

Proskauer's Secondaries School: Traditional LP-led Transactions

October 2023

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Agenda



Secondary Transactions: What, Why & How



Setting the Stage: Traditional LP-Led Transactions



Definitive Documentation



State of the LP-Led Market

Secondary Transactions: What



Buying and selling of investor stakes in private investment funds

No public market = no liquidity

Two basic categories: GP-led & LP-led

Secondary Transactions: Why

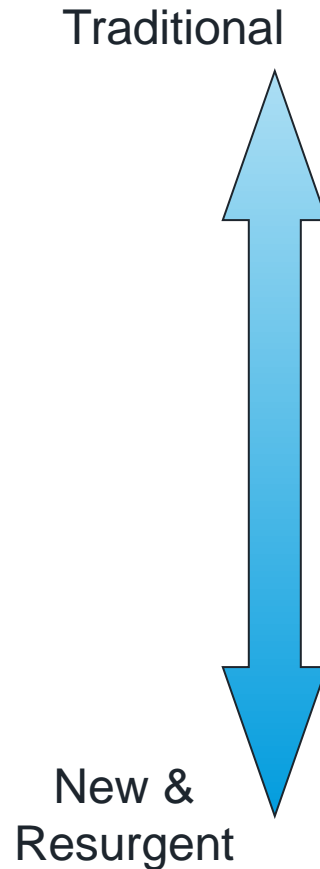
Seller's Motivation

- Liquidity and/or portfolio wrap-up
- Asset class overallocation
- Portfolio rebalancing
- Regulatory restraints

Buyer's Motivation

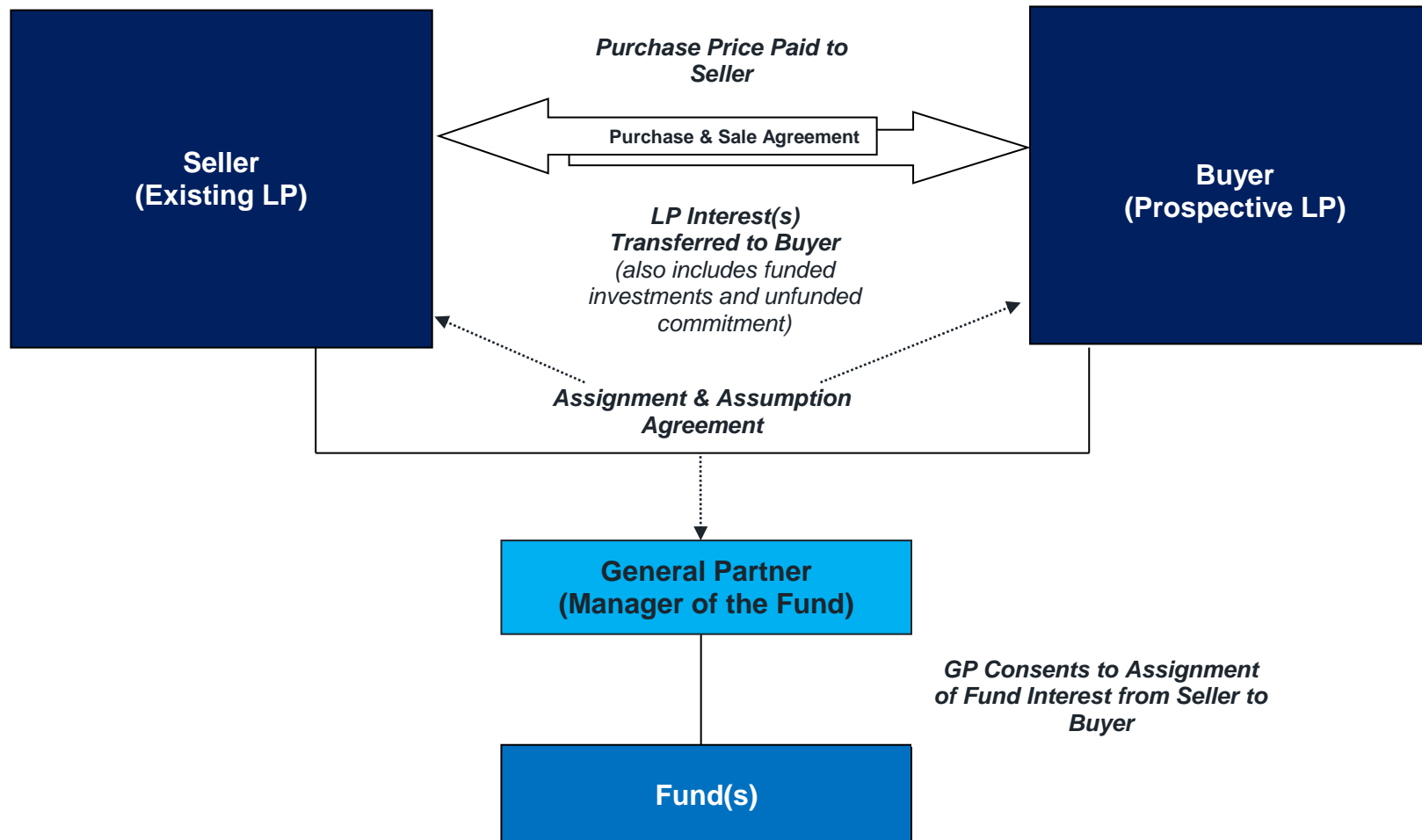
- Pricing discounts
- Portfolio diversification
- Access to blue-chip managers and/or companies
- Risk-adjusted compared to primary investments

Secondary Transactions: How



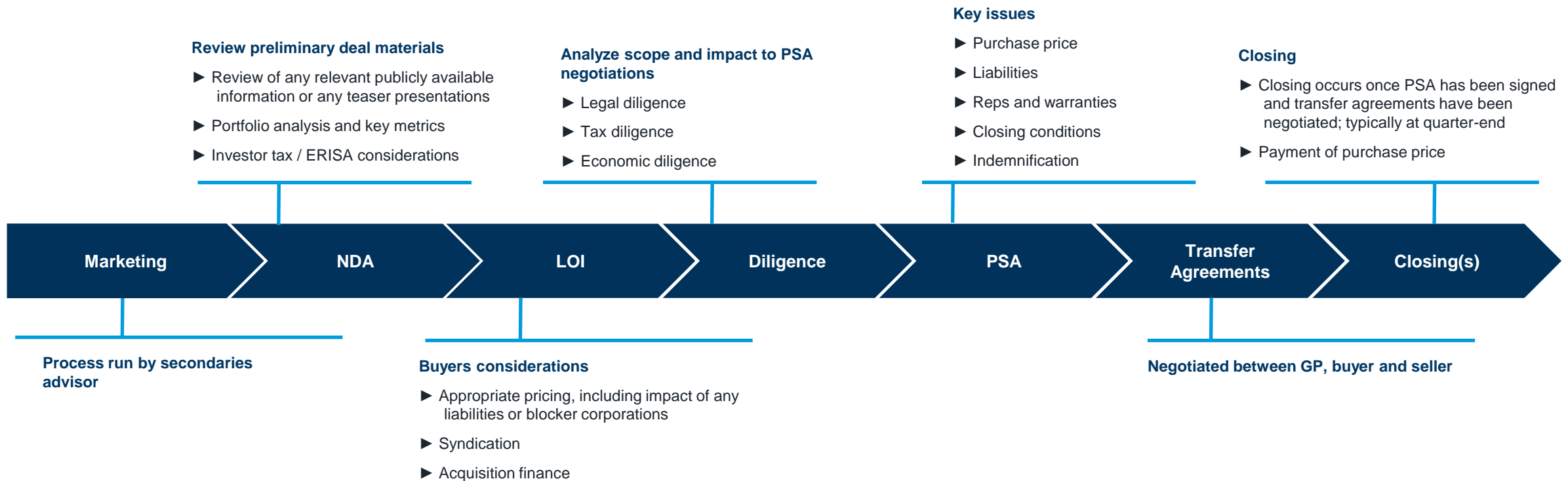
- Single interest & portfolio
- Strips & carveouts
- Stapled secondaries
- Seller financed/delayed payment
- “Seasoned primary”
- Young secondaries
- Annex funds
- Listed vehicles
- Synthetic secondary (economic transfer/TRS)
- GP liquidity (purchase of GP commitments)
- Secondary directs
- Structured secondary (JV or structured cashflow)
- Hedge fund investors as sellers (“gated” interests)
- Hedge funds as sellers (side pockets/illiquid assets)
- Tertiary liquidity (interests in FOF or other secondary funds)
- Manager spinouts
- Large portfolio transactions
- Tender offers
- Continuation funds (single & multi-asset)
- NAV facilities
- Preferred equity

LP-Led Transactions: Typical Structure



LP-Led Transactions: Indicative Timeline

Typically 3-6 months (for buy side)



LP-Led Transactions: Negotiating NDAs

Definition of “Confidential Information” or “Evaluation Material”

Representations

Permitted uses

Confidentiality about the process

Disclosure required by law or regulatory process

Non-solicitation of employees

Return of information

Disclaimers

Enforcement and remedies

Term

Standstill

LP-Led Transactions: Letters of Intent (“LOI”)

What is being sold

Price and how it is calculated and adjusted

Bid pricing assumptions (e.g., no blockers, LP clawback liabilities and other excluded obligations)

Exclusivity

Expense sharing

Closing conditions

Legal Diligence: Contractual & Regulatory

Underlying Fund Structure & Regulatory Landscape

- Delaware or Cayman or Other?
- 3c1 or 3c7?

Underlying Partnership Agreement(s)

- Rights of first refusal (ROFR)
- Transfer requirements
- PSA disclosure points (e.g., litigation, opt-outs, AIVs, blockers)
- Other Buyer-specific concerns

Side letters

- Individual LP ROFRs

Economic Diligence: Carried Interest Waivers/Deferrals



GP may waive carry allocations and then recover waived amount from later profits from investments held for more than three years



Can distort the economic deal between Buyers and Sellers



Buyers should consider including as an “excluded obligation”



Potential purchase price adjustment?

Economic Diligence: Management Fee Waivers/Deferrals



GP may waive management fees to fund commitment instead of funding with after-tax dollars



Can distort the economic deal between Buyers and Sellers



Buyers should consider including as an “excluded obligation”



Potential purchase price adjustment?

Tax Diligence: Assets

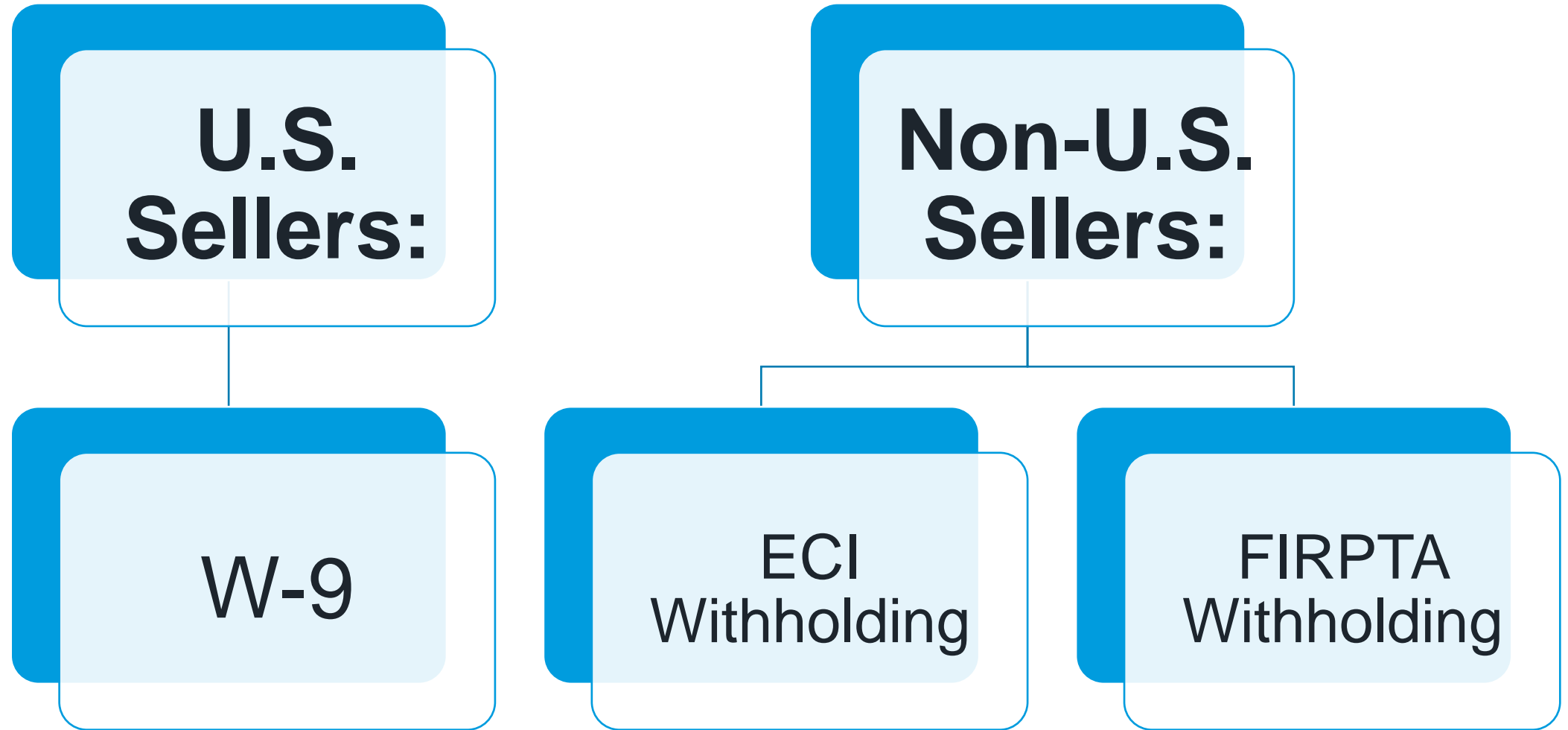


Blockers

PTP

Transfer
Taxes

Tax Diligence: Withholding



Break

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Purchase and Sale Agreements (“PSA”)



What it is and what it’s not



What’s included



Key PSA terms and issues

PSA: Purchase Price

Each interest priced based on “Cut-Off Date” capital account

Purchase price adjustment for interim cashflows

- Adjustments for withholding taxes and blocker taxes?
- Are liquidated interests transferred?
- Negative purchase price

Currency conversion issues

Deferrals

PSA: Liabilities

Buyer assumes all obligations except “Excluded Obligations”

Excluded Obligations

- LP giveback
- Waived/deferred management fees and carried interest
- Withholding taxes and seller’s pre-closing taxes
- Portfolio agreement scheduling and liabilities
- Breaches of fund docs

Reps and Warranties

PSA: Seller Reps and Warranties

Authorization/title/good standing

Delivery of “portfolio property agreements” and other docs and communications

No default, breach or opt-out

No pending LP clawback

No blocker elections

No elections with respect to GP-led transactions

No litigation

Big boy reps

Brokers

Scheduling of capital accounts, distributions, contributions

Tax reps

Compliance with law

Source of funds/AML/OFAC

Solvency

PSA: Buyer Reps and Warranties

Authorization/duly formed/power

Securities law reps

No litigation

Brokers

Source of funds/AML/OFAC

Solvency

Big boy reps

PSA: Pre-closing Covenants (Sign-then-Close Transaction)

Cooperation to verify schedules and obtain consents

Notice to buyer of fund-related developments/communications (e.g., amendments, elections)

GP-leds

No solicitation

No rescinding authorization

Delivery of fund reporting

Covenants related to purchase price deferral

PSA: Closing Conditions

Reps and warranties remain true and accurate as of each closing date

All PSA obligations performed

No new legal proceedings

Delivery of closing/rep-bring down certs

Delivery of tax certificates

Approvals have been obtained

Delivery of purchase price, title, and all assignment agreements

Satisfaction of first closing threshold, if any

PSA: Survival of Reps

Fundamental reps: SOL or until liquidation of fund

Non-fundamental reps: typically 12-24 months

Sandbagging

PSA: Indemnification

Typically sole source of protection/recourse for breach

Thresholds

Caps

PSA: Post-closing Covenants

Seller forward erroneous distributions and communications

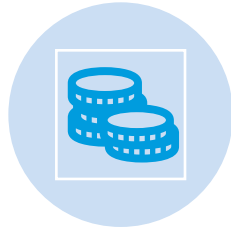
Buyer forwards certain tax refunds

Cooperation on any applicable tax filings

PSA: Other provisions



EXPENSES



TRANSFER
TAXES



BROKER
FEES



NOTICES



ASSIGNMENT
OF PSA



CONFIDENTIALITY



GOVERNING
LAW



TERMINATION

Transfer Agreements and Closing Process: Introduction



Broker outreach

Request transfer agreements
Diligence inquiries
Commence ROFO/ROFR



Transfer agreement negotiations

Typically handled by buyer/seller counsel and fund counsel
GP has leverage



Typical GP requirements

Timing – generally quarter end
PTP restrictions
Deadline to finalize transfer documentation
Payment of legal expenses
1446(f) withholding documentation
Buyer subscriptions/IQS
AML/KYC clearance

Transfer Agreement: Material Terms

Commitment Amounts

Release (*Seller only*)

Consent to Direct Transfer

Transfer Costs

GP Confirmation of AIVs

PSA Controls

Waiver of Legal Opinion

ROFR Waiver (needed only for ROFR funds)

Effective Date

Transferor and Transferee Representations

Confirmation of the Satisfaction of Transfer
Conditions

PTP Reps

Joint and Several Indemnification

Transfer to Affiliates (*Buyer only*)

Closing Process



Buyer subscription process and KYC/AML clearance



Transfer documentation finalized



Signatures released after documentation is agreed and purchase price is received

State of the LP-Led Market

Banner year in 2021 → significant slowdown in 2H 2022 and 1H 2023

Creativity in deal terms (e.g., deferred purchase price)

Stronger outlook for 2H 2023 and 2024

- Substantial pent up selling demand
 - Denominator effect
 - Overallocation
 - Liquidity crunch
- Closing bid / ask delta
- Strategy dependent

Questions?

Event Speakers



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Appendix

Carried Interest Waivers – Example

Example with no Carry Waiver:							Cut Off Date					
Call for Investment		Realize 50 of Gain		Distribution		Realize 40 of Gain		Distribution		Buyer Proceeds	Buyer Profits	
	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance		
LP	100	100	40	140	(40)	100	32	132	(32)	100	132	32
GP	0	0	10	10	(10)	0	8	8	(8)	0		

Example with Carry Waiver:						Cut Off Date						
Call for Investment		Realize 50 of Gain		Distribution		Realize 40 of Gain		Distribution		Buyer Proceeds	Buyer Profits	
	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance		
LP	100	100	40 50	140 150	(40) (50)	100	32 22	132 122	(32) (22)	100	132 122	32 22
GP	0	0	10 0	10 0	(10) 0	0	8 18	8 18	(8) (18)	0		

Assume Buyer pays 100% of GAAP Capital Account and there is no Management Fee or GP Commitment

Management Fee Waivers – Example

Example with no Fee Waiver:				Scenario 1 Cut Off Date				Scenario 2 Cut Off Date				
Call for Investment		Call for Management Fee		Pay Fee		Call for Investment		Gain on Investments = 200		Scenario 1	Scenario 2	
Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Buyer Profit	Buyer Profit	
LP	100	100	10	110	(10)	100	50	150	196	346	196	196
GP	2	2	0	2	0	2	1	3	4	7		

Example with Fee Waiver:				Scenario 1 Cut Off Date				Scenario 2 Cut Off Date				
Call for Investment		Call for Management Fee		Pay Fee		Call for Investment		Gain on Investments = 200		Scenario 1	Scenario 2	
Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Amount	GAAP Balance	Buyer Profit	Buyer Profit	
LP	100	100	10 9	110 109	(10) (9)	100	50 51	150 151	196 195	346	196 195	196 195
GP	2	2	0	2	0	2	1 0	3 2	4 5	7		

In all scenarios, Buyer pays 100% of GAAP Balance Capital Account



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