

Savvy PE Attys Can Cash In On Blazing Secondaries Market

By **Benjamin Horney**

Law360, New York (June 15, 2017, 3:21 PM EDT) -- The rising popularity of the private equity secondaries market is due in part to investors' desire for increased flexibility in their investment portfolios, and as the industry continues to make the subsector a priority, the need for attorneys who can capably advise on the intricacies of secondaries deals and funds is at an all-time high.

The private equity secondaries market involves the sale or acquisition of investors' existing interests in investment vehicles. The practice allows investors a chance to get out of investment commitments early in response to any number of issues, including regulatory or strategic changes, and is done for a variety of reasons, such as a general lust for liquidity or the ability to rebalance a portfolio.

"The market has gained new prominence in the last few years," said Loretta Shaw-Lorello, vice chair of Covington & Burling LLP's private funds practice and a partner in the firm's private equity practice.

The significant notoriety awarded to the private equity secondaries market can be traced back to the end of the global financial crisis, and private equity shop Collier Capital noted in a recent report that the volume of secondaries transactions today is two and a half times its pre-crisis peak in 2007.

"The earliest large transactions were after the crisis and were banks selling off portfolios," explained Stephanie Srulowitz, a partner in Weil Gotshal & Manges LLP's U.S. private funds practice. "As the market started to develop and become robust, the people buying in really liked it. Once those deals became popular, they started to be used as solutions by other types of investors."

The increasing popularity of the practice is also demonstrated by the fact that private secondaries funds were the second most popular type of PE investment vehicle in the first quarter of this year, accounting for \$14 billion of the roughly \$90 billion raised across all asset types, according to data from research firm Preqin.

"The first quarter of 2017 proved to be a landmark quarter for the secondaries industry, which continues to go from strength to strength," said Patrick Adefuye, head of secondaries products at Preqin. "Investors have committed a record level of capital to funds since the turn of the year with the potential for accelerated cash flows and outperformance of traditional private capital vehicles both proving to be driving factors behind the current market expansion."

The numbers establish that private equity secondaries are an up-and-coming market that should only continue to see more activity, meaning more lawyers are likely to look to the space as they seek an

increased workload and a diversified client list.

According to Kelly Labritz, a special counsel in Covington's corporate group and a member of the firm's private equity and private funds practices, working on secondaries transactions involves a combination of skills from multiple different practice types. In order to properly advise PE clients looking to do secondaries deals, you should be well-versed in the areas of mergers and acquisitions and private equity fund formation, she said — one or the other often doesn't suffice.

"It's a blending of those two disciplines," Labritz said. "I do know some people who are pure funds lawyers that have never done secondary transactions before, and it doesn't work out very well. You've also got M&A lawyers who think they can just jump in, but if you're not very familiar with fund structures, you're going to get lost too."

That's because there are issues specific to secondaries work that simply don't pop up during the course of regular fund formation or M&A work. Secondaries deals involve the transfer of investment interests that were already previously negotiated, and the details of transferring such interests can sometimes necessitate clever maneuvering from legal advisers.

"Generally speaking, fund agreements don't allow unfettered right to transfer," SruLOWITZ said. "It's almost always restricted."

Thus, it's important for attorneys to be prepared to navigate tricky negotiation situations in which they are looking out for their client's desires while also paying attention to the needs of the other side. It isn't just the selling party you're dealing with — it's also the other investors that contributed to the fund in the first place and the general partner of the fund itself.

"These sales are often conditioned upon the approval of the GP," explained William Sturman, a corporate partner at Covington and co-head of the firm's private funds and investments group. "And there's not a lot of incentive for the GP to consent."

For instance, he noted, it's reasonable for a general partner to question why they should negotiate terms at all since those terms were established at the outset of the fund and have already been agreed to by all of the other parties involved. On the flip side, however, GPs can be incentivized to accept some negotiation on terms because secondaries deals give them an opportunity to develop new relationships with investors whom they could potentially work with again down the road.

"Some GPs are very accommodating, and some are not," he noted.

It's still somewhat early in the era of private equity secondaries deals, but as the market matures and evolves, more lawyers will be needed to help come up with creative strategies for getting deals done. Those who pounce now and develop the necessary skills will be better suited to succeed and prosper than those who wait until the market is completely and totally established.

"The days of simple, easy secondaries deals is coming to an end, and now we need to get creative," Labritz said.

--Editing by Christine Chun and Aaron Pelc.

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