

# First-time Funds Series – Video #4: Drafting Legal Documents and Finalizing Terms

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## SPEAKERS



**Mark Morrison**



**Colby Harris**

06:12

In the fourth video of our first-time funds series, [Mark Morrison](#) and [Colby Harris](#) of our Private Equity practice focus on drafting legal documents and finalizing terms for the fund.

They discuss key considerations, including:

- the private placement memorandum and how the document serves a specific purpose for both potential investors and the issuer;
- a limited partnership agreement—a legal document that governs the relationship between the fund and its investors;
- how investors can formalize their commitment of the capital to the fund with a subscription agreement; and
- the purpose of the management agreement and guarantee.

Play the video above to watch the informal discussion and stay tuned for the next episode of our first-time funds series on fund timelines and making investments.

## Video Transcript



**Colby Harris (00:06):** Hi everyone, and welcome to the fourth installment of our First-time Funds discussion. My name is Colby Harris. I'm an Associate in our Private Equity Group, and I'm here today with my colleague Mark Morrison to discuss first-time funds focusing on drafting legal documents and finalizing the terms for your fund.

**Mark Morrison (00:23):** Thanks so much, Colby, and thanks to everyone for tuning in. I'm a Senior Associate in Torys' Private Equity Funds Group, and I'm excited to kick off our discussion today on legal documents insurance. Let's get right into it with an exploration of Private Placement Memorandums.

Usually, the first document prepared in connection with a first-time fund, and likely the first document to be reviewed by potential investors with respect to a first-time fund is a Private Placement Memorandum, sometimes called an Offering Memorandum and typically referred to, simply, as a "PPM". The PPM is a document prepared by the issuer and provided to potential investors when marketing securities that are not registered under applicable federal or state laws and are instead offered to investors pursuant to one or more exemptions to securities registration.

**Mark Morrison (01:11):** The PPM serves a specific purpose for both potential investors and the issuer. For potential investors, the PPM provides vital information regarding the fund, its management team, strategy and key terms of operating documents. It also includes important information regarding possible risks related to investments that may affect investors return as well, as the rights and restrictions of the class of securities being offered.

From the perspective of the issuer, the PPM serves as both a marketing and protective tool. While the PPM provides the issuer with the opportunity to market the fund to prospective investors, the PPM also protects the issuer against legal liability because in providing potential investors with factually accurate, non-misleading and essential disclosure regarding its strategy, fund terms, management team, prior experience and other information—most importantly, the risks of investing in the fund—the issuer shields itself from any subsequent claims of misstatements and/or omissions by investors. Now I'm going to pass it back to Colby to talk about the next major document in establishing fund, the Limited Partnership Agreement.

**Colby Harris (02:22):** Thanks, Mark. A Limited Partnership Agreement (or "LPA" for short) is the legal document that governs the actions of the fund and the relationship between its partners. The provisions of the LPA should track very closely to the fund's term sheet that's laid out in the PPM.

These provisions include the mechanics that, among other things, will dictate how the fund admits new partners and calls capital, where and how it can make investments, how it makes distributions and collects fees, and how a variety of key decisions are made.

The LPA will be entered into between the general partner of the fund and the investors who will be its limited partners.

**Mark Morrison (03:02):** Thanks, Colby. You mentioned the LPA governs the relationship between the fund and its investors. Could you tell us a bit more about how investors formalize their admission to the fund?

**Colby Harris (03:13):** Yeah, absolutely. The way investors formalize their commitment of the capital to the fund is by completing a Subscription Agreement. This document sets out the terms and conditions of the investment. They will include securities, tax and anti-money laundering representations from both the fund and the investor, as well as the investor's contact information and details for capital calls and distributions. The Subscription Agreement is also where the investor will provide the necessary "Know Your Client" (or "KYC") information and supporting documentation.

**Mark Morrison (03:45):** Right. And are there any other documents that might be connected to an investor's commitment to the fund?

**Colby Harris (03:52):** Yeah, that's a really good question. In certain circumstances, typically with more sophisticated institutional or strategic investors, there will be additional rights or benefits that an investor will require in connection with their investment. There can be a variety of rationales for these requests, including but not limited to regulatory or legal restrictions specific to that investor.

In addition to these investors potentially negotiating changes in the LPA itself, often the investor and the general partner will enter into what's called a "Side Letter", which sets out the additional rights the investor is entitled to. As mentioned, Side Letters are much more common in funds that are engaging institutional or strategic investors.

And as a result, are a lot less common in friends and family funds. Now to end the segment, I'll pass things off to Mark to talk about two final documents: the Management Agreements and the Guarantee.

**Mark Morrison (04:47):** Thanks, Colby. The purpose of the Management Agreement is to appoint the manager to the fund and to outline the terms of its services, as well as its duties and obligations to the general partner and the fund. The Management Agreement also sets out the service fee, also referred to as the management fee, charged to the general partner in consideration for the manager's services. Now, the general partner clawback is the tool used in the event that the general partner or its affiliate as the carry recipient is paid too much carried interest under the distribution waterfall, which our colleagues, Cameron and Lauren will discuss in Video #8.

In such a circumstance, the carrier recipient will need to pay the excess back to the fund, which then in turn will pay back to the limited partners the amounts they are owed. Clawbacks are often supported by guarantees from a well-capitalized entity in the sponsored organizational structure or by the individual care recipient. And such a guarantee provides a backstop for limited partners that, if any clawback calculation is not satisfied, the guarantor will step in and make the limited partner's goal.

**Colby Harris (05:56):** Great, thanks Mark. And thanks again to everyone for tuning into this segment of our first-time funds discussion. We hope this was helpful and informative and look forward to bringing you our next segment.

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