Delaware Chancery Litigation Highlights Considerations for GP-Led Secondaries

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An action filed last month in the Delaware Court of Chancery by an investor in a private equity fund highlights the potential risks to fund sponsors when investors are dissatisfied with continuation vehicle ("CV") transactions and the related conflict of interest and fiduciary duty issues that can arise in these deals. Through the action, the plaintiff successfully delayed closing of the CV transaction pending resolution of the dispute. Though the underlying fund agreements require the merits of the dispute to be resolved in confidential arbitration, the plaintiff sought an injunction preventing the CV from closing before that arbitration could conclude. Shortly after the lawsuit was filed, the sponsor of the fund ("Sponsor") agreed to defer closing of the CV transaction to permit the arbitration to take place, and that agreement now governs the timing of the transaction.

This dispute is a relatively rare example of an investor bringing a public court challenge to a GP-led CV and highlights the process, valuation and conflict of interest concerns that have long been a focus of the SEC when analyzing these transactions under the Investment Advisers Act of 1940 ("Advisers Act").[1] This dispute therefore provides a useful case study of how these transactions may be scrutinized under fiduciary duty standards. The fact that the lawsuit was even filed shows the importance of a well-run election and investor consent process so that even investors who do not agree with the transaction do not go to court to block it. Such an action can, at the least, cause negative publicity and can also have longer-term impacts on fundraising or even spark interest from the SEC.

Background

The plaintiff investor alleges that in October 2025, the Sponsor proposed a single-asset CV transaction involving a portfolio company of its 2011 vintage buyout fund. The plaintiff's complaint alleges that timing was condensed and the Sponsor first notified limited partner advisory committee ("LPAC") members of its proposal on October 23, 2025, scheduled an LPAC meeting for October 30, and sought to call a vote at the meeting.

The plaintiff alleges that it and several other LPAC members objected to what it characterized as the rushed nature of the transaction, including that the information arrived in what it believed to be piecemeal fashion and, in many cases, without time to review. The plaintiff further alleges that the Sponsor did not accommodate investors' request for an investor-only *in camera* LPAC meeting before the vote on the transaction. As a result, the plaintiff alleges that most of the LPAC simply declined to vote at all at the October 30 meeting and the transaction was not approved.

The plaintiff asserts that over the next several weeks, the Sponsor solicited approval by engaging and sharing information with LPAC members on an individual basis, including the marketing materials that had been provided to prospective third-party investors in the CV. The plaintiff alleges that the materials provided to prospective CV investors contained different information than the materials provided to existing investors being asked to approve the transaction, including different assessments of key information relating to its valuation and different financial models for potential exits.

Approximately two weeks after the October 30 LPAC meeting, the plaintiff claims that, without holding any additional meetings, the Sponsor notified investors that the CV had been approved and circulated a CV election form to all investors providing them the right to sell (*i.e.*, receive cash consideration for their stake in the underlying asset, based on the valuation agreed with the CV investors) or roll their interest into the new CV, which would reset the Sponsor's entitlement to carried interest at the new valuation (a benefit to the Sponsor because, according to the plaintiff, the Sponsor was unlikely ever to be entitled to carry at the previous valuation).

The plaintiff alleges that, when it received the election form, it sought additional information from the Sponsor and asked the Sponsor to delay the process to allow the plaintiff additional time to consider its options. The plaintiff's complaint alleges that it sent a demand for arbitration on November 24, 2025, which required a 45-day waiting period under the terms of the fund's governing documents, and requested that the Sponsor delay closing of the CV until arbitration could begin. When the Sponsor did not commit to doing so, the plaintiff initiated litigation in the Delaware Court of Chancery seeking an injunction to preserve the arbitrator's ability to award effective relief. On December 4, 2025, the day after several financial publications reported that the lawsuit had been filed, the Sponsor agreed with the plaintiff to delay closing of the CV until the arbitrator could issue a decision.

Advisers Act Fiduciary Duty and SEC Focus on GP-Led Secondaries

The SEC has, for many years, highlighted adviser-led secondaries and CVs as a priority area for review. Among other potential concerns, the SEC has pointed to the fact that the adviser is effectively on both sides of the transaction and often stands to benefit from extended fees or a reset carried interest in the continuation vehicle. These dynamics can implicate the adviser's fiduciary duty, including the need to identify and mitigate conflicts where possible and then provide full and fair disclosure so that investors can give informed consent. Short decision timelines coupled with complex or voluminous information, undisclosed conflicts and material information disparities have all been flagged by the SEC or its staff as areas of focus in these transactions.

The allegations in the plaintiff's complaint track many of those themes. The complaint alleges a compressed process, different information provided to prospective CV investors compared to existing fund investors, the use of a valuation that the plaintiff asserts did not give existing investors the benefit of certain value increases and fee terms that would favorably reset the Sponsor's economics compared to the status quo. Though the claims in this case were brought under state law, not the Advisers Act, the factual allegations seem to align with historical areas of SEC focus in these transactions, illustrating the types of fact patterns that may draw questions from the SEC.

Takeaways

Regardless of the ultimate outcome of this case, the fact pattern highlights several practical takeaways for fund sponsors to consider when pursuing a CV transaction:

- Process. The complaint focuses heavily on process. The plaintiff alleges a rushed timeline, limited time to review materials and pressure to vote at an early meeting, followed by a period where the Sponsor allegedly engaged individually with certain LPAC members to seek their approval while not engaging with others. The plaintiff notes several instances where it allegedly did not receive information until what it described as the last minute and contrasts this with guidance from the Institutional Limited Partners Association that disclosures should be provided "as early as possible." Commercial realities frequently require transactions to move quickly, but sponsors should consider whether a neutral factfinder reviewing the transaction would believe it was unduly rushed. It can be helpful in certain situations not to request a vote at an LPAC meeting and instead to seek approval in a follow-up communication to investors after the fact, which might prevent investors from feeling pressured to decide immediately and support the argument that there was sufficient opportunity to make an informed decision.
- Disclosure. The complaint highlights several alleged discrepancies between information provided to prospective CV investors and information provided to existing investors. For example, the plaintiff alleges that information communicated to prospective CV investors was materially more optimistic than the information communicated to existing investors. The plaintiff also criticized the timing and framing of the discussion of the Sponsor's economics. Disclosures to separate groups of participants frequently will vary in some respects given the different choices that they are being asked to make, but sponsors generally should assume that their disclosures will be read side-by-side and take care that all the materials are sufficiently consistent. Material information about conflicts, valuation and economics should be presented to all investors. This aligns with statements from the SEC that giving one group of investors more favorable or more complete information than others can raise Advisers Act issues.
- Transaction Value. The plaintiff's complaint takes issue with the proposed valuation at which the transaction would take place. Frequently, pricing is negotiated with prospective CV investors based on the valuation of an asset at a specified "reference date," after which consents are sought from existing investors. This generally is viewed as a method to reduce or mitigate valuation conflicts by allowing the transaction to occur at a market-determined price set in negotiation with third parties, but the plaintiff's complaint argues that the chosen reference period meant that existing investors did not get "credit" for value increases that happened after the reference date. Due to the structural reality requiring CV valuations to be negotiated prior to seeking investor consent, valuations may appear slightly out of date but, to the extent possible, it is helpful to use as recent a reference date as is possible (which may nonetheless be several quarters in the past).

- Economic Terms. In the complaint, the plaintiff takes issue with proposed economic differences between the existing fund and the CV, including resetting carried interest at the new valuation. It is often appropriate for such terms to vary between a main fund and a CV due to the concentrated investment in a small number of identified assets, rather than blind pools. Likewise, it is not a given that CV investors should be able to elect terms that were negotiated years earlier and could reflect market practices that no longer exist. When fees vary, it is often helpful to explain the reasons to investors. Investors naturally prefer fees to be as low as possible and this alone does not mean a sponsor must grant the request, but sponsors that are receptive to investor feedback, even if they ultimately decline to make changes, may be less susceptible to a challenge and will be better placed to demonstrate that investors had granted their informed consent to associated conflicts.
- Limits of Arbitration. Many sponsors choose to require disputes arising out of fund governing documents to be submitted to confidential arbitration, which can in certain situations move more quickly than a court process or be subject to rules that are better tailored to commercial matters. Likewise, certain investors, especially investors outside the U.S., may prefer arbitration if they believe they would not be treated fairly in a U.S. court. Though arbitration has many benefits, this dispute shows that even governing documents with comprehensive arbitration clauses may result in public court filings. In this case, the governing documents contained a mandatory 45-day waiting period before arbitration could be commenced, which the Sponsor would not waive. This resulted in the plaintiff seeking injunctive relief, drawing press attention that otherwise might have been avoided. Sponsors that prefer arbitration and confidentiality should review their dispute resolution provisions to ensure that they are in line with the sponsor's objectives.
- Regulatory Lens. Although this dispute arises from a private investor challenge and may be resolved in confidential arbitration, it touches on issues the SEC has highlighted in its public statements on GP-led secondaries. Sponsors should be prepared for the possibility that GP-led transactions will be reviewed by the SEC through the lens of their fiduciary duty to their clients. Full and fair disclosures and a well-run process can allow sponsors to navigate any regulatory attention more smoothly.

Although the facts are specific to this transaction and the Sponsor will have its own defenses, the complaint underscores the value of careful regulatory analysis when engaging in sponsor-led transactions like CVs. Sponsors considering these transactions should consider the timeline and strategy for communication with the LPAC and investors, as well as the terms of the transaction itself, with a view to how those choices will be assessed under the Advisers Act fiduciary duty standard and in any future SEC review of the transaction.

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[1] This action did not assert any claims under the Advisers Act, which does not afford a private right of action for claims like the investor's, and instead vests such authority solely with the SEC. Such causes of action can, however arise under state law, which the plaintiff asserts as the basis for its claims here. *The case is Del. Ch. No. 2025-1389 (Nov. 26, 2025).*

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