The Rise of the Pledge Fund in Energy

Smaller GPs that enter the energy market without a strong track record or name recognition often have difficulty raising blind-pool funds. Mark Proctor of Vinson & Elkins says these emerging managers are increasingly turning to a pledge fund structure.

Marc Proctor
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There are many challenges that emerging private equity fund managers face, including a minimal track record or not being a well-known name. One thing that can be added to that list—at least in the energy space—is the difficulty of raising blind-pool capital. A possible solution? The pledge fund structure.

Mark Proctor, a partner in private equity for law firm Vinson & Elkins, says "you're seeing a bifurcation in the market" where the larger, more well-known names continue to fundraise and build their track records in energy. Meanwhile, smaller players in an increasingly competitive field may have trouble raising capital—especially from institutional investors—without a solid track record to show. Enter the increasingly popular pledge funds.

As Proctor explains it, the pledge fund involves a GP going to several investors and making an agreement to show them a certain number of deals, with the understanding that the LPs will look at those deals in an expedited timeframe. "And then if they invest in those deals, you agree upfront on what the economics will be and whether or not you're going to cross-collateralize those deals for purposes of the carried interest," he says. "We've seen a tremendous amount of interest in those structures. And that's going to be a trend as money keeps flooding into the industry."

While there are some single-asset pledge funds, Proctor says that's not the norm. Usually it's a collection of entities or a fund meant to invest in multiple deals, he adds, "but where—instead of the GP having all the discretion to put the limited partners into every deal—the GP actually has to go to the limited partners with each deal, get them to buy into that deal and then those who are interested participate in the deal; those who are not sit the deal out."

The investor base for pledge funds tends to be slightly different from that of a traditional PE fund, he explains. The smaller investors like family offices and less-massive pension plans that want the ability to say no to an investment, are common. The more traditional investors tend to stick with the larger PE deals and the blind pools being raised by the more established firms, Proctor adds.

There is a final sticking point to the pledge fund structure: Like some GP groups that prefer to have committed capital at the ready when they need it, there are also sellers that are wary of the structure. Their reason? They don't have confidence that the purchase capital can be rounded up. ■