THE REVIEW OF
SECURITIES & COMMODITIES REGULATION
AN ANALYSIS OF CURRENT LAWS AND REGULATIONS AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 54 No. 21 December 8, 2021

LIFE AFTER THE END OF THE LIFE OF A PRIVATE FUND

Private equity sponsors may find that as their funds approach the limits of their terms, they need more time and follow-on capital to achieve the best outcome for themselves and investors. In this article, the authors discuss the ins and outs of 10 different methods that have been used to achieve that result, from term extensions to preferred equity interests. In closing, they note the paramount importance of full disclosure and compliance with fund documentation.

By Victoria S. Forrester, Udi Grofman, and Matthew B. Goldstein *

As the private equity industry continues to mature, so does the menu of alternatives that private equity sponsors ("GPs") may consider as their funds reach the "end" of their "lives" upon the expiration of the funds' terms. The traditional "five-year" commitment period and "10-year" term have shown that in a maturing market exposed to various market cycles and dislocations, a rigid model can prove to be imperfect and, in some ways, ill-suited to aligning the interests of GPs with the investors in their private funds ("LPs"). In this article we will discuss strategies and structures that GPs may consider and may implement in their funds as they approach the end of the funds' terms, with a particular focus on the evolving GP-led secondary market. In the case of each of the alternatives described herein there are a number of legal, regulatory, and contractual considerations (including the terms of a fund's governing documents) to be taken into account.

Ordinarily, when a private fund approaches the end of its term, it will dispose of its remaining assets, make final distributions to its LPs, and wind up shortly thereafter. Evolving market cycles, the need for more time for portfolio companies to mature, and even the possibility that a GP could lose a company's management team to a competitor PE firm have shown that it is often impractical — and at times relatively economically inefficient — to wind up a private fund swiftly. Additionally, as a private fund approaches the end of its life, one or more of its portfolio companies may require follow-on capital to preserve value, achieve a targeted value, or to enhance an otherwise struggling company, or to achieve greater diversification across the fund's investments.

Often linked to the need for more capital is the need for more time. GPs may need more time than the prescribed "10-year term" in order to allow their investments to be liquidated at the valuations the GPs believe they can achieve. For example, exiting at a later date may permit monetizing one or several portfolio companies in a more attractive economic environment, may allow the GP's investment thesis more time to play out, or otherwise allow for portfolio companies to mature and appreciate in value. The economic split between GPs and LPs is another important consideration in respect of the alternatives discussed in this article, particularly since these economic incentives at the end of a private equity fund's life may not be aligned. More time often means more management fees and/or a

* *VICTORIA S. FORRESTER, UDI GROFMAN, and MATTHEW B. GOLDSTEIN are partners in the private funds practice at Paul, Weiss, Rifkind, Wharton & Garrison LLP. Their e-mail addresses are vforrester@paulweiss.com, ugrofman@paulweiss.com, and mgoldstein@paulweiss.com.*

INSIDE THIS ISSUE

● ***THE VOLCKER RULE: NEW EXCLUSION FOR QUALIFYING VENTURE CAPITAL FUNDS, Page 261***