

Morgan Lewis

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# PRIVATE FUND INVESTORS ROUNDTABLE

**Fund Restructurings, Closures, and Workouts**

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# **FUND RESTRUCTURINGS, CLOSURES, AND WORKOUTS**

**BRIAN HERMAN**

**JARROD HUFFMAN**

**JEDD WIDER**

# Common Causes of Funds Becoming Distressed, Restructuring, etc.

- Illiquidity in market for underlying assets
- End-of-fund-term situations
- Termination or removal rights, key person events
- Highly leveraged funds
- Counterparty insolvency
- Market turmoil

# Illiquidity Is a Common Cause of Distress

- Illiquidity has become one of the most common causes of funds becoming distressed
- Illiquidity often gives rise to valuation issues
- Recent examples:
  - Technology-focused funds in the early 2000s
  - Funds of hedge funds during the 2008 financial crisis (when underlying funds were gated)
  - Registered ultra-short bond funds during the 2008 financial crisis
  - Certain high-yield bond funds, including registered funds such as the Third Avenue Fund, which suspended redemptions and entered into liquidation in 2015

# Hypothetical Case

- Private fund, Delaware limited partnership
- Assets include liquids and illiquids
- Significant losses in NAV due to a declining and/or volatile market
- Significant investor redemption requests

# The Different Constituencies

- Investment Manager/General Partner

## Open-End Fund

- Investors redeemed and awaiting receipt of redemption proceeds
- Investors desiring to redeem their interests
- Investors not redeeming their interests

## Closed-End Fund

- Investors desiring to sell or redeem their interests
- Investors not selling or redeeming their interests

# Big Picture Issues

*"You can please some of the people all of the time, you can please all of the people some of the time, but you can't please all of the people all of the time."*

– Abraham Lincoln

- Business Objectives:
  - Fund/entire fund platform remains as a going concern, or is wind-up inevitable?
  - What's preferable: preservation of assets or liquidation?
- Legal Objectives:
  - What do you want to do vs. what can you do?
    - Careful analysis of redemption, suspension, and reporting obligations in fund documents and side letters
    - Ensuring that all investors are treated fairly and equitably
  - Balance the interests of the aforementioned investor constituencies



# Restructurings, Closures, and Workouts

- Some potential alternatives to winding-up
  - GP restructurings/stapled secondaries
    - Rollover or new fund options
  - Buy-Sell provisions
  - Suspend (i) calculation of NAV, (ii) issue of shares, (iii) redemptions, and/or (iv) payment of redemption proceeds, with a view to lifting suspensions when market conditions improve
  - Implement suspensions indefinitely and liquidate/soft wind-down
  - Impose fund-level gate, i.e., delayed payment period as fund sells assets
  - Side pocket the illiquid investments and sell off illiquids over time
  - Create liquidating special-purpose vehicle for illiquids; all limited partners have pro rata interest in vehicle
  - Permit distribution or payment of redemption proceeds in kind



# Material Considerations

- Conflicts of interest
  - General Partner/Manager vs. Limited Partners
  - Redeeming Limited Partners vs. New or Continuing Limited Partners
- Breach of contract
  - Partnership agreement, side letters
- Consents
  - Obtaining of appropriate consents from investors
- Valuations
  - Pressure on valuations
  - Fairness opinions

# Valuation Issues

- Liquidity and valuation are inextricably linked
- Markets may be “liquid,” but at prices that are not necessarily the prices at which a manager would like to sell its assets
- Illiquidity and inability to value may lead to suspension and issues in calculating management fees and performance allocation
- Valuation policy
  - Assuming that the valuation policy is appropriate and functioning properly, ensure consistency between practice and policy
  - If the valuation policy is not functioning properly due to market conditions or otherwise, consider reviving the valuation policy accordingly and keep it consistent with practice

# Litigation and SEC Risks

- Litigation Risk
  - Breach of contract – potential conflict with side letter provisions regarding suspension, liquidation, side pockets, special-purpose vehicles, distributions in kind, etc.
  - Fraud in the inducement in connection with any representations by a manager made to encourage investment (or encourage withdrawal of redemption request) that turn out to be materially inaccurate
  - Claims that the funds were mismanaged
- SEC Risk
  - More activist SEC examination program post-Madoff
  - Consider self-reporting