USA – DELAWARE

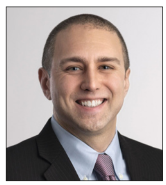
Trends and Developments

Contributed by:
Joshua J. Novak and Drew G. Sloan
Richards, Layton & Finger

Richards, Layton & Finger has shaped Delaware law since 1899 and remains at the forefront of the state's evolving corporate practice. As a multidisciplinary firm, Richards, Layton & Finger offers clients a broad range of experience and regularly handles nationally prominent matters. The firm contributed to drafting and amending key Delaware business statutes, including the General Corporation Law of the State of Delaware, Delaware Limited Liability Company Act, Delaware Revised Uniform Limited Partnership Act and Delaware Statutory Trust Act. Its lawyers authored and maintain two leading treatises: Delaware Law of Corporations and Business Organizations, and Lubaroff & Altman on Delaware Limited Partnerships. The firm's lawyers and alumni have served in the Third Circuit, US District Court and Delaware Court of Chancery, and in Delaware leadership roles: chief justice of the Supreme Court, governor and secretary of state. Richards, Layton & Finger is Delaware's Lex Mundi member and part of SCG Legal and USLFG.

Authors

Joshua J. Novak advises clients on a wide range of transactions involving Delaware general partnerships, limited partnerships, limited liability companies and series entities. He counsels clients throughout the entity life cycle, from formation to termination, and advises private investment funds on formation, operations, wind-downs and related matters. His practice also encompasses securitisations and other structured finance transactions, mergers and acquisitions, fiduciary-duty issues, contract interpretation, governance, IPOs, asset sales and Delaware legal opinions. Josh is a contributor to Lubaroff & Altman on Delaware Limited Partnerships and regularly presents on Delaware LLC and partnership law.



Drew G. Sloan advises clients on Delaware alternative-entity matters, with a focus on private equity funds and structured finance transactions. He provides counsel and legal opinions on formation, operational and governance matters involving Delaware limited partnerships and limited liability companies, as well as mergers, acquisitions, conversions and dissolutions, as well as investment fund, structured finance, joint venture and financing transactions. He previously served as vice chair of the American Bar Association's Real Property, Trust & Estate Law Section Partnerships and Limited Liability Companies Committee. Drew served as an editor of the 2024 edition of Delaware Laws & Programs Affecting Business.

Richards, Layton & Finger, P.A.

One Rodney Square
920 North King Street
Wilmington, DE 19801

Tel: 302.651.7700
Fax: 302.651.7701
Email: media@rlf.com
Web: www.rlf.com

RICHARDS LAYTON & FINGER

Growing Liquidity Crunch and Illiquid Assets: Addressing End-of-Life Issues in Delaware Funds

A record amount of private equity capital currently sits in funds that many investors expected to have fully wound up years ago. As of the end of 2025, the net asset value (NAV) of US private equity assets held in funds at least a decade old was USD348.5 billion, about three and a half times what it had been in 2015 (Mark Maurer, "Private-Equity Assets Stuck in 'Zombie Funds' Are at a Record High", *Wall Street Journal* (21 July 2026)). These funds are becoming increasingly common. Sponsors that acquired portfolio companies and other assets at 2020 and 2021 multiples and financed at rates near 0% may struggle to find buyers willing to pay those prices today (Id.). Exit activity is still running well below the 2021 peak, and distributions as a share of NAV have fallen to record lows (Patrick Warren et al., "Private Capital in Focus: Depressed Distributions, No End in Sight", MSCI (22 May 2025); Daniel Hadley, "Night of the Living Fund: The Rise of Zombie Private Equity", MSCI (12 May 2025)). A sponsor holding assets it believes may be worth more than today's bid must decide whether selling now best serves its investors' interests.

What makes these situations challenging to resolve, though, is the inability of even the most diligent parties to draft fund agreements that contemplate every possible scenario. Fund agreements drafted over a decade ago did not contemplate today's economic reality, making the decision of how to dispose of a fund's "illiquid" assets more difficult. This article addresses issues, and potential solutions, from a Delaware law perspective, with a particular focus on private equity funds formed as Delaware limited partnerships.

The end of a fund's term

Section 17-801 of the Delaware Revised Uniform Limited Partnership Act ("Delaware LP Act") outlines the rules governing the end of the term of a Delaware limited partnership. Specifically, Section 17-801 provides that, amongst other times, a fund dissolves and begins to wind up its affairs at the time specified in a partnership agreement, but if no such time is so set forth, it has perpetual existence. Further, Section 17-1101 (c) of the Delaware LP Act provides that it is the policy of the Delaware LP Act to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements. As such, sophisticated business parties take great effort in drafting fund agreements to specifically provide for mechanics around critical events in the lifespan of an investment fund, including fundraising, management, distributions and disposition of assets.

Drafting options are virtually unlimited when preparing a fund agreement, and the term and end-of-life provisions are no exception. It is common to see a finite term, with the possibility of extension upon obtaining various approvals. Often, the general partner (GP) can unilaterally extend the term of the fund for one or two years, with further extensions possible with advisory committee or limited partner consent.

However, what often gets overlooked is the timing of winding up the fund's affairs, including the disposition of its assets. Under Section 17-803 (b) of the Delaware LP Act, upon dissolution of a Delaware limited partnership, the persons winding up the fund's affairs shall "gradually settle and close the limited partnership's business, dispose of and convey the limited partnership's property", and take other actions to bring the affairs of the fund to a close. Delaware law affords broad flexibility to the GP or other persons winding up the limited partnership's affairs, and does not, as a default matter, prescribe a fixed timeframe during which the winding up must be completed (6 Del. C. §17-803 (b); see *Techmer Accel Holdings*, *LLC v Amer*, 2010 WL 5564043, at *4 (Del. Ch. Dec. 29, 2010) (noting "the possible lengthy duration of the winding up period")). Delaware law does not require assets to be sold at fire-sale prices during winding up, and GPs often are given leeway to hold on to assets until market conditions improve or a reasonable buyer can be located. This is where careful fund agreement drafting can play a critical role.

Many fund agreements lack definitive provisions with respect to the time in which a fund's activities must be wound up. For investors seeking to extract their capital from the fund, this can create myriad issues. Equally problematic for GPs is a prescribed period of time in which the winding up must be completed, as market conditions and other factors may make it increasingly difficult to dispose of certain fund assets for adequate consideration. This latter concern may also affect the fund's limited partners, as requiring the fund to dispose of assets within a certain period of time could lead to selling assets at a steep discount.

Concerns as fund end of life approaches

As is the case with most actions taken by GPs on behalf of a fund, consideration of fiduciary duties is paramount in determining how to most effectively dispose of fund assets at the end of its term. While primarily driven by the precise language of the fund agreement, which, under the Delaware LP Act, may expand, restrict or eliminate fiduciary duties, at base, sponsors are tasked with maximising value and investor returns according to the business realities as they exist at the time of sale.

One potential issue we regularly see as a fund's term nears its end concerns the sponsor's entitlement to management fees. While some fund agreements provide that management fees cease upon the dissolution of the fund, others are drafted such that the sponsor will continue to receive management fees until the winding up of the fund has been completed. Both approaches have potential advantages and disadvantages.

For example, a fund sponsor that ceases to receive management fees during the winding-up process may not be incentivised to "work for free". This could be especially true if the fund has underperformed and the sponsor is not receiving any carried interest. Such a scenario could also lead to the fund becoming a so-called "zombie fund", where employees of the sponsor have moved on to new ventures, making it more difficult for the fund to facilitate and oversee the disposition of its remaining assets. Conversely, a fund sponsor that continues to earn management fees until the fund is terminated may give rise to concerns about competing incentives with respect to the length of time it takes to dispose of all of the fund's assets.

Careful drafting and creativity may help address this problem. For instance, a fund agreement could be drafted to provide a financial incentive to complete the winding up sooner rather than later. This could take various forms, including a one-time incentive fee, a step-down in the management fees paid each year of winding up, or a financial penalty in the event that the winding up process is not completed within a stated period of time. Another drafting option, in either the fund agreement or a side letter, could be to obligate the sponsor to purchase an investor's interests in the fund if the winding up process is not completed within a set amount of time. Of course, issues regarding the valuation of the illiquid assets could lead to disputes over the purchase price of the applicable investors' interests, but such a provision could be a viable option that benefits both the investors (by giving them liquidity) and the sponsor (by allowing it to hold on to assets it believes have higher value than current market conditions offer).

Another area of focus implicated at the end of a fund's term involves investor side letters. These heavily negotiated documents can address such topics as management fees, reduction in carried interest, and timing and/or consent rights relating to dissolution and winding up of a fund. GPs navigating the asset disposition phase of a fund will need to carefully consider these side letter agreements to determine the proper path forward. Additional thought and care might also be warranted, from both the sponsor's and the investor's perspectives, at the time of negotiation of side letters for purposes of specifically addressing these increasingly common end-of-life issues.

Market-evolved solutions – the continuation vehicle/GP-led secondary

Often, fund sponsors see potential in a particular investment that may take time to fully realise – time that an existing fund may not have due to the expiration of its term. In such a scenario, continuation vehicles, often referred to as "GP-led secondaries", may provide the best solution – a path for the sponsor to continue to retain the investment while giving investors the opportunity to cash out. In a GP-led secondary transaction, a fund sponsor will create a successor fund to acquire the applicable assets from the existing fund and give the existing investors the option to exit their investment or to continue as investors in the successor fund.

According to a recent article, GP-led secondary transactions now represent almost half of all secondary transactions, growing at a compound annual growth rate of approximately 30% from 2017 to 2025 (Victor

Ko, “Private Equity Secondaries: From Niche to Necessary”, Neuberger (27 March 2026)). This growth has “been the defining growth driver” in the broader secondaries market, which saw a nearly 48% increase in transaction volume from 2024 to 2025 (Id.). However, these GP-led secondaries do not come without their own set of particular issues.

As discussed above, GPs and fund sponsors are often subject to fiduciary duties under Delaware law, absent any modifications thereto contained in the fund’s partnership agreement. These GP-led secondaries can implicate the duty of loyalty, as the sponsor is on both the buyer and seller sides. Such a scenario can put the sponsor in a difficult position – its duties may obligate it to get the highest price for the existing fund assets, while its role as sponsor of the successor fund lead it to seek the best price possible for the successor fund purchasing the assets.

One potential solution to this tension is to build a fiduciary duty cleansing mechanism into the fund agreement. While limited partner advisory committees (LPACs) can be hesitant to act or take on significant responsibility, case law that has evolved in the publicly-traded Delaware master limited partnership (MLP) context may warrant an increased role for LPACs in this context.

In the MLP space, conflicts committees, consisting of independent directors unaffiliated with the sponsor, are often tasked with negotiating transactions between the MLP and the sponsor on the MLP’s behalf. The partnership agreement governing the MLP will, in connection with the conflicts committee’s role, provide extensive provisions addressing the functioning of the conflicts committee and the favourable consequences to the sponsor that securing conflicts committee approval can achieve. These provisions include:

- a rebuttable presumption that when acting, the conflicts committee has done so in good faith;
- contractually defining what “good faith” means; and
- providing that any resolution or course of action by the MLP’s GP or its affiliates in connection with any conflict of interest shall be permitted and deemed approved by all of the MLP’s partners, and shall not constitute a breach of the MLP’s partnership agreement, any other agreement contemplated in the MLP’s partnership agreement, or of any duty stated or implied by law or equity, if the resolution or course of action in respect of such conflict of interest is approved by the MLP’s conflicts committee.

With such a provision, the sponsor may gain comfort that it may avoid a successful fiduciary duty claim, and investors benefit since the terms of the conflicted transaction were negotiated and agreed to by disinterested individuals who considered the interests of the investors (see *Morris v Spectra Energy Partners (DE) GP, LP*, 2017 WL 2774559 (Del. Ch. 27 June 2017);*Allen v Encore Energy Partners, L.P.*, 72 A.3d 93 (Del. 2013);*Brickell Partners v Wise*, 794 A.2d 1 (Del. Ch. 2001)). Delaware courts will hold parties to the process and contractual terms they agreed to in writing, so a clearly drafted provision in a fund agreement addressing conflicts of interest could benefit both the sponsor and the fund’s investors.

Another option involving these GP-led secondaries is to build authorisation for such secondaries into the fund agreement at the outset. While this route is perhaps the most logical approach, in practice it can prove to be much more difficult. As the last decade or two have taught us, it is difficult, if not impossible, to predict the future with any high degree of accuracy. Market conditions can quickly change, sponsors can be acquired, and other significant events that are impossible to predict may occur. Consequently, building in such authorisation may be most useful when coupled with a degree of flexibility (and perhaps coupled with cleansing mechanisms similar to those in the MLP conflicts committee context discussed above).

Court oversight

Finally, from an investor’s point of view, if all else fails and the sponsor is unsuccessful in disposing of the remaining fund assets in a timely manner, the investor may apply to the Delaware Court of Chancery to wind up the fund’s affairs. Under Section 17-803 (a) of the Delaware LP Act, the Delaware Court of Chancery, upon cause shown, may wind up the partnership’s affairs itself or appoint a liquidating trustee to do so.

However, such an endeavour can be costly, as it will likely involve litigating the circumstances by which court involvement is sought. Incurring such costs may not be prudent, especially when considering the potentially limited value and illiquidity of any remaining assets.

Final thoughts

As a fund enters its end-of-life stage, disposition of its illiquid assets can create significant issues for both investors and the sponsor. As the total amount of capital invested in private equity funds significantly increases each year, these issues are only likely to be exacerbated over time. Critically considering these issues while drafting the fund agreement can offer real benefits for all involved, and incorporating some of the concepts discussed above may help to ease these burdens down the road.

The views expressed in this article are those of the authors and not necessarily of Richards, Layton & Finger or its clients.