

Counterparty? What counterparty?

Buyers who acquire assets from a fund that is winding down need to be aware of several key issues, including the lack of a counterparty from which to recover any losses, according to Proskauer's Andy Shore.

By **Guest Writer** - 1 day ago

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What specific issues do secondaries buyers need to be aware of when acquiring assets from a vehicle that is in wind-down mode?

Andy Shore: The key issue for a buyer is that your counterparty is unlikely to be in existence for any meaningful period post-closing. Even when it is, it may not have any significant assets. Therefore, as a buyer, you have to be conscious that while you may think you have a good deal under the sales and purchase agreement, your ability to recover any losses from the seller is significantly reduced. To make matters worse, finding another party to stand behind the seller's liabilities (particularly where the liquidating seller is a fund of funds) is challenging.



Andy Shore

What types of issues could occur that would lead a buyer to want to seek recourse from a counterparty in the first place?

AS: In a fund of funds wind-down, for example, the principal scenarios in which a buyer may need to recover a loss from the seller under an SPA relate to the fact an underlying GP will require the buyer to assume all seller obligations and liabilities relating to the interest being purchased. The GP will want the option to recover the loss from its existing LP (ie, the buyer) and not be forced to track down a seller for which it may not have an ongoing relationship. Seller liabilities may include LP clawbacks, breaches by seller of the fund documents, tax liabilities of seller and seller's share of GP costs relating to the transfer.

What can be done to mitigate these issues?

AS: If it's not possible to find a third party to guarantee the liabilities of the seller under the SPA, then buyer should focus its attention on due diligence. In particular, confirming with the GP whether there is any known risk of a future LP clawback or if there has been any past breaches by seller.

While the seller is likely to wind up shortly after closing, buyer should also seek to obtain agreement from the seller that it will not liquidate for a specified period (ie, six months post close, or until the next set of audited accounts/reports are due from the underlying fund). This will allow buyer at least a short period of time post-close to discover any issues.

Escrows and deferred consideration options are not workable for a seller that wants to liquidate.

The opportunity for the buyer in these situations is to understand what is important to seller, and what is possible for them (which is often different from a typical secondary). Buyer can use that leverage to achieve other, more favourable terms in the SPA.

If a problem arises after a deal has closed but prior to liquidation, what can buyers do?

AS: If a problem arises post-closing, and buyer would typically have recourse to the seller for any losses under the SPA, the buyer should let the seller know that there is a potential issue as soon as possible. While on notice, it is more difficult for the seller to complete its liquidation as it is usually expected to ensure there is no outstanding liabilities prior to liquidation. The buyer may therefore increase its likelihood of recovering any loss from seller.

What actions can all parties take to help minimise potential problems in such deals?

AS: Good diligence of the portfolio is key, and that involves good early communication with the underlying GPs and any intermediary. The more the parties understand the status of the portfolio interests prior to signing, and in particular the risks of any clawback situation, the less chance of surprises later in the process.

Andy Shore is a partner at law firm Proskauer. He advises asset managers, institutional investors and investment advisors on issues including formation, raising, maintenance and ongoing operation and compliance of their investment funds. He also advises on internal governance, compliance and organisation, carried interest and co-investment arrangements, spin-outs, reorganisations and restructurings.