

# THE CORPORATE COLLATERAL PACKAGE IN SUBSCRIPTION CREDIT FACILITIES: A SQUARE PEG IN A ROUND HOLE

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Those in the subscription credit market are all familiar with traditional collateral arrangements over the capital call rights of Cayman funds formed as exempted limited partnerships (**ELP**).

Recently, there has been a consistent increase in the use of Cayman funds formed as Cayman exempted companies. The use of Cayman companies (as opposed to ELPs) in the traditional collateral capital call deal has given rise to the need for some unique structures.

Any proposed security over a Cayman exempted company's right to draw down outstanding capital commitments from its shareholders differs significantly from the arrangements which have become common practice in relation to securing capital call rights of Cayman ELPs.

Unlike a traditional ELP capital call financing, where the capital call rights are a contractual obligation which can be assigned by way of security, the "contractual rights collateral package" in corporate subscription deals is typically linked to the obligations of the company (acting through its directors or investment managers) to issue shares. The creation of an obligation of the investors in the company to purchase shares "to-be-issued" in the future is different from the obligation of an investor in an ELP to fund the remainder of its commitment to the ELP as part of its existing interest and creates enforcement concerns and additional insolvency risks.

## ENFORCEMENT CONSIDERATIONS

Of utmost concern to a lender is its ability to enforce an investor's obligations to contribute to the fund

irrespective of the fund's ability to issue shares to the investor on payment.

Following a capital call, the investor might expect to be issued additional shares for the capital contribution which has been made and that such issue will only then give rise to the payment obligation to the company (proceeds of which are subject to claim by the bank pursuant to its security entitlements).

There are essentially two key elements for consideration: (a) the shares not being issued and (b) the corresponding payment not being made, perhaps due to a change in prevailing conditions and investor sentiment toward the fund at the time.

Concerns regarding share issuance are enhanced where directors have an absolute discretion to decide not to call or waive any request for share issuances or where the company's ability to issue shares may be challenged if insolvent.

## POTENTIAL INSOLVENCY RISK

If a winding up petition is issued before the call was made, there is a question as to whether section 99 of the Cayman Companies Law (the avoidance of dispositions) would require a validation application to be made to the Court, because the issue of shares post-petition would be considered "an alteration of the status of the company's members". Without Court approval of the share issue, the capital call would

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be void and the money would be recovered for the benefit of the liquidation estate of the company.

To address these concerns, we suggest that capital contributions be structured such that no further shares are required to be issued or that directors of the fund have a discretion but not the obligation to issue further shares for capital contributions. Like most other concepts, this is ideally baked in from inception of the fund and, whether on inception or by way of amendment of these documents, needs to be included in the subscription documents, the Articles of Association and any offering document.

Recently, Appleby’s lawyers closed a uniquely structured security package whereby investors were issued shares at a nominal par value on closing coupled with a remaining obligation to fund their outstanding commitment with respect to those shares when called to do so by the company. Only on full satisfaction of the outstanding commitments would the investors be able to exercise their rights to those newly issued shares. The company in turn then granted the lender a security interest over its right to enforce the shareholders’ obligations to fund their remaining commitments. The issue of the enforceability of an investor’s obligation to purchase new shares was therefore removed in favour of an approach without similar enforceability concerns.

If, at the time of the call, the company is insolvent or of doubtful solvency, the payment that is made by

the shareholder is likely to provide no benefit to the shareholder. Faced with this prospect, there would be an increased risk of shareholders challenging the enforceability of the call arrangement and the event of default provisions in the subscription documents.

### SHAREHOLDER CHALLENGE

To avoid such resistance from shareholders, a lender should insert contractual provisions that seek to avoid any opportunities for shareholders to successfully challenge the effectiveness of the subscription agreement or any call, amend the Articles of Association to ensure payment obligations survive insolvency, secure the fund’s bank accounts and ensure representations as to capital call and payments are valid through insolvency in all constitutional documents.

### CONCLUSION

It is critical to engage counsel at the early stages of a corporate fund subscription financing deal to address these unique concerns. Although not without its challenges, with careful review and relevant amendments, a robust corporate fund security package can be achieved.



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