Proskauer

A Guide to GP-Led Solutions

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The unprecedented level of uncertainty caused by COVID-19 is expected to trigger portfolio company and fund level liquidity issues as fund sponsors grapple with unexpected need for additional capital in segments of their portfolios, whether due to stalled public markets, lack of available credit, or otherwise. In addition, we expect segments within the limited partner ("LP") community will seek sources for liquidity due to decreased realization events and declining public markets, while we expect others (particularly secondary funds, preferred equity providers and other asset managers) will view the current disruption as an attractive opportunity to put available capital to work.

Fortunately, many tools and strategies have been developed in recent years to address situations that were not necessarily expected when a fund was formed, including: (a) portfolio companies taking longer to mature, leading to later exits and need for additional capital, (b) managers seeking to hold investments for longer periods to reap the benefits of continued growth, (c) LPs seeking liquidity and (d) secondary investors looking to put large amounts of capital to work. These strategies can be useful to address the challenges the industry is expected to face over the coming months.

In this article, we present an overview of, and considerations for, structures for general partner ("GP")-led solutions to address the liquidity needs of funds, LPs and portfolio companies. We also present some suggestions on how sponsors and investors should consider these types of solutions when launching or evaluating an investment in a new fund or considering amendments to existing fund agreements.

Certain Types of GP-Led Solutions

The table below lays out several types of GP-led solutions, along with common scenarios and issues that each solution can address and specific considerations and traps for the unwary inherent in each solution. Further below, we outline more general considerations that sponsors and LPs should consider when evaluating these strategies. As always, a thorough review of existing fund documentation (including limited partnership agreements, side letters and credit agreements) should be conducted before beginning any process.

While each deal is unique and will present its own issues, sponsors considering any of the strategies described above should consider a number of general considerations, which will apply to most GP-led solutions to varying degrees:

- Valuation of any fund's portfolio may be difficult in the current market. Some market-testing of the purchase price, fairness opinions and significant process transparency are generally needed to address the inherent conflicts of interest in GP-led solutions.
- Determinations of the long-term viability of an existing portfolio – and thus the appropriateness of investing more capital – may be more difficult than usual. Transparency in discussions between the GP and LPs (including limited partner advisory boards) regarding the future of the portfolio will be important.
- The fact the GP and its affiliates will be on "both sides" of many of these transactions (e.g., managing both the fund and an SPV in a fund restructuring or continuation vehicle) creates conflicts of interest and a risk of claims for breach of fiduciary duties. Because of this, transparency and disclosure are very important. Fairness opinions and "status quo" options can also help to alleviate some concerns.
- Market uncertainty makes outcomes of a GP-led solution inherently less predictable and could lead to hindsight-driven challenges to a GP's actions and motivations; strong disclosure of risks and conflicts is key.
- Consents to transfers, tag-alongs, drag-alongs, rights of first refusal and other rights may be applicable at the portfolio company level, depending on the structure of a deal. Applicability of these types of rights will often be dependent on "affiliate transfer" provisions in company documentation – e.g., is an SPV treated as an affiliate of the original holder and thus exempt from applicable third party rights? Analyzing all relevant agreements and complying with required processes and notice periods can be complex and time-consuming.
- Regulatory issues including the applicability of the Hart-Scott-Rodino Act and tender offer rules should be analyzed carefully.

Considerations for the "Next Generation"

As certain challenges inherent in the framework of traditional private investment fund terms and documentation have emerged in recent years, the GP-led solutions discussed above have been developed to fill in gaps and course-correct parties' incentives late in the life of funds. While it is too early to know how the current market disruption will affect the next generation of funds, sponsors and investors may well find themselves looking for creative liquidity solutions ten or twelve years down the road. Planning ahead for this eventuality and drafting fund documents accordingly now can reduce friction and costs in the future. While we generally recommend considering the following issues in any case, COVID-19 is a reminder that unforeseen events can and do happen during the lifecycle of a fund.

- **Terms and extensions**. Consider the appropriateness of a traditional 10-year term in light of a fund's strategy and all parties' recent experiences. Consider providing for additional extension periods (with limited partner advisory committee ("LPAC") or LP approvals) to streamline and add predictability to continuation planning.
- **Amendment Provisions**. Consider crafting special rules for amendments to effectuate GP-led transactions. In particular, some agreements require each LP that would be diluted by an amendment to consent to that amendment. GPs may seek an exception to this general rule if a certain percentage of diluted LPs approve or participate in a transaction that results in the dilution.
- **Expenses**. Parties should consider who will bear expenses related to GP-led transactions, bearing in mind that these expenses may include advisory fees as well as GP-level and portfolio-level analysis and documentation in addition to fund-level analysis and documentation.
- **Conflicts Provisions**. Parties should consider including specific rules as to when LP/LPAC approval will be required in connection with a transaction; these may be in addition to or different from general conflict of interest or related-party transaction approval rules. For example, provisions may include an automatic waiver of conflicts of interest if a specified percentage in interest of current LPs participate in or otherwise consent to a transaction.

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Industry participants are likely to continue to refine the strategies described above in order to address new business objectives and respond to new challenges in the current market. Deepening experience and innovation, together with careful consideration of the issues laid out in this article and detailed reviews of applicable fund documents, can help address the challenges the industry is expected to face through the coming months and beyond.

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