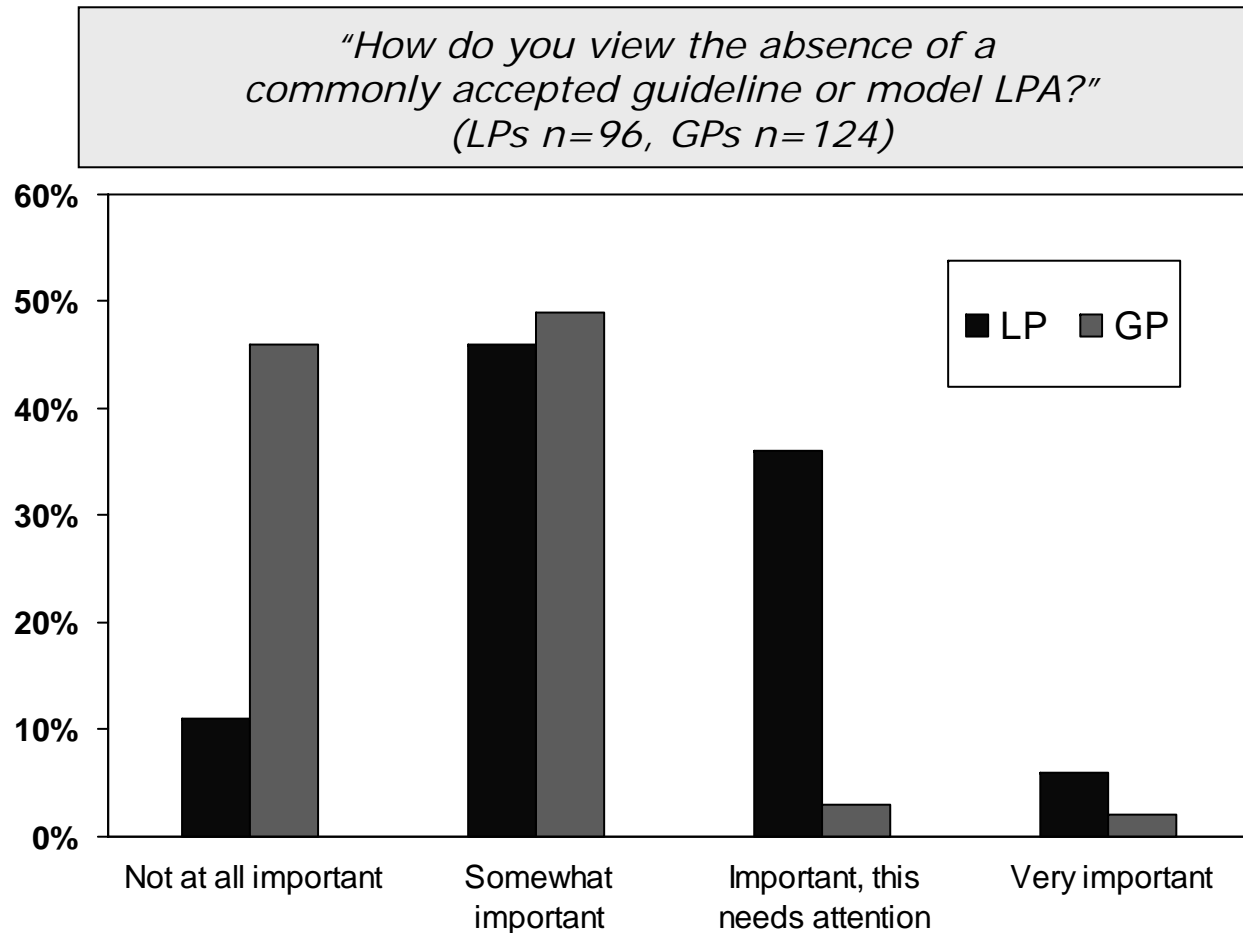
*“[GPs] How many LPs invested in your latest fund?” (n=121)*



## Opinion of Model LPA (1)

---

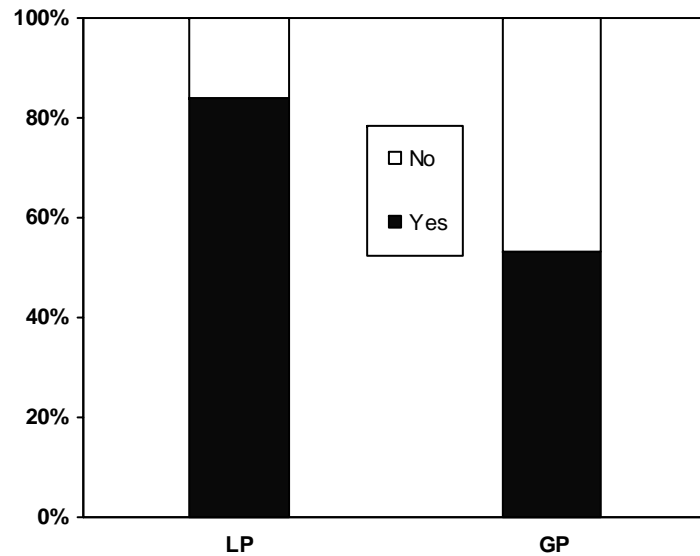
A majority of LPs and GPs agree that a model LPA is at least somewhat important. However GPs and LPs differ on the relative importance.



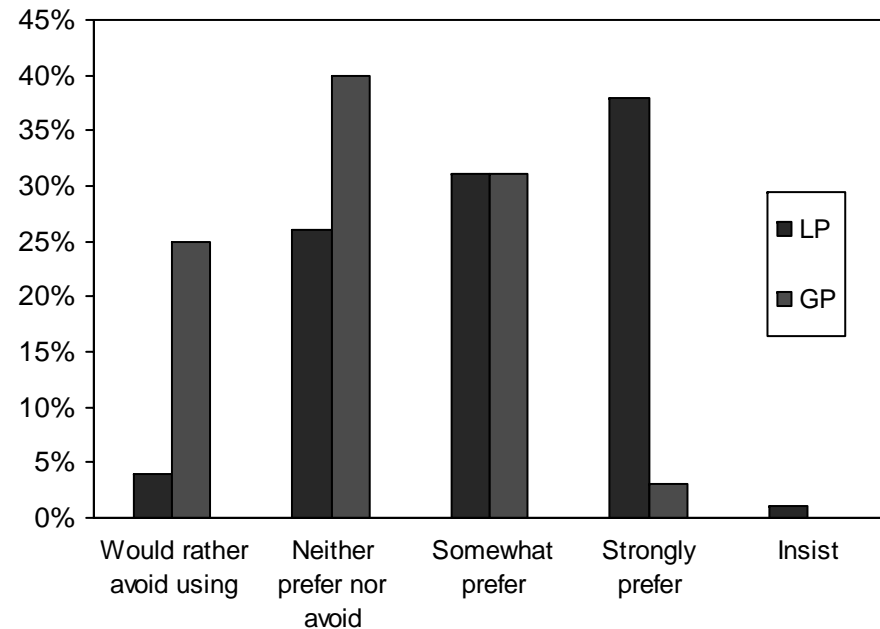
## Opinion of Model LPA (2)

A majority of both GPs and LPs agree that a model LPA would be a useful starting point for negotiating investments in private equity funds

*"Would a model LPA be useful as a starting point for negotiating investments?"*  
(LPs n=93, GPs n=120)

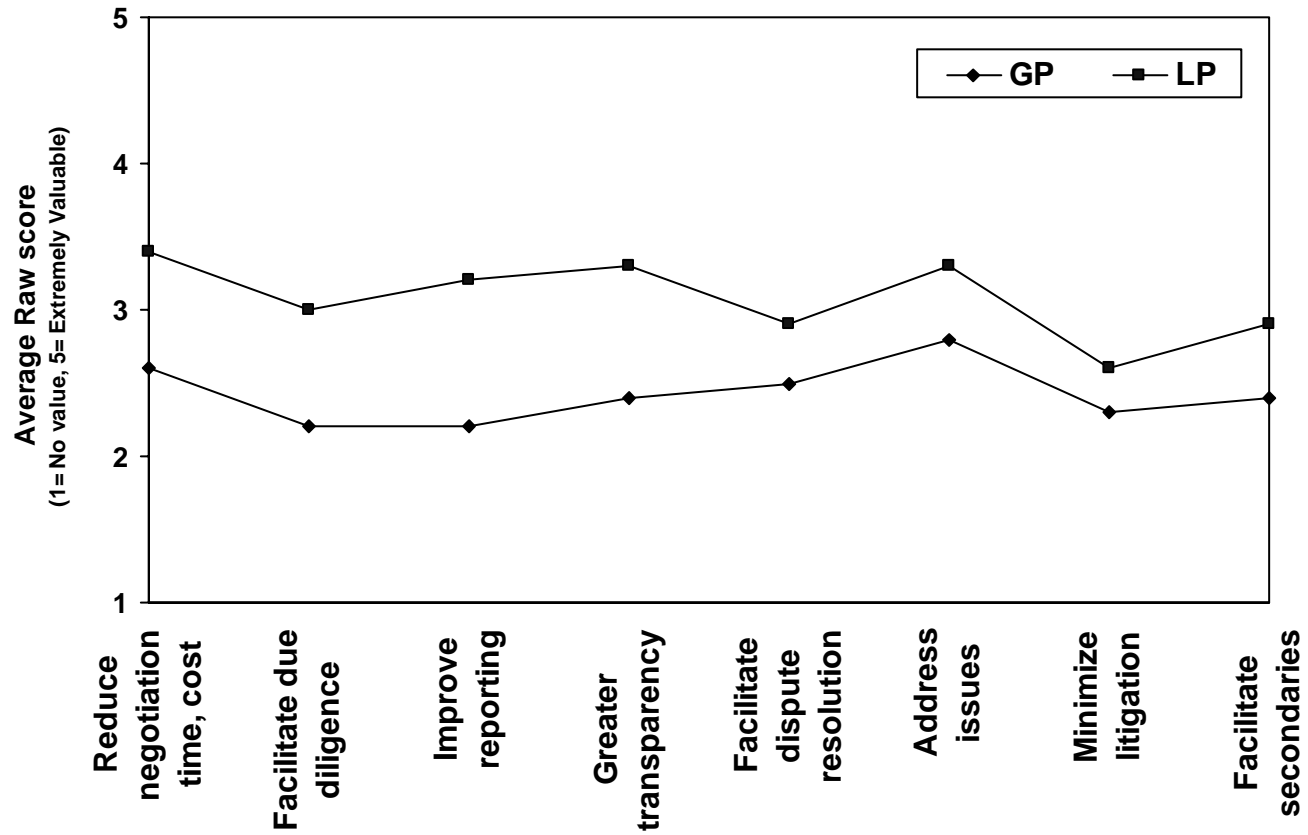


*"To what degree would you prefer guideline LPA documents be used?"*  
(LPs n=97, GPs n=122)



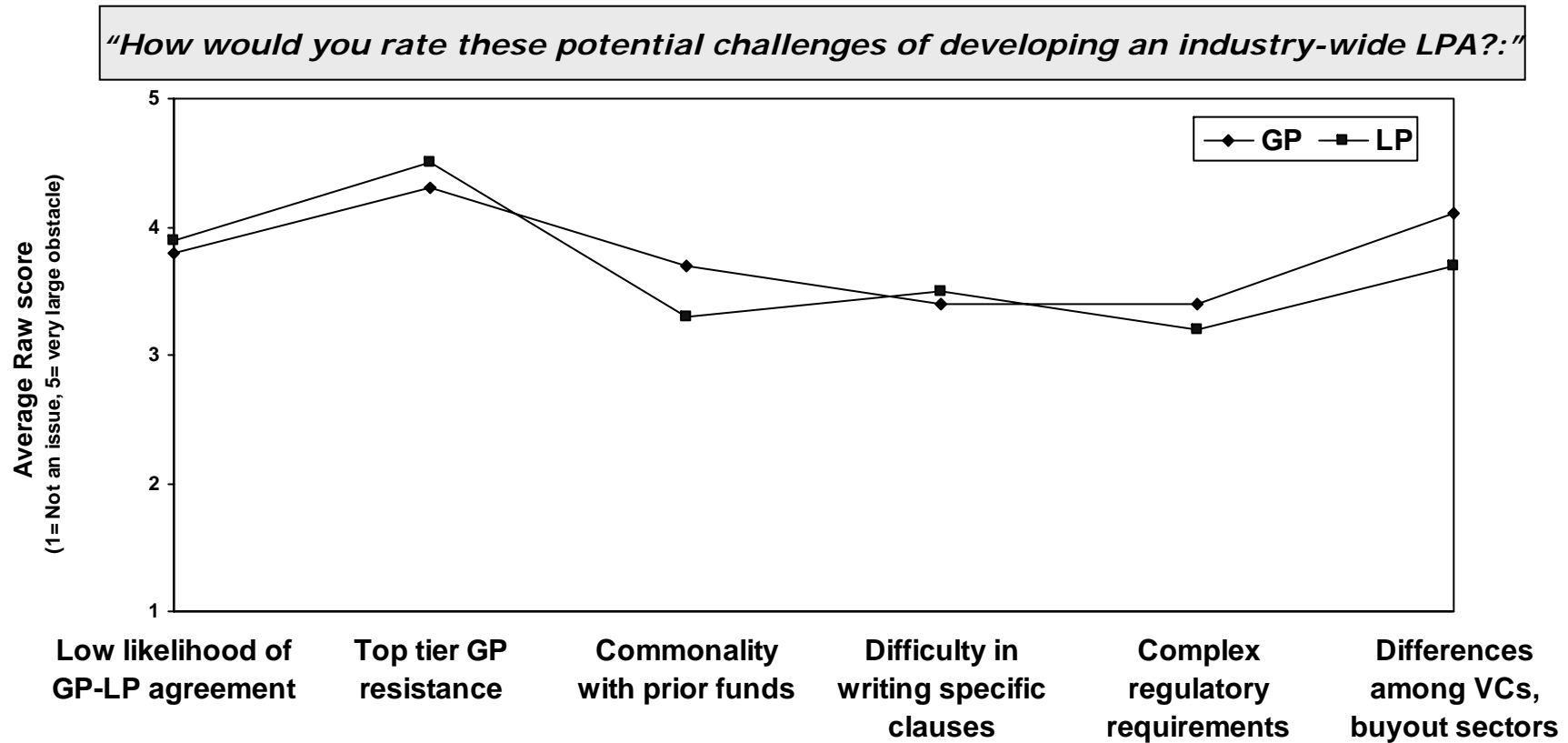
# Value of Model LPA

*"Please rate how potentially valuable an industry-wide guideline or model LPA would be for addressing the following concerns:"*  
(LPs n=94, GPs n=121)



# Challenges in Development

GPs and LPs see the same challenges in developing an industry-wide LPA guideline



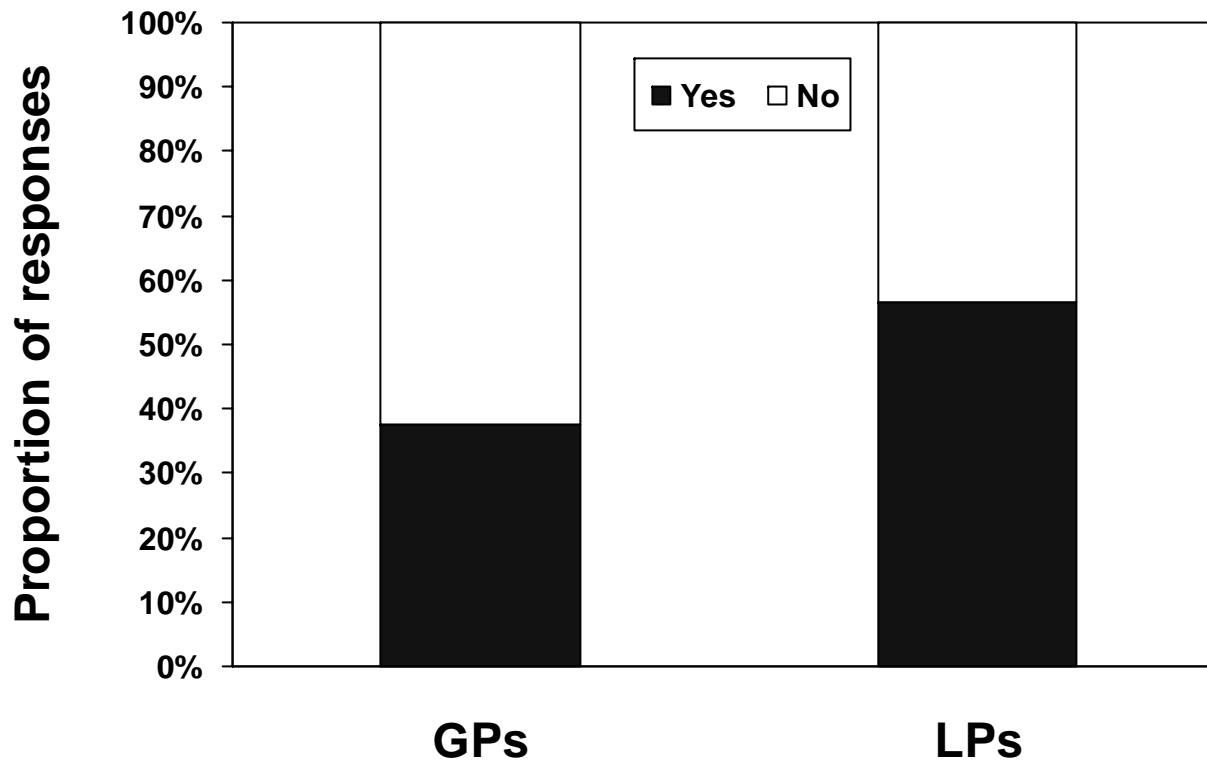
Overcoming top-tier GP resistance is seen as a greater challenge than resolving differences between GPs and LPs, or even sector-specific issues

## Industry Interest in Model LPA Dialogue

---

There is meaningful interest within both GP and LP camps in a conference to discuss a guideline LPA

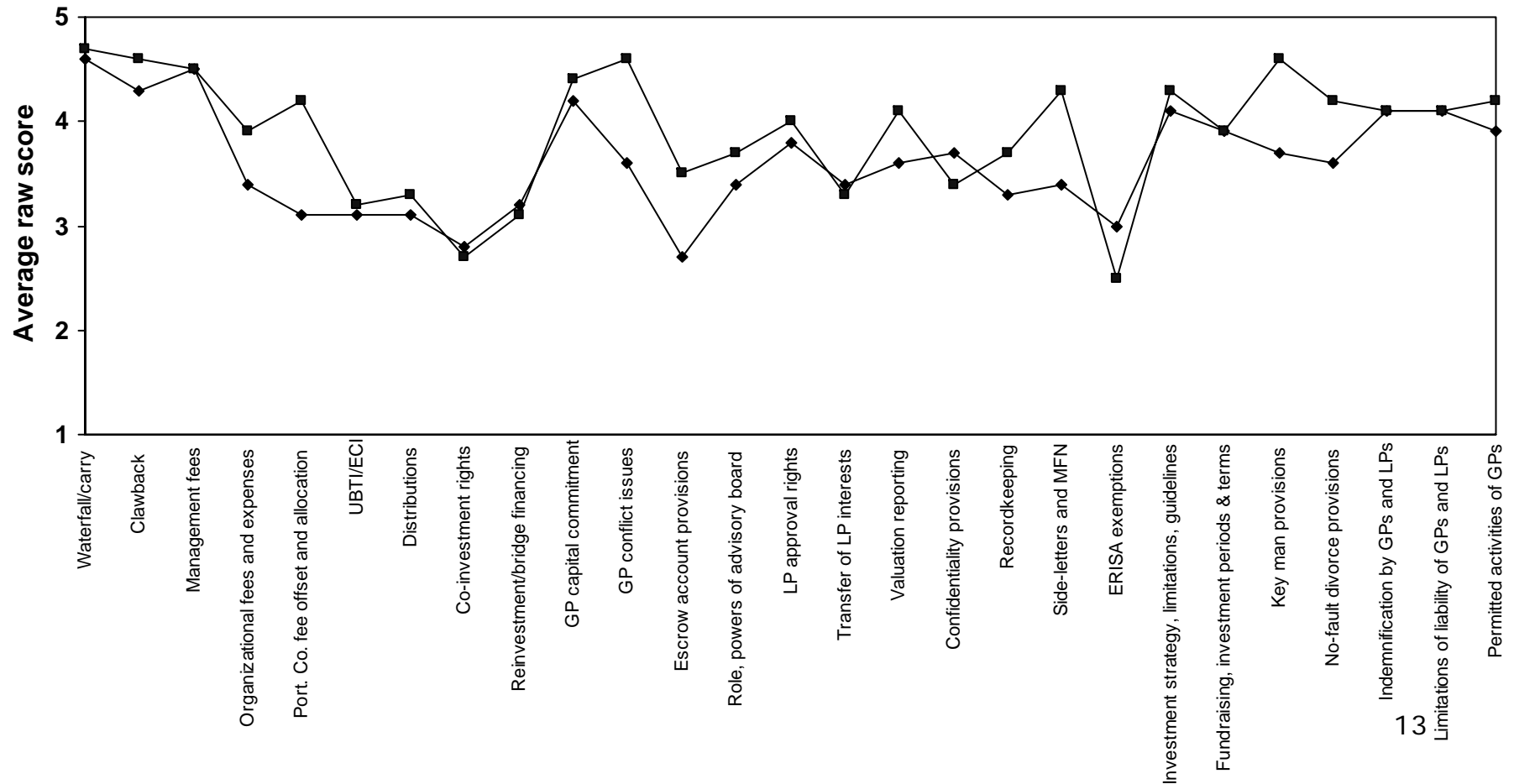
*"If a conference were to be held regarding development of a guideline LPA document, would you be interested in participating?"*  
(LPs n=94, GPs n=122)



# LPA Clauses (1)

GPs and LPs agree broadly that the same LPA clauses are most important to their respective investment goals

*"Please indicate how important the structure and clarity of the following clauses are to you."  
(LPs n=97, GPs n=117)*



## LPA Clauses (2)

---

Most important provisions for both sides link to economic terms

### *Top 10 (Rank Order) Most Important LPA Provisions*

#### General Partners (n=117)

1. **Waterfall structure, carry calculations**
2. **Management fees**
3. **Clawback provisions**
4. **GP capital commitment**
5. Limitations of liability for GPs and LPs
6. Indemnification by GPs, LPs
7. **Investment strategy, limitations, and guidelines**
8. Fundraising period, investment period & term
9. **Permitted activities of GPs**
10. LP approval rights

#### Limited Partners (n=97)

1. **Waterfall structure, carry calculations**
2. **Clawback provisions**
3. GP conflict issues, including allocation of opportunities
4. Key man provisions
5. **Management fees**
6. **GP capital commitment**
7. Side-letters, and MFN
8. **Investment strategy, limitations, and guidelines**
9. **Permitted activities of GPs**
10. Portfolio company fee offsets

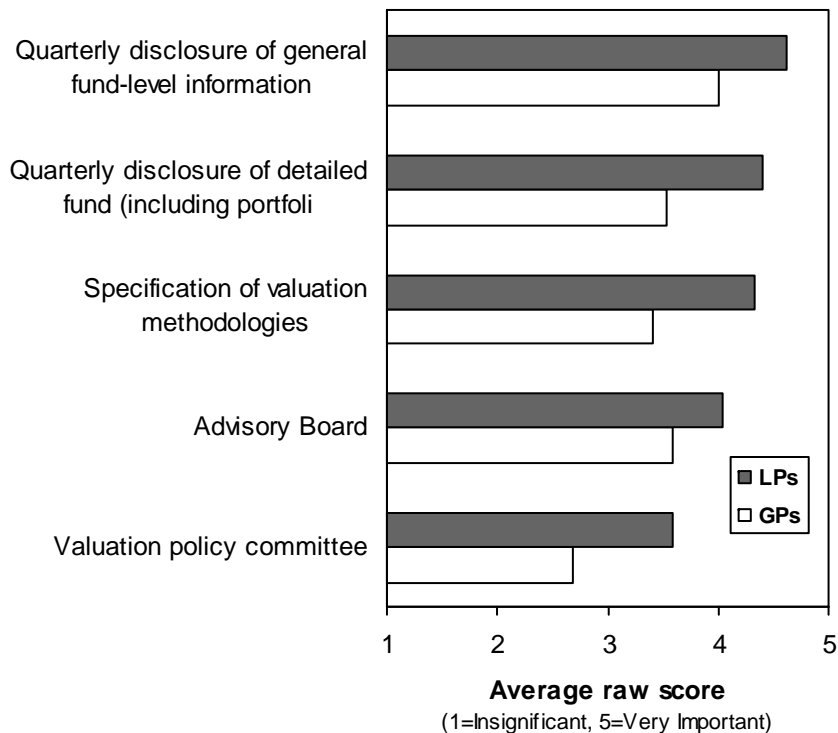


There may be fertile ground for an LPA that helps to clarify economic participation in the partnership

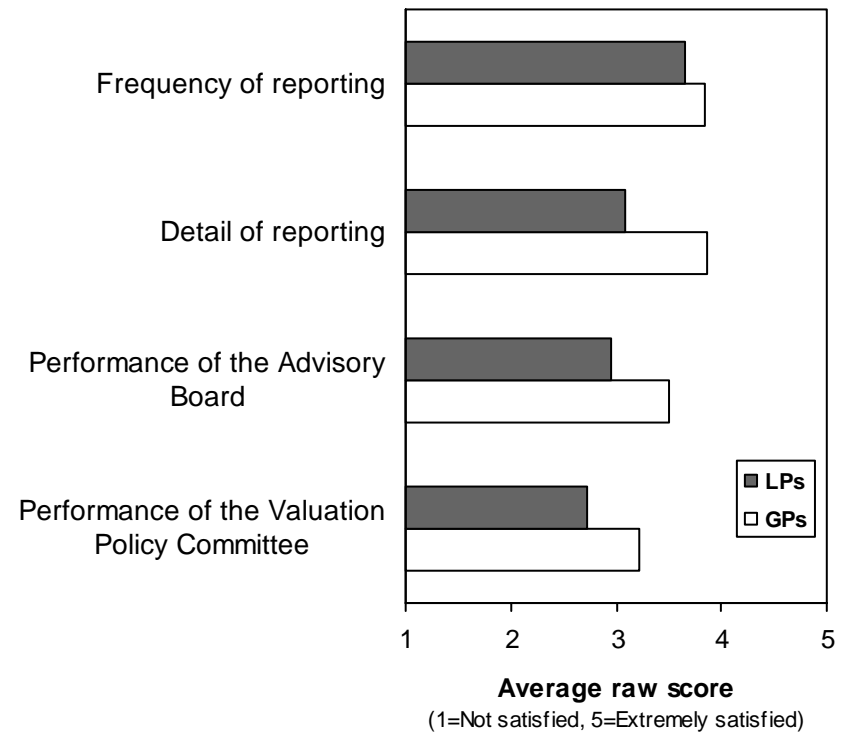
# LPA as Governance Structure (1)

GPs and LPs hold the same picture of the *relative* importance and effectiveness of fund governance mechanisms

*"Please rate how important the following fund governance mechanisms are to you?"*  
(LP n=96, GP n=122)



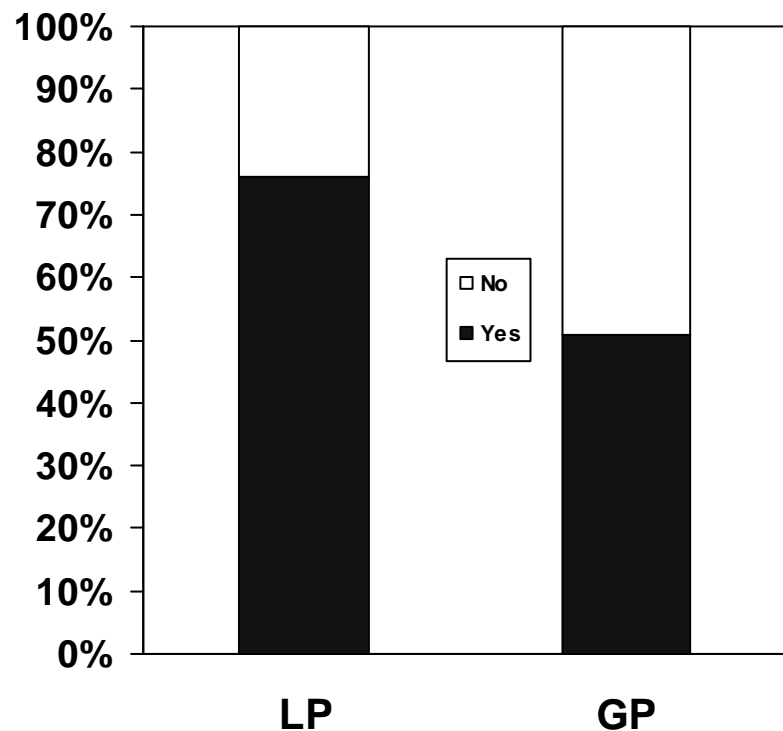
*"How satisfied are you with the following?"*  
(LP n=96, GP n=122)



## LPA as Governance Structure (2)

LPs are more disposed to strengthening the LPA as a governance document – especially regarding disclosure

*“Do you believe that the LPA should govern the transparency and detail of fund and portfolio company valuation reporting?”*  
(LPs n=92, GPs n=122)



*“What other governance issues do you think could best be addressed within the LPA?”*

*“Conflict of interest disclosures, and disclosure of changes in LPs.”*

*- Fund of funds (\$10-25B assets under mgt)*

*“A rep [sic] attesting to the compliance with the terms of the lpa before and after a capital call would be useful.”*

*- Public pension plan (\$10-25B assets under mgt)*

*“Transfer of GP interests, and valuation of in-kind distributions.”*

*- Corporate pension plan ((\$10-25B assets under mgt)*

*“Purchase price disclosure in sale of LP interests, or secondary market transactions.”*

*- Buyout fund manager (<\$100MM committed capital in fund)*

# Conclusions

---

- GPs and LPs more or less share the same view of the LPA landscape:
  - They agree on which elements are most important
  - They agree on which elements are most effective
- LPs are more interested in stronger governance structures than GPs
- While all parties can identify some merits to a guideline LPA, the challenges to overcome are rated high
- Some GPs call attention to the SBIC regulation, which already imposes a standardized LPA
- There is significant interest among respondents in an LPA conference, and the survey results suggests that GPs and LPs share sufficient common ground that can be discussed in such a forum

# About the Center for Private Equity and Entrepreneurship

---

The Center for Private Equity and Entrepreneurship aims to produce practical and insightful global private equity and entrepreneurship research and education. The Center intends to be a trusted independent source of information on best practices and trends in private equity and entrepreneurship. It covers both macro and micro issues relating to private equity in areas such as capital markets, financing structures, governance and entrepreneurship. The Center is actively involved in the practitioner communities of private equity and entrepreneurship, both to gain information about current trends and challenges and to share insights and solutions. The Center interacts with institutional investors, venture capitalists, buy-out investors, corporate venturers, angel investors, entrepreneurs, portfolio companies, industry lawyers and accountants, industry associations, and the media.

A thought leader in the field of private equity, the Center's work is represented in prestigious publications and industry conferences. The Center is a regular contributor to the *Venture Capital Journal*, the leading industry magazine, and its directors are often sought out as authorities by top business publications, such as *The Wall Street Journal*. The Center seeks to educate Tuck students in private equity investing and entrepreneurial management through such courses as Private Equity Finance, Advanced Entrepreneurship, Field Studies in Private Equity and through supporting internships, fellowships and independent studies.

For additional information on the Center for Private Equity and Entrepreneurship please visit: <http://mba.tuck.dartmouth.edu/pecenter/>

# Acknowledgements

---

- The survey questionnaire was developed by the team of the Center for Private Equity and Entrepreneurship led by Professor Colin Blaydon and Adjunct Assistant Professor Fred Wainwright. Tuck research assistants Erickson DeOliveira and Angela Groeninger made strong contributions to this effort. The Limited Partnership Agreement committee members provided valuable insights and suggestions.
- The analysis and presentation of the survey results were conducted and developed by:
  - Professor Colin Blaydon
  - Adjunct Assistant Professor Fred Wainwright
  - Research Assistant Erickson DeOliveira