Portfolio Media. Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

PE Investors Should Reject Life Tenure For General Partners

By **Kenneth Witt and Marc Lieberman** (February 20, 2020, 5:47 PM EST)

Kenneth Witt

Marc Lieberman

Institutional investors in private equity and venture capital funds typically take the view that general partners should not have life tenure, but rather, ought to be removable for good cause by the investors who entrust them with their money.

We too often see proposed terms in fund limited partnership agreements that, in effect, ensure that the general partner cannot be removed during the term of the fund for any reason. Recently, at least one major industry group, the Institutional Limited Partners Association, has begun to push back against efforts by general partners to obtain life tenure.

With a view to accommodating the legitimate interests of both the general partner and the investors, we have several suggestions for removal provisions in private equity and venture capital limited partnership agreements, but our focus in this article is upon the standard for determining when cause for removal is triggered, as opposed to what actions by the general partner constitute cause for its removal.

There is a spectrum of approaches for determining when investors are entitled to remove a general partner for cause:

- Upon the vote or consent of a stated percentage of the limited partners, ranging from a majority to a super-majority;
- Upon the vote or consent of the stated percentage of limited partners, plus a determination by a court or arbitral panel that cause exists for removal, which may include a grant of temporary injunctive relief by a court pending final resolution of a dispute, as well as a final determination;
- Upon the vote or consent of the stated percentage of limited partners plus a final determination by a court or arbitral panel of cause, with final meaning completion of the trial or arbitration; or
- Upon the vote or consent of the stated percentage of limited partners, plus a final and nonappealable determination by a court that cause for removal exists.

Investors have a legitimate concern about waiting for a final and nonappealable court determination of whether there exists cause for removal of the general partner. In nearly all court systems, such a process could take years and continue well beyond the remainder of the 10-year term of most funds.

In those cases where the governing limited partnership agreement only allows the general partner to be removed upon the vote of a supermajority of limited partners plus a final and nonappealable finding of cause, even in the extraordinary circumstance when the investors vote by a supermajority

to oust the general partner for egregious behavior, including fraud, they still could be forced to leave their investments in the hands of the general partner for the remaining term of the fund.

The U.S. Small Business Administration's model form of limited partnership agreement for small business investment companies provides that, subject to the consent of the SBA, an agreed percentage of the limited partners may determine that cause for removal exists and remove the general partner without the need for the intervention of a court, like the first of the options listed above.

Somewhat less liberally, the recently promulgated model form of limited partnership agreement published by ILPA provides that a general partner can be removed upon a vote of a majority of the limited partners on a court's determination of cause:

> [After a court has confirmed that] Removal Conduct has occurred, a written notice approved by a Majority in Interest may be delivered to the General Partner informing it that the Limited Partners are electing to remove the General Partner or terminate the Fund.

While the ILPA form agreement is brand new, and has yet to be widely accepted, we believe it represents a reasonable accommodation of the interests of the general partner, who justifiably fears the possibility, however remote, of arbitrary action by the limited partners to force his removal, and the interests of the limited partners in having a realistic and enforceable removal provision.

Even absent confirmation by a court, if a sufficient number of limited partners find cause for removal of the general partner, there is likely to be something seriously wrong.

Adding confirmation of cause by a court — whether in the form of a judgment or interim injunctive relief — would not interpose an insuperable obstacle to removal of the general partner.

In our view, fund limited partnership agreements that condition general partner removal only upon a final and nonappealable finding of cause essentially make it impossible to remove the general partner for cause during the term of the partnership. Thus, investors ought to think twice about agreeing to such provisions, given the mischief they may create.

Kenneth S. Witt and Marc R. Lieberman are partners at Kutak Rock LLP.

Disclosure: Lieberman sits on the Institutional Limited Partners Association's task force that drafted its model limited partnership agreement.