Private Equity
Alert

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Coronavirus (COVID-19): Considerations for Private Equity Sponsors

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The global outbreak of the novel coronavirus pandemic (COVID-19) continues to adversely impact commercial activity globally, causing significant volatility and instability in financial markets throughout the world. The full extent of the global impact of the outbreak is still uncertain, and the reaction of governments throughout the world is quickly evolving. COVID-19 has already had and will continue to have serious implications on the global markets, including the private equity industry. Below are certain items related to the impact of COVID-19 for private equity sponsors to consider:

Fundraising Implications

- **U.S. Securities Filings and Non-U.S. Marketing Registrations.** Sponsors should expect that certain governmental offices, including Asian and European governmental branches, will be shut down or significantly delayed during the COVID-19 outbreak. This may make it difficult, if not impossible, for sponsors to register their funds in certain jurisdictions during their current fundraising periods, which may curtail certain fundraising efforts. Sponsors should make required filings as early as possible to avoid delays and communicate with their outside counsel to determine which jurisdictions are currently impacted and whether any filing extensions have been granted. For example, the U.S. Securities and Exchange Commission announced that, subject to certain conditions, Form ADV and Form PF extensions will be granted as a result of COVID-19 implications.
- **Meetings with Potential Investors and Diligence Days.** As the United States and other countries implement travel bans, and as various countries and cities impose lock downs or other quarantines, sponsors should expect that most in-person meetings will be delayed or canceled, thus impeding fundraising efforts. Sponsors should consider utilizing video teleconference meetings where possible and, if necessary, extending fundraising periods as described below.
- **Fundraising Time Periods.** In addition to in-person meeting and registration delays, many companies are imposing mandatory work-from-home policies, which could delay investors' investment committee meetings and internal diligence processes. Further, investors are likely to be focused on the broader impact of COVID-19 rather than their potential commitment to any single private investment fund. Sponsors should review their partnership agreement ("LPA") to determine the length of the fundraising period and the process for extending to the extent that may be relevant. See also "*Investor Responsiveness*" below.

- **Subsequent Closing Mechanics**. The typical closed-end style fund has each investor participate in all investments as if all investors participated in the first closing. However, to the extent a sponsor has already made investments in portfolio companies that have suffered material diminution in value as a result of COVID-19, subsequent closing investors are less likely to want to participate in such investments and sponsors may therefore have to choose between (a) lower-than-expected fundraising totals and (b) excusing subsequent closing investors from some or all existing investments or otherwise trueing up their participation in the fund in some way, which such action may require consent from existing investors.
- **Risk Factors.** Sponsors to consider including risk factor disclosure in private placement memoranda or supplements thereto outlining the significant risks to the fund, existing portfolio companies or potential portfolio companies related to COVID-19.

Ongoing Fund Implications

- **Portfolio Company Distress.** Quarantines, restrictions on travel, disruption in global supply chains and the volatility of global markets should be expected to impact a spectrum of industries, including many portfolio companies. In addition to checking in frequently with portfolio company management, sponsors should consider the following:
  - To the extent a sponsor plans to infuse cash into a portfolio company via an additional equity investment or debt, such sponsor should consult its LPA to confirm investment concentration limitations, follow-on investment limitations (both concentration and timing), borrowing restrictions and, with respect to debt, whether such investments are permitted and/or limited. Even if such action is not currently contemplated, consider reviewing such limitations in the event circumstances change and rapid action is required.
  - Portfolio companies may be delayed in providing tax and financial reporting. Sponsors should confirm reporting deadlines in their LPA and side letters so such obligations are properly contemplated.
  - To the extent the value of investments in portfolio companies are written down, it could impact the expected receipt of carried interest and/or result in a clawback. Sponsors to consider potential impact on their carry plans and whether additional reserves at that level might be prudent. In addition, certain funds are required to take write-downs into account when calculating management fee payments.
  - It is possible that sponsors may not believe it is in the best interest of the fund to sell a portfolio company during the COVID-19 outbreak even if a fund has reached the end of its term. Sponsors should consult their LPA to determine the length of the term of such fund and the process for extending it. To the extent a fund is in dissolution, consult with counsel to determine the fiduciary duties and obligations related to selling assets under such circumstances.
- **New Investment Opportunities.** Given the changing economic climate, certain sponsors may delay the acquisition of new portfolio companies or look to make strategic investments in new markets, jurisdictions or asset classes. Sponsors should review their LPA and related disclosure to confirm that any such new investment is permitted. For example, private equity sponsors may be increasingly inclined to make toe-hold or other investments in public securities given their distress, which such investments are often subject to a variety of limitations. Sponsors should also be mindful of their commitment period timing and the process for extending it, if required.
- **Subscription Facilities.** To the extent sponsors have subscription facilities, they should review the terms of their credit agreements to ensure the COVID-19 outbreak does not permit the lender to terminate the agreement or decrease the facility size. Consideration should also be given to whether drawing down on revolving facilities might be prudent given the circumstances.

- **Impacts on Limited Partners.** Travel restrictions, mandatory work-from-home policies and quarantines will likely impact limited partners' responsiveness. Specifically, investors' ability to execute consents, agree to amendments and make capital calls may be delayed. Certain investors may have "force majeure" or similar provisions in side letters that could excuse them from making capital contributions on time in the event of a pandemic such as COVID-19. Sponsors should give investors as much lead-time as possible to make any required capital contributions, execute documents and consider amendments and waivers and anticipate that certain investors may be delayed in responding. As an example, if a sponsor wants to make a toe-hold investment, lend a portfolio company capital or make a follow-on investment, in each case outside what is contemplated by their fund documentation, seeking waivers from limited partner advisory committees may take longer than would typically be expected, notwithstanding how timely the request might be.
- **Insurance**. Sponsors should carefully review insurance policies at the level of the management company, fund and portfolio companies to see what, if any, COVID-19-related disruptions and liabilities might be covered by existing insurance policies.
- **Business Continuity Plans**. In addition to acting in a manner consistent with applicable government regulations and recommendations, sponsors should also be complying with and reviewing their own business continuity plans. Further, sponsors should be checking in with key service providers to confirm that such service providers are continuing to provide consistent service in light of COVID-19. For example, sponsors that outsource their capital call and distribution notices a third party who is significantly disrupted by COVID-19 may find themselves unable to call capital in an efficient manner, which may be especially critical in such uncertain times.
- **Annual Meetings.** In addition to travel restrictions, many local and federal governments are cautioning against or banning large in-person gatherings. Consider whether to delay annual or other limited partner or limited partner advisory committee meetings or otherwise hold such meetings virtually instead of in-person. Sponsors should confirm any changes to meeting practices fall within the parameters of their LPA.
- **Investor Communications.** Finally, sponsors should ensure that amidst COVID-19 chaos, they are communicating effectively with their investors. Whether it is via a formal notice, special telephonic meeting or otherwise, sponsors should take care to explain to their investors the potential impacts of COVID-19 and the current economic climate on the sponsor, the fund and its investments and any mitigating actions the sponsor intends to take.

While the full impact of COVID-19 on the private fund sector is still to be determined, it has already caused IPOs to be delayed, potential deals to fall apart and fundraisings to be delayed. However, significant private equity transactions are being completed and material fund closings held, in each case notwithstanding the circumstances. Private equity sponsors should keep the above considerations in mind when thinking about their businesses and, above all, stay safe, secure and sane in this chaotic COVID-19 environment.

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