

# Checklist of Considerations for Private Equity Funds

APRIL 1, 2020

*This briefing was originally written on March 16 and was updated on April 1.*

Given these uncertain times, we've prepared a general summary of high-level matters for our fund clients to consider to help navigate this crisis. Obviously, this is a rapidly changing situation, and the discussion below may become outdated. **Accordingly, please use the below for general information purposes only and not legal advice. As always, please reach out with any specific questions or issues you have.**

## I. Fund-Level/partnership matters

- A. Consider whether any required notice provisions in LPAs or side letters have been triggered. Whether or not any notice provisions have been triggered, if you have not already done so, consider LP communications to convey manager's response to COVID-19 crisis.
- B. Review capital call lines to check availability. Typically, these lines would only be drawn in advance of a capital call.
- C. Consider providing guarantees to facilitate portfolio company borrowings, but take into account limitations imposed by LPA fund diversification provisions and borrowing restrictions.
- D. Consider the impact of COVID-19 on the valuation of your portfolio investments. Closely review the valuation procedures in your fund documents and compliance manual. Extra consideration will need to be taken when setting quarterly valuations. Consider consulting with the advisory board or outside service providers in connection with your valuation process.
- E. In light of potential significant declines in valuations, GPs should review existing fund documents to evaluate potential clawback and additional reserve obligations.
- F. Consider requesting LPs in private equity funds that are winding down or in liquidation to reallocate unfunded commitments into new funds as a way to underwrite new commitments.
- G. Consider seeking approval to revise fund documents to extend the commitment period or term of the fund; if the fund documents include an option to extend, consider exercising extension rights.

- H. In respect of any ongoing offerings, consider supplementing offering memoranda to address risks associated with COVID-19 (and similar contagion outbreaks) and its potential effects on the manager's business and the fund's investments.
- I. For registered investment advisers and exempt reporting advisers, consider addressing COVID-19 (and similar contagion outbreaks) risks in subsequent Form ADV amendments when otherwise due.
- J. Consider reviewing fund documents to determine whether investment objectives permit alternative investments, such as investing in securities of public companies, distressed investing, etc.
- K. Consider expanding insurance coverage applicable to the fund, GP, and/or manager and whether any claims are available under current insurance policies.
- L. Continue to monitor and address business continuity policies and procedures, including cybersecurity matters and vendor due diligence, in connection with business disruptions. Consider amendments to such policies and procedures once the COVID-19 crisis has passed in order to address key lessons learned.
- M. Review management fee provisions in fund documents and understand interplay with terms of management services agreements with portfolio companies in the event GP is considering deferring or waiving fees at either the portfolio company or fund level.
- N. Review default remedies under your fund documents and be prepared with options in the event of an LP default on capital calls.
- O. Consider providing alternatives to holding in-person LP meetings.
- P. Consider enhancing investor presentations and expanded use of technology that would allow for more virtual pitch meetings in lieu of in-person visits.

## II. NEW INVESTMENTS

- A. Consider the extent to which due diligence investigations (both business and legal) will need to be revisited to account for COVID-19-impacted issues (e.g., interruptions in supply chains, the potential inability of customers to make payment, the ability of the target company and its customers and suppliers to perform under material contracts, the adequacy of the target's insurance policies, etc.).
- B. Consider the impact on historical financial performance when determining deal value and the adequacy of normal levels of working capital.
- C. Understand that there will likely be limited availability of debt financing.
- D. It is likely that rep and warranty insurance policies will treat the impact of COVID-19 as an exclusion.
- E. The parties that support you in your transactions (financing, equity co-invest, rep and warranty insurance, and others) will likely expect a fulsome COVID-19 analysis—on both the supply side and the demand side—in order to support the transaction.
- F. Acquisition agreement terms viewed as “market” pre-COVID-19 may need to be reconsidered in light of the COVID-19 pandemic. For example, reps and warranties, financing covenants, interim operating covenants, conditionality, termination rights and remedies, MAE definitions, and special indemnities should be reviewed through a COVID-19 lens and adjusted accordingly.
- G. As we come out of this crisis, COVID-19 may actually “mask” other underlying business issues, so you will need to be more diligent in your legal and financial analysis following this crisis.

## III. DEALS IN EXECUTORY PERIOD

- A. Whether the impact of COVID-19 constitutes an MAE will need to be determined on a case-by-case basis. It is likely that the current situation would not constitute an MAE under the typical formulation. That said, this may

change depending on the length and severity of the crisis. While credit agreements typically use an MAE definition that is similar or mirrors the MAE definition in the acquisition agreement, credit agreements have a fixed and usually shorter duration than that of an acquisition and, therefore, lenders may analyze an MAE differently than acquirors and sellers.

- B. Prepare for the need to pay reverse termination fees if lenders do not fund when required.
- C. A target company's responses to COVID-19 may result in breaches of covenants during the executory period. For example, a target company may inadvertently breach the covenant to operate in the ordinary course of business as a result of its response to COVID-19.
- D. Analyze the extent to which other closing conditions may be affected (including the "bring-down of reps" condition).
- E. Consider the availability of termination rights in the purchase agreement.

## IV. PORTFOLIO COMPANY MATTERS

### A. Employment Matters

1. Depending on the portfolio company's business, consider allowing employees to work remotely, or whether there is a need for furloughs, lay-offs, pay reductions, or reductions in force.
2. If employees are working remotely, ensure procedures remain in effect to ensure data privacy and security.
3. Consider amending paid time off ("PTO") policies to provide for additional PTO for employees who cannot work remotely but are required to stay home from work. Legislation that went into effect on March 18, 2020 (the "Families First Coronavirus Response Act") requires employers of fewer than 500 employees to provide paid sick leave and expanded paid FMLA leave for certain COVID-19-related reasons; determining whether related entities can be aggregated for purposes of the 500-employee threshold may require legal analysis. For more information, please read "[Potential Impacts on Private Equity Funds and their Portfolio Companies from the Department of Labor's Preliminary Guidance on the Families First Coronavirus Response Act](#)."
4. Legislation signed into law on March 27, 2020 (the "CARES Act") has a significant impact on certain employment matters. State and federal laws, including those relating to employee privacy, family and medical leave, disability, discrimination, and the like must also be taken into consideration (e.g., OSHA, ADA, FLSA, FMLA, HIPAA, WARN, etc.). Examine the CARES Act distribution, withdrawal, and loan alternatives for qualified retirement plans. Additional Winston publications regarding the CARES Act can be found here:
  - a. [Benefits Blast Blog: Who CARES about Executive Compensation after COVID-19?](#)
  - b. [Executive Compensation Blog: Executive Compensation and Other Restrictions Under the CARES Act – TARP Redux?](#)
  - c. [Benefits Blast Blog: Employer Provisions in the Senate CARES Act](#)
  - d. [Benefits Blast Blog: COVID-19 Legislative Proposal Affecting Retirement Plans – Senate CARES Act](#)
5. Consider whether your portfolio company is eligible to take advantage of tax-deductible payments to employees under the Stafford Act. An additional Winston publication can be found here: [COVID-19 Tax-Free Section 139 Benefits: Silver Lining on the Cloud of a Novel Disaster](#)
6. Consider obligations under CBAs that may be impacted.
7. Certain state and federal employment laws may impose liability on shareholders and/or directors for unpaid employee obligations. This risk is heightened for shareholders and/or directors exercising operational control over the portfolio company's employment practices.
8. Consider implementing an emergency succession plan that identifies personnel who can serve as temporary or permanent replacements in the event that senior management personnel and/or board members contract

COVID-19 and are unable to fulfill management duties.

9. Consider whether incentive equity plans should be restructured in light of COVID-19's impact on portfolio company valuation and future prospects, including revisions to participation thresholds and/or performance vesting metrics.
10. Consider whether the portfolio company needs to provide necessary equipment and/or expense reimbursement to employees now working from home.

## **B. Financing**

1. Consider portfolio company liquidity needs, and whether it makes sense to draw down on revolvers now while in covenant compliance in case of difficulty borrowing in the future.
2. Consider financial covenant compliance issues and the extent to which relief from lenders, equity cures, and covenant resets may be necessary or available.
3. Consider any notice requirements under credit agreements that may be triggered.
4. Boards of portfolio companies with solvency concerns may need to consider creditor interests in addition to equity holder interests in the exercise of their fiduciary duties.
5. Consider seeking additional EBITDA add-back flexibility that expressly permits add-backs for lost revenue due to closing or curtailing business.
6. Monitor deposit account balances and consider whether lenders may have set-off rights against such accounts.
7. Review grace periods to cure defaults under credit agreements and consider entering into forbearance agreements and amendments to address such defaults.
8. Consider whether your portfolio company can access small business loans or other loans under the CARES Act. Portfolio companies owned by the same fund will likely be deemed affiliates for purposes of calculating employees to determine if such portfolio companies qualify as small businesses. In addition, an analysis of who controls portfolio companies that are set up as special purpose vehicles outside of the fund will need to be conducted to determine whether such portfolio companies are affiliated with the fund. Additional Winston publications can be found here:
  - a. [Investment Funds and SBIC Briefing: Investment Senate Passes SBA Paycheck Protection Loan Program](#)
  - b. [COVID-19: FAQs on SBA Assistance to Small Businesses](#)
  - c. [Private Equity Briefing: Economic Stabilization and Assistance](#)
  - d. [COVID-19: SBA Paycheck Protection Program Update - SBA and Treasury Department Publish Loan Program Details and Application](#)

## **C. Tax Stimulus** Consider whether your portfolio company is eligible for other tax deductions or benefits under the CARES Act. Additional Winston publications can be found here:

1. [Tax Briefing: Tax Provisions in the CARES Act's Phase Three Stimulus in Response to COVID-19](#)
2. [Summary of Tax Provisions in the CARES Act's Phase Three Stimulus in Response to COVID-19](#)

## **D. Operational Matters**

1. Review material contracts for notice requirements and timing.
2. Consider the impact of an inability to perform by the portfolio company or the counterparty.
3. Consider the impact of travel restrictions on sales.
4. Portfolio companies should consider the impact of the federal Worker Adjustment and Retraining Notification Act (the "WARN Act") before closing locations or instituting a mass layoff. It is unclear at this time whether the notice requirements under the WARN Act will be exempted as a result of the effects of the Coronavirus.

Portfolio companies may also be subject to state “mini-WARN” law obligations, though there is an exception to the notice requirement under the WARN Act and certain state mini-WARN laws for unforeseeable business circumstances.

5. Review contracts for provisions that may be implicated by COVID-19, including termination rights, force majeure provisions, and events of default.
6. Consider the impact of delaying payments due under material contracts to the extent necessary to preserve portfolio company liquidity.
7. Consider adding COVID-19 warnings and disclaimers to marketing materials and contracts, particularly for businesses that host customers on portfolio company premises.
8. Consider impact of COVID-19 on portfolio company audits (e.g., restrictions on site visits, timing to deliver audited financial statements to lenders and equity holders, and the potential of receiving a “going concern” qualification).

## E. Insurance Matters

1. Review the portfolio company’s insurance policies to determine the extent of available coverage, and take note of notice obligations and timing thereof.
2. Note that under these circumstances, depending on the terms of the policy, business interruption insurance policies may not provide adequate coverage for all potential losses.
  - a. As of the date of this publication, Massachusetts, New Jersey, and Ohio have introduced legislation to force insurance companies to pay business interruption claims **EVEN** if the policy includes pandemic or virus exclusions (which many companies put in the policies after SARS). If this legislation passes in any of these states, other states may follow. You should have your insurance brokers closely monitor these developments.
3. Examine whether coverage under other policies (such as workers’ compensation, property, professional liability, event cancellation, environmental, and pollution policies) is available.
4. Review the need to add additional policies and coverage. This review should assume that new policies will likely add disease-related exclusions.

## F. Regulatory Matters

1. Coordinate and communicate with regulatory authorities to the extent changes in operations impact regulatory oversight or authorizations.
2. Expect longer lead times to receive regulatory approvals from governmental entities.
3. Consider establishing regulatory monitoring responsible parties to stay apprised of developments related to new governmental restrictions and legislation providing aid and other financial relief to businesses.

We would be happy to provide more detailed information or advice with respect to any of the foregoing, as well as information tailored to your specific circumstances and facts. Please also let us know if you are not currently receiving Winston & Strawn client alerts, and we will make sure to have you included.

Please feel free to contact any of the individuals below or your Winston & Strawn relationship attorney if you have any questions.

10 Min Read

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