

**Southpaw Asset Management LP**  
**Part 2A of Form ADV**  
**The Firm Brochure**

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Two Greenwich Office Park  
Greenwich, CT 06831  
Telephone: (203) 862-6200  
[www.southpawassetmanagement.com](http://www.southpawassetmanagement.com)

Southpaw Asset Management LP is an investment adviser that is registered with the United States Securities and Exchange Commission. Registration with the United States Securities and Exchange Commission does not imply a certain level of skill or training.

**This brochure provides information about the qualifications and business practices of Southpaw Asset Management LP. If you have any questions about the contents of this brochure, please contact us at (203) 862-6200. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.**

**Additional information about Southpaw Asset Management LP is also available on the SEC's website at: [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

## Material Changes

We last updated Part 2 of Form ADV in July 2011. Our business activities have not changed materially since the time of that update.

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## Advisory Business

Southpaw Asset Management LP, a Delaware limited partnership, provides discretionary investment advice to privately offered pooled investment vehicles and institutional accounts. Clients' investment mandates generally give our firm broad discretion to invest across asset classes and industry sectors. We seek to preserve capital while generating attractive risk-adjusted returns by dynamically allocating capital across investment strategies, sectors, and asset classes. On behalf of our clients, we may invest across capital structures, including, among others, bank debt, corporate bonds (high yield and investment grade), convertible bonds, trade receivables, trade claims, swaps, promissory notes, preferred stock and common stock.

The privately offered pooled investment vehicles that we manage (our "private fund clients") have a master-feeder structure, and we do not tailor investments by our private fund clients to meet the individual needs of investors in the pools. We also manage separate accounts on behalf of several clients, and our investment advisory services for these accounts may be tailored extensively depending on each client's investment mandate.

Southpaw Asset Management LP was founded in 2005 and is wholly owned by Howard Golden and Kevin Wyman. As of December 31, 2011, our firm had discretionary regulatory assets under management of \$1,354,618,994. We do not manage any client assets on a non-discretionary basis.

An affiliate of our firm, Southpaw GP LLC, serves as the general partner to two of our private fund clients.

## **Fees and Compensation**

For our private fund clients, management fees and performance-based compensation that we, or an affiliate of ours, collect equal 2% per year and 20% of gains, respectively. We deduct management fees from investors' capital account balances at the beginning of each quarter. For our private fund clients that are partnerships, our performance-based compensation is typically structured as a profit-sharing allocation through a general partner interest held by one of our affiliates. Each investor in our private fund clients is subject to a performance allocation at the end of each year or upon a withdrawal, but only with respect to the withdrawn amount. Our performance-based compensation is subject to a cumulative loss carryforward restriction, or "high water mark," which means we only receive a performance profit allocation when an investor's account value for the year has recovered any losses since the last profit allocation we received.

Certain initial or "seed" investors in our private fund clients pay discounted management fees pursuant to supplemental agreements or "side letters." Also, investors in our private fund clients who are associated with our firm, such as our officers or employees, or their family members or friends, generally do not pay management fees or incur performance fees. Fees for our private fund clients are otherwise generally not negotiable.

In addition to the management fees and any performance-based compensation, clients also bear various other fees and expenses, including, among others, legal costs, accounting and audit fees, research-related fees and expenses, interest on borrowings, administrative expenses, custodial fees, and commissions and other trading costs. Investors in our private fund clients indirectly bear their *pro rata* share of these costs, as well as other expenses that are described in our private fund clients' offering documents. We describe trading costs in greater detail in the subsequent "Brokerage Practices" section of this brochure. Although investors in our private fund clients who are affiliated with our firm do not pay management fees or performance-based compensation, they do pay their *pro rata* share of our private fund clients' operating costs.

We generally do not permit investors in our private fund clients to withdraw capital other than at the end of a quarter, so refunds of prepaid fees for partial quarters are not applicable to investors in our private fund clients. We assess investors that contribute capital on a date other than the beginning of a quarter a pro-rated management fee based on the amount of time that the capital will be invested during the quarter.

Management fees on our managed accounts currently range from 1% to 2% of net assets of the account, but these are negotiable based on the scope of our services. Performance-based compensation that we charge our managed account clients typically equals 20% of net profit, subject to a high water mark, but again, performance-based compensation may be negotiable. Although our managed account clients typically pay their management fees at the end of each month or quarter and their performance-based fees at the end of each year, if a client with a separately managed account that pays in advance terminates its advisory relationship with our firm at a time other than the end of a month or quarter or the end of a year, we will calculate and

refund any unearned prepaid fees. After providing our managed account clients with invoices, we may deduct fees they owe us or they may pay us the fees owed, depending on each individual arrangement.

## **Performance Based Fees and Side-by-Side Management**

Our firm, or our affiliate, receives performance-based compensation from our private fund clients. To the extent that any separately managed accounts do not pay performance fees, we could have an incentive to favor our private fund clients when allocating investment opportunities. Similarly, if different private fund clients have investors with different high water marks for purposes of calculating incentive allocations, we could have an interest in favoring the fund with investors that are most likely to pay performance fees. The potential to earn performance-based compensation could also give us an incentive to invest client assets in an aggressive or speculative manner. Finally, performance fees are based in part on unrealized gains and losses, so we may have an incentive to inflate the value of client assets through fair valuation determinations. Despite the presence of these conflicts of interest, we seek to act fairly when we allocate investment opportunities and value client assets. Our firm has adopted written policies and procedures that are designed to ensure fair allocations and valuations over time. Current and prospective clients and investors are invited to discuss our allocation and valuation policies and procedures with us.

As noted above, our firm has entered into side letter arrangements with a group of initial investors in our private fund clients. These arrangements grant the initial investors discounted fees, enhanced withdrawal rights, and enhanced reporting regarding our private fund clients' performance, investments, and operations, among other things. The side letter arrangements also include "most favored nation" provisions that allow the initial investors to receive the benefit of any modification or waiver of terms given to another investor in the same fund. These side letter arrangements could advantage the initial investors at the expense of other investors.

To the extent that we manage separate accounts that trade in parallel with our private fund clients, beneficial owners of the separate accounts are likely to have information about our investment activities that is more detailed and timely than the information we provide to investors in our private fund clients. Timely access to our firm's trading information could advantage separate account owners at the expense of investors in our private fund clients.

## **Types of Clients**

Our firm provides investment advisory services to our private fund clients, which generally require a minimum initial investment of \$5 million per investor. This brochure is not an offer to invest in our private funds. Any offer to invest in our private funds will only be made through the provision of their confidential offering documents. Our private funds are not registered under the Securities Act of 1933 or the Investment Company Act of 1940.

We also manage separate accounts on behalf of institutional investors or high net worth individuals, particularly when they are seeking management for a sufficiently large pool of assets. We may manage our separate accounts in ways that are similar to our private fund clients, in ways

that are designed to liquidate relatively illiquid securities over an extended period of time, or in other ways.

## **Methods of Analysis, Investment Strategies and Risk of Loss**

On behalf of our clients, we generally employ a dynamic long-short credit strategy by creating diversified portfolios of loans and fixed-income instruments of predominantly North American issuers. However, at times, we also invest in equity securities and securities of issuers located in other regions. We target our investments in securities that we believe exhibit a meaningful disparity between their intrinsic value and their market value.

Our firm sources investment ideas internally, as well as from officers' and employees' extensive networks of industry professionals. Our investment personnel conduct qualitative and quantitative research, which can include reviews of an issuer's financial statements, capital structure, industry comparables, industry trends, evaluations of management, and discussions with competitors, suppliers and distributors. However, our investment professionals' review of a particular investment opportunity may be limited, and may not include the processes described above, particularly in connection with certain event-driven and capital structure arbitrage investments.

While we seek to preserve clients' capital, all investing involves a risk of loss. Certain risks associated with an investment in any client we advise include:

- *Investing in Undervalued or Overvalued Securities:* A primary aspect of our investment strategy involves making long investments in securities that we believe are undervalued and shorting investments that we believe are overvalued. However, there can be no assurances that the securities will in fact be undervalued, or overvalued, and thus these investments are rather speculative. In addition, our clients may need to hold the securities for a long time before realizing their anticipated value. During this period, a portion of our clients' funds will be committed to these securities, thus possibly preventing our clients from investing in other opportunities.
- *Event-Driven Investments:* On behalf of our clients, we often select investments based on an anticipated catalyst (industry-wide or company-specific). The underlying business generally plays little or no role in the objective and perceived risks associated with the investment. Catalysts can include liquidations, litigation, mergers, tender and exchange offers, restructurings, regulatory events, legislative actions, and asset sales, among other things.

Event-driven investing requires making predictions about the likelihood that an event will occur and the impact such event will have on the value of a company's securities. If the event fails to occur or its effect was not foreseen, losses can result. For example, the adoption of new business strategies or completion of asset dispositions or debt reduction programs by a company may not be valued as highly by the market as anticipated, resulting in losses. In addition, a company may announce a plan of restructuring which promises to enhance value and fail to implement it, resulting in losses to investors. In liquidations and other forms of corporate reorganizations, the risk exists that the

reorganization either will be unsuccessful, will be delayed or will result in a distribution of cash or a new security, the value of which will be less than what we paid for it. The consummation of mergers and tender and exchange offers can be prevented or delayed by a variety of factors, including: (1) opposition of the target company's management or shareholders, which will often result in litigation to force the proposed transaction; (2) intervention of a governmental or other regulatory agency; (3) efforts by the target company to prevent the impending transaction, including a merger with, or a friendly tender offer by, a company other than the offeror; (4) in the case of a merger, failure to obtain the necessary shareholder approvals; (5) market conditions resulting in material changes in securities prices; (6) compliance with any applicable securities laws; and (7) inability to obtain adequate financing.

Because of the inherently speculative nature of event-driven investing, our clients' results may fluctuate from period to period. Accordingly, investors should understand that the results of a particular period will not necessarily be indicative of results that we expect to obtain in future periods.

- *Opportunistic Investing:* Opportunistic investing entails utilizing capital where it is needed most, mostly in complex, deep value situations. For example, it might be opportunistic to invest in companies that are in distress, selling assets, leaving or entering new businesses or changing their capital structures. Similar to event-driven investing, opportunistic investing is highly speculative and results can fluctuate significantly over time.
- *Capital Structure Arbitrage:* Engaging in capital structure arbitrage entails making investments that seek to capitalize on situations where the pricing of different types of securities within the capital structure of the same company become dislocated due to overreactions to specific credit or industry news, or macro factors such as capital flows or world events, among other things. In effecting a capital arbitrage strategy, we typically buy a company's bank debt and sell short the same company's corporate bonds. The primary benefit of making long investments in a company's bank loans is that, if the company goes into bankruptcy or liquidation, it is legally required to pay its bank debt prior to other claims on assets, such as corporate bonds. Our ultimate goal is for the bank debt to increase in value, while the corporate bonds decrease in value. However, if instead these securities move in opposite directions than we anticipated, our clients may incur substantial losses.
- *Leverage/Borrowing:* We may borrow against the assets of our clients when we believe that the proceeds from doing so will exceed the interest paid on the borrowing. Borrowing involves risk to our clients because the interest on the borrowed amount may be greater than the income from or increase in the value of the securities purchased with the borrowed amount. Also, the value of the securities purchased with the borrowed amount can decline below the amount borrowed.

Any investment profits made with the proceeds from borrowings in excess of interest paid on the borrowings will cause the income and value of a client to be greater than would otherwise be the case. On the other hand, if the value of the additional securities

purchased with the borrowed money does not increase enough to cover the interest paid on the borrowings, then the income and value of a client will be less than would otherwise be the case. Generally, borrowing-type techniques used to increase potential returns are all forms of leverage. We do not currently employ leverage to make investments, but rather we typically utilize borrowed bonds to cover securities sold short (see below for a discussion of short selling securities).

- *Hedging Transactions:* Our clients may, at times, engage in hedging transactions. Employing hedging techniques reduces a portfolio's vulnerability to various risks. Hedging entails determining certain risks in one's portfolio and making trades to offset those risks. For instance, if an investor buys stock in a company, it may also short the stock of a competitor company. Hedging against a decline in the value of a portfolio position does not eliminate fluctuations in the values of portfolio positions or prevent losses if the values of such positions decline, but rather it establishes other positions designed to gain from those same developments, thus moderating the decline in the portfolio positions' value. On the other hand, hedging transactions also limit the opportunity for gain if the value of the portfolio position should increase.

The success of a client's hedging strategy is subject to our portfolio managers' ability to correctly assess the degree of correlation between the performance of the instruments used in the hedging strategy and the performance of the investments in the portfolio being hedged. There is a risk that we may not always choose the right variable to hedge against. For example, a client may own stock in an oil and gas company and bet that the price of oil will fall as a hedge, only to find out that the company's main asset is gas. Also, it is important to note that we may not always choose to hedge against, or might not anticipate, certain risks, and, our clients' portfolios will always be exposed to certain risks that cannot be hedged.

Loss of the ability to hedge, from either a change in the law or an inability to borrow a security when necessary, may result in losses to our clients from the resulting unhedged exposure or depreciation in the retained instrument's value.

Many other investment strategies we employ can be used as hedging techniques, such as options, swaps and short selling (all discussed below).

- *Equity Securities:* Our portfolio managers buy undervalued equity securities, seeking to profit from both security selection and thematic sector or market timing decisions. The value of these investments will generally vary with their issuer's performance and movements in the equity markets. Consequently, our clients may suffer losses if they invest in equity instruments of issuers whose performance diverges from our expectations or if equity markets generally move in a single direction and we have not hedged against such a move.
- *Short Selling:* Short selling of securities occurs when we borrow securities, promising to buy them at a later date. If the price drops, we can buy the securities at the lower price and make a profit on the difference. If the price of the securities rises, we have to buy them back at the higher price, and the investment loses money. Buying the securities can itself

cause the price of the securities to rise further which would exacerbate the potential for loss.

- *Fixed-Income Securities:* Some of our clients invest in bonds or other fixed-income securities. Fixed-income securities provide periodic returns and the eventual return of the principal at the end of the term. The value of fixed-income securities changes in response to interest rate fluctuations and market perception of the issuer's ability to pay off its obligations. Fixed-income securities are also subject to the risk that their issuer may be unable to make interest or principal payments on its obligations.
- *High Yield Securities:* Debt securities (including bonds) and preferred securities in which our clients invest may or may not be rated by credit rating agencies. If they are rated, such ratings may range from the very highest to the very lowest. Securities rated below investment grade normally provide a yield that is significantly higher than that of investment grade securities, but are quite speculative for reasons enumerated below. The lower-rated categories include debt securities that are in default and debt securities of insolvent issuers. The rating that a credit rating agency assigns to a security does not reflect an assessment of the volatility of the security's market value or the liquidity of an investment in the security. The values of lower-rated securities (including unrated securities of comparable quality) fluctuate more than those of higher-rated securities because investors generally believe that there are greater risks associated with them. In addition, the lower rating reflects a greater possibility that the financial condition of the issuer, or adverse changes in general economic conditions, or both, or an unanticipated rise in interest rates, may impair the ability of the issuer to make payments of principal and income. The inability (or perceived inability) of issuers to make timely payment of interest and principal would likely make the values of our clients' securities more volatile and could limit their ability to sell the securities at prices approximating the values we had placed on such securities. In addition, the market prices of lower-rated securities are likely to be more volatile because: (1) an economic downturn or increased interest rates may have a more significant effect on the yield, price and potential for default; and (2) past legislation has limited (and future legislation may further limit) investment by certain institutions in lower-rated securities or the tax deductibility of the interest by the issuer, which may adversely affect the value of such securities. Our clients will not necessarily dispose of a security when its rating is reduced below its rating at the time of purchase.
- *Distressed Debt and Securities:* Distressed debt refers to bonds and other forms of securities issued by a company that is undergoing bankruptcy or reorganization or is likely to do so in the near future. Distressed bonds will have low ratings as discussed above. The debt securities of distressed corporations are often overly discounted by the market, as risk adverse investors tend to sell securities due to an actual or potential bankruptcy filing. These situations can create attractive buying opportunities for investors specializing in valuing distressed securities. Our clients purchase these instruments with the anticipation that the company will emerge from its financial difficulties and become profitable again. In the interim, the purchase of the debt allows the new shareholders or bondholders to actively participate in the process of reorganizing the company as it attempts to position itself for a return to profitability. The risk of investing in distressed debt and securities is that the subject company's projected performance never takes place. When this is the case,



the stocks and bonds that our clients bought may become worth less than the amount initially paid for them, resulting in a loss. In some instances, however, particularly in the case of senior debt and other preferred claims, the ability to realize upon such claims successfully during a liquidation may also turn out to be profitable investment opportunities.

On the other hand, when investing in distressed debt, the amount and timing of payments, if any, by the debtor can be uncertain. Receiving late or incomplete loan payments can adversely affect our clients' return.

In addition, when investing in the securities of companies involved in bankruptcy proceedings or reorganizations, we may have a more active participating in the affairs of the issuer than investors typically assume. In connection with these activities, our clients risk being involved in litigation or being unable to dispose of the defaulted securities. As a creditor in a bankruptcy or other proceeding, we may be unable to enforce our clients' rights in any collateral or may have our clients' security interest in any collateral challenged, disallowed or subordinated to the claims of other creditors. While we will attempt to avoid taking actions that could lead to lender liability or equitable subordination claims (discussed immediately below), we cannot assure clients or investors that these claims will not be asserted or that we will be able to successfully defend against them.

- *Mezzanine Debt:* Our clients may invest in mezzanine loans from time to time. Mezzanine loans are an option a company might utilize when its real estate is already being used to secure a primary loan, but the company has a need for a secondary loan. This type of loan is secured not by the real estate, but by the stock belonging to the company that owns the property. Companies generally use mezzanine loans when they have to raise a large amount of money for expansions or for other types of large expenditures.

There are certain risks associated with investing in mezzanine loans. First, it is likely that our clients' mezzanine investments will be subordinate to the borrower's more senior debt, and if the borrower defaults under the more senior loan, the lenders of the more senior loan will have preferential claims over those of our clients. In this case, the borrower's assets would first be used to repay the senior lender, so there is the risk that all or substantially all of the borrower's assets will be unavailable to repay our clients and other subordinate lenders. In addition, if our clients attempt to enforce a borrower's obligations, our clients could be subject to a borrower's claims of breach of contract or other unfair lending claims. If a borrower goes bankrupt, our clients also run the risk of being roped into bankruptcy proceedings which can be costly and lengthy. Lastly, there can be no assurance that a borrower will repay its mezzanine loans or that our clients will ultimately be able to collect on any of the collateral pledged for the loans.

- *Bank Debt and Loan Participations:* Some of our clients may invest significant amounts in bank loans and participation loans. Participation loans are large loans made by multiple lenders to a single borrower. Investing in these loans involves unique risks such as: (1) the possible invalidation of an investment transaction as a fraudulent conveyance to defer, hinder or defraud creditors under creditors' rights laws; (2) environmental liabilities that

may arise with respect to collateral securing the loans; and (3) limitations on our clients' abilities to enforce their rights with respect to participation loans. In addition, participating in loans exposes our clients to potential lender liability claims, which are claims under which borrowers allege that their lenders are not treating them fairly. Lender liability claims are based on the premise that a lender has violated a duty of good faith and fair dealing owed to a borrower or has assumed a degree of control over a borrower resulting in the creation of a fiduciary duty owed to the borrower or its other creditors or shareholders.

In addition, under common law principles that form the basis for lender liability claims in some cases, if a lender (1) intentionally takes an action that results in the undercapitalization of a borrower to the detriment of a borrower's other creditors; (2) engages in other inequitable conduct to the detriment of a borrower's other creditors; (3) engages in fraud with respect to, or makes misrepresentations to, a borrower's other creditors; or (4) uses its influence as a stockholder to dominate or control a borrower to the detriment of a borrower's other creditors, a court may elect to subordinate the claim of the offending lender to the claims of the disadvantaged creditors, a remedy called "equitable subordination."

- *Investing in Loans Generally:* When investing in any type of loan, there is always the risk that a borrower made a material misrepresentation or omission in the process of obtaining the loan. This inaccuracy or incompleteness can adversely affect the valuation of the collateral underlying the loan and/or can adversely affect our clients' ability to perfect or effectuate a lien on the collateral securing the loan.
- *Commercial Mortgage-Backed Securities:* Commercial mortgage-backed securities are interests in packages of mortgage loans that are backed by commercial property, such as apartments and retail shops. Typically, mortgage loans on commercial properties are structured so that a substantial portion of the loan principal is payable at maturity (rather than during the course of the loan term). Thus, repayment of the loan principal often depends on the future availability of real estate financing and/or the current value and salability of the real estate. If real estate financing is unavailable at that time or borrowers are unwilling to refinance or dispose of encumbered property to pay off the loans, the loans may default.

Most commercial mortgage loans underlying mortgage-backed securities are nonrecourse obligations, which means that there is no recourse against the borrower's assets other than confiscating and selling the property (foreclosure). Foreclosure can be costly and delayed by litigation or bankruptcy. When considering factors such as the property's location, the legal status of title to the property, the property's physical condition and financial performance, environmental risks and governmental disclosure requirements with respect to the property's condition, a third party may be unwilling to purchase the property at a foreclosure sale or pay a price sufficient to satisfy all of the borrower's obligations. In addition, the borrower may always retain any revenues from the underlying property or use the revenues to pay others, maintain insurance, pay taxes or pay maintenance costs. Such diverted revenue generally cannot be recovered without a court-appointed receiver to control cash flow related to the property.

- *Convertible Securities:* Convertible securities are bonds, debentures, notes, preferred stocks or other securities that can be converted into or exchanged for a specified amount of common stock of the same or a different issuer within a particular period of time at a specified price or formula. The holder of a convertible security typically receives interest or a dividend until the security matures or is converted or exchanged. Convertible securities are unique in that they generally (1) have higher yields than common stocks, but lower yields than comparable non-convertible securities; (2) are less subject to fluctuation in value than the underlying security due to their fixed-income characteristics; and (3) provide potential for capital appreciation if the market price of the underlying security increases.

The value of a convertible security is a function of its “investment value” and its “conversion” value. A convertible security’s investment value is determined by its yield in comparison to yields of other securities of comparable maturity and quality that do not have a conversion privilege. Changes in interest rates influence a convertible security’s investment value, as investment value declines as interest rates increase and vice versa. The issuer’s credit standing and other factors may also affect the convertible security’s investment value. A convertible security’s conversion value is determined by the market price of the underlying security. If the conversion value is low relative to the investment value, then the investment value principally governs the price of the convertible security. As the market price of the underlying security approaches or exceeds the conversion price, the conversion value will increasingly influence the price of the convertible security.

A convertible security generally will sell at a premium over its conversion value by the extent to which investors place value on the right to acquire the underlying security while holding a fixed-income security. Typically, the amount of the premium decreases as the convertible security approaches maturity.

A convertible security may be subject to redemption at the issuer’s option. If one of our clients’ accounts holds a convertible security that its issuer redeems, this could adversely affect our client’s ability to achieve its investment objective.

- *Municipal Bonds:* A municipal bond is a debt security issued by a state, municipality or county to finance its capital expenditures. Municipal bonds are generally exempt from federal taxes and from most state and local taxes.

The ability of municipal issuers to make timely payments of interest and principal may be diminished during general economic downturns and as governmental cost burdens are reallocated among federal, state and local governments. State constitutions or laws may limit the taxing powers of any governmental entity and an entity’s credit will depend on many factors, including the entity’s tax base, the extent to which the entity relies on federal or state aid, and other factors beyond the entity’s control.

Issuers of municipal securities may seek protection under Chapter 9 of the U.S. Bankruptcy Code. Although similar to other bankruptcy proceedings in some respects, municipal bankruptcy is significantly different in that it does not contemplate liquidation of the assets of the municipality and distribution of the proceeds to creditors. Municipalities must voluntarily seek protection under bankruptcy; creditors cannot

commence municipal bankruptcy proceedings. Due to limitations placed upon the power of the bankruptcy court in Chapter 9 cases, the bankruptcy court generally is not as active in managing a municipal bankruptcy case as it is in corporate reorganizations. The bankruptcy court cannot appoint a trustee nor interfere with the municipality's political or governmental powers or with its properties or revenues, for example by ordering reductions in expenditures, increases in taxes, or sales of property, without the municipality's consent. In addition, the municipality can continue to borrow in the ordinary course without bankruptcy court approval if it is able to do so without affecting the rights of existing creditors. Neither creditors nor courts may control the affairs of the municipality indirectly by proposing a readjustment plan that would effectively determine the municipality's future tax and spending decisions, so our influence over any bankruptcy proceedings would be very limited. In the event of bankruptcy of a municipal issuer, our clients could experience delays in collecting principal and interest, and may not be able to collect all principal and interest to which they are entitled.

Revenue bonds issued by state or local agencies to finance the development of low-income, multi-family housing involve special risks in addition to those associated with municipal securities generally, including the risk that the underlying properties may not generate sufficient income to pay expenses and interest costs. These bonds are generally non-recourse against the property owner, may be junior to the rights of others with an interest in the properties, may pay interest that changes based in part on the financial performance of the property, may be prepayable without penalty and may be used to finance the construction of housing developments which, until completed and rented, do not generate income to pay interest. Additionally, unusually high rates of default on the underlying mortgage loans may reduce revenues available for the payment of principle or interest on such mortgage revenue bonds.

- *Promissory Notes:* We may, at times, purchase, or purchase an interest in, promissory notes. Promissory notes are a type of debt instrument issued by companies seeking to raise capital. In return for the loan, companies agree to pay investors a fixed return over a set period of time. Similar to other forms of debt, promissory notes carry the risk that the issuers may not be able to meet their obligations. Even promising, smart public companies can stumble because of competition, bad management decisions, or unfavorable market conditions. If a company's financial health weakens suddenly, it may not be able to pay interest and/or principal owed to our clients.

In addition, promissory notes with terms of nine months or shorter are not required to be registered with any governmental authority. Since these notes are not subject to regulatory review, there is a risk that they may be issued under a fraudulent scheme, in which case an investor may lose a part or all of its investment.

- *Trade Receivables and Trade Claims:* Trade receivables are a type of securitized debt backed by the amounts due to a business following the sale of goods or services to an individual or another company. However, they are unsecured in that there is no underlying hard asset that can be repossessed in the event of non-payment. Two key features of trade receivables investments are that they are short term (typically a 60-day or

less turn around) and non-interest bearing. The quick payment rate of trade receivables means that investors are continuously exposed to the changing fortunes of the obligor.

Trade claims are unsecured rights of payment arising from obligations other than borrowed funds. Trade claims include vendor claims and other receivables that are adequately documented and available for purchase from high yield broker-dealers.

The performance of trade receivables and trade claims depends in part on the obligor's current financial condition, competitive position in its industry and strategic direction. Investors in trade receivables and trade claims are also exposed to the risk of dilution, which occurs when the amounts invoiced by the obligor are reduced for reasons other than payment or default (for example, the return of goods, invoice errors, product disputes over quantity, quality or delivery). Finally, as with all debt investments, there is always a risk that the obligor may default on its payments.

- *Swaps and Other Derivatives:* At times, our clients may invest in swaps and other forms of derivative contracts. A derivative is a financial instrument that is a contract between two parties, the value of which is linked to another security or commodity, or an "underlying asset." Most of the derivatives in which we may trade are over-the-counter, meaning they are privately negotiated between two parties, as opposed to being traded on an exchange. Over-the-counter transactions typically involve significant transaction costs.

A swap is a type of derivative in which counterparties agree to exchange one stream of cash flow for another, each stream being based on an underlying asset. For example, an investor realizing returns from an equity investment can swap those returns into less risky fixed income cash flows without having to sell its equities. Swaps are particularly sensitive because various market variables affect the values of the cash flows, causing them to fluctuate.

Any derivative contract typically involves leverage, as it exposes our clients to potential gain or loss from a change in the price of an underlying asset in an amount that exceeds the amount of cash or assets required to establish or maintain the derivative contract. Consequently, an adverse change in the price of the underlying asset can result in a loss to our clients that is more exaggerated than would have resulted from an investment that did not involve the use of leverage inherent in a derivative contract. Finally, derivative contracts are risky because, ultimately, their success depends in part on the counterparty's financial condition, that is, the counterparty's ability to turn over the cash flow it promised.

- *Options:* There are risks associated with the sale and purchase of options. Our clients may invest in call and/or put options. Call options are the right to buy a security at a certain price within a defined time period. Put options are the right to sell a security at a certain price within a defined time period. A buyer of either type of option assumes the risk of losing its entire investment in the option. A buyer of a call option risks losing its investment if the particular security never reaches the designated price within the set time period. A buyer of a put option risks losing its investment if the particular security does not decline enough to reach the designated price within the set time period.

- *Investing in Small Capitalization Companies:* Market capitalization is a measurement of a company's size equal to the share price times the number of shares outstanding (shares that have been authorized, issued and purchased by investors). From time to time, we may invest some of our clients' assets in the securities of small capitalization companies and recently organized companies. Historically, these securities have been more volatile in price than those of larger capitalized, more established companies. Small capitalization and recently organized companies' securities pose greater investment risks because the companies may have limited product lines, distribution channels and financial and managerial resources. Further, there is typically less publicly available information concerning such companies than for larger, more established businesses. In addition, the small capitalization companies' securities may not be traded in the volumes typical for larger companies, and thus it may take longer to sell such securities or we may have to accept potentially less favorable purchase prices. Ultimately, investing in companies with limited operating histories is more speculative and entails greater risk than does investing in companies with an established operating record.
- *Private Placements:* Our clients may invest in securities that are subject to restrictions on resale because they have not been registered under the Securities Act of 1933 or that are otherwise not readily marketable. Limitations on the resale of these securities may have an adverse effect on their marketability, and may prevent our clients from being able to dispose of them promptly at reasonable prices. Our clients may have to bear the expense of registering the securities for resale and the risk of substantial delays in effecting the registration.
- *Foreign Securities:* While investing in foreign securities is not a principal focus of our clients' investment strategies, we may occasionally buy and sell foreign securities for our clients' accounts. Investing in foreign securities involves certain risk factors not typically associated with investing in U.S. securities, such as fluctuation between exchange rates and the costs of converting from one currency to another. In addition, there may not be much information available regarding foreign securities because foreign companies and governments may not be subject to accounting, auditing and financial reporting standards and requirements comparable to those of the U.S. There also might be a greater risk of political, social or economic instability and the possibility that foreign taxes may be imposed on our clients' income. Finally, when investing in foreign bonds, there is always a risk that their issuer will default and be unable to pay the interest and/or principal payments due on the bonds, as the financial stability of foreign issuers may be more precarious than that of U.S. issuers.
- *Short-Term Trades:* Short-term trading involves a certain degree of risk. Short-term trading denies a client the strategy of minimizing risk by holding a position over a longer time period. In addition, frequent trading results in high turnover and brokerage commission expenses which can adversely affect a client's performance if its trading is not sufficiently profitable.
- *Limited Number of Investments:* At times, our clients may only participate in a limited number of investments. Consequently, the success of each of those clients could be substantially adversely affected by the unfavorable performance of a single investment.

## **Disciplinary Information**

Neither our firm nor any of our employees has been involved in any legal or disciplinary events in the past 10 years that would be material to a client's evaluation of our firm or our personnel.

## **Other Financial Industry Activities and Affiliations**

Southpaw Asset Management LP and Southpaw GP LLC are controlled by the same owners. As noted previously, Southpaw GP LLC serves as the general partner to two of our private fund clients. Our private fund clients do not have independent management, and while our offshore fund clients have a majority of independent directors, we hire and retain those directors. Although this arrangement may give us heightened control and discretion over our private fund clients, we manage any potential conflicts of interest by strictly adhering to the investment strategy and investment allocation policy discussed in their offering documents.

Neither our firm, nor any of our officers or employees, has any other industry affiliations or outside business activities that would be material to a prospective client or investor's evaluation of our firm.

## **Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

Our firm has adopted and implemented a written Code of Ethics that is designed to ensure that our firm and our employees understand the need to abide by all applicable securities laws and regulations, put the interests of clients ahead of their own interests, report any perceived violations to our Chief Compliance Officer, and avoid even the appearance of insider trading. Our Code of Ethics requires employees to obtain pre clearance for any personal trading activity involving securities other than mutual funds and exchange traded funds (ETFs). Under certain circumstances, employees may hold personal investments in the same securities that our clients hold. These personal investments could be in the same or different portions of an issuer's capital structure. If such an investment poses a conflict of interest, we will seek to act in a way that favors the interests of our clients. Furthermore, our Chief Compliance Officer will not approve any requests for personal trading authorization that are expected to give even the appearance of being adverse to the interests of our clients. Upon request, we will provide any current or prospective client or investor with a copy of our Code of Ethics.

Our firm and our officers and employees are strictly prohibited from engaging in insider trading. Under certain circumstances, we may determine that we, or one of our employees, have obtained, or may have obtained, material non-public information. Our firm maintains a "restricted list" that is designed to prevent our clients, officers, and employees from engaging in insider trading. Our firm's use of a restricted list and caution in connection with potential exposure to material non-public information may limit clients' investment opportunities.

Although we do not currently effect them, our clients generally give us the ability to engage in cross trades, which occur when one client purchases a security from another client that is selling the same security. Cross trading may give rise to a conflict of interest because cross trades are not

independently negotiated and may provide an opportunity for an investment manager to collect related commissions. However, should we decide to effect cross trades between clients in the future, our firm has adopted policies that employees must follow in order to mitigate any associated potential conflicts of interest. First, prior to executing a cross transaction, the employee recommending the trade must prepare a memorandum explaining the reasons why the transaction is suitable for each client involved. The memorandum must be signed by a supervisor of the employee who prepared it and initialed by our Chief Compliance Officer, and we will maintain copies of the memorandum in the appropriate client files. Second, the cross transaction must be effected for cash consideration at a price determined based on objective data. Employees may not cross trade restricted securities or securities for which market quotations are not readily available. Clients must not pay any brokerage commissions, fees (except for customary transfer fees), or other compensation to our firm or any affiliate of ours in connection with any cross transaction.

Our firm's officers and employees may invest personally in our private fund clients. These investments could pose a conflict of interest with our other clients because officers and employees may be motivated to allocate time, attention, and/or investment opportunities to our private fund clients at the expense of other clients. We have adopted written policies and procedures governing the allocation of investment opportunities, and will seek to treat all clients fairly over time.

## **Brokerage Practices**

### Selecting and Compensating Trading Counterparties

Our firm has discretion to select the counterparties used to trade clients' accounts. However, many of our clients' investments involve securities with limited liquidity, so there are often few trading counterparties available to execute our intended trades.

We seek to obtain best execution on behalf of our clients based on a variety of factors, including:

- Net transaction prices, which may include implicit or explicit transaction costs;
- A counterparty's ability to execute the intended trade in a timely manner;
- A counterparty's ability to execute large or difficult orders;
- The perceived quality of a counterparty's back office operations and the frequency of errors; and
- A counterparty's ability to preserve the confidentiality of our trading activities.

We do not consider client or investor referrals when selecting trading counterparties.

Our Chief Compliance Officer and Portfolio Managers meet quarterly to evaluate the execution quality we have obtained on behalf of clients.



In certain instances, we may execute over-the-counter securities transactions through an agency broker, which may cause clients to incur commissions and mark-ups or mark-downs.

Southpaw may receive proprietary research from trading counterparties, but the receipt of this research is not a factor in Southpaw's best execution analyses. Southpaw believes that the proprietary research that it may receive is widely distributed among financial services firms, is not provided contingent upon any specific volume of trading, and does not impact the trading costs borne by clients.

#### Aggregating Transactions

If more than one client is trading the same security on the same day, we generally seek to aggregate the orders so that all participating clients receive the same average price and pay their *pro rata* share of any transaction costs. We typically allocate partially filled orders *pro rata* based on the size of each participating client's initial order. However, we may deviate from our general allocation policy to avoid de minimus position sizes, or in other circumstances if our Chief Compliance Officer determines that a deviation is fair to all affected clients.

#### Directed Brokerage Arrangements

Our clients generally do not direct us to trade through any particular counterparty. A client's insistence on the use of one or more particular counterparties in connection with the trading of its account can have a materially adverse effect on the quality of execution that is available to the client. Among other things, clients that direct our use of trading counterparties may pay higher transaction costs, be excluded from aggregated orders, and trade after our other clients have traded.

### **Review of Accounts**

Our firm's Portfolio Managers, Kevin Wyman and Howard Golden, review our client accounts on an ongoing basis. Our Portfolio Managers set price targets and risk parameters, such as maximum position sizes, expected holding periods, sector exposure, geographic exposure, and liquidity. Our Portfolio Managers review reports on a daily basis that show clients' investments, associated risk measurements, and position-level profits and losses.

Our review processes may vary materially to the extent that separately managed account clients have positions or investment mandates that differ significantly from those of our private fund clients. For example, our review processes are likely to differ from those of our private fund clients for separately managed account clients that retain us to advise on the liquidation of a preexisting pool of securities with limited liquidity.

Our firm's reports to clients vary. Investors in our private fund clients receive monthly written updates, as well as annual audited financial statements and tax information. The monthly updates often include information about the applicable fund's performance, key drivers of returns, macroeconomic analysis, and various measures of the fund's exposures. We work with our separately managed account clients at the inception of each relationship to establish an appropriate reporting schedule.

As noted previously, we have entered into side letter arrangements with certain seed investors in our private fund clients. These arrangements call for additional reporting information that is not routinely provided to other investors. Upon request, we will provide investors with lagged information about our private funds' holdings, as well as more current information about general portfolio characteristics, such as measures of concentration, return, and volatility.

## **Client Referrals and Other Compensation**

As disclosed in our private fund clients' confidential offering documents, our firm and an affiliate of ours pay a private bank a portion of the management fees and performance-based compensation we receive from investors that the private bank referred to us.

## **Custody**

We are deemed to have custody of our private fund clients' assets because of the authority that we and our affiliate have over our private funds' assets. We will also be deemed to have custody of other clients' assets to the extent that we can automatically debit fees.

Our private fund clients' cash and securities are generally held by banks and broker/dealers that meet the definition of a "qualified custodian" under the SEC's "custody rule." Certain fund assets, such as bank debt, trade claims and some investment contracts, are uncertificated and are not reflected on the books and records of our private fund clients' qualified custodians. However, our private funds' auditor reviews all of their assets on an annual basis. Each year, all investors in our private funds receive our private funds' audited financial statements.

With respect to separately managed accounts, clients can choose a qualified custodian to hold their funds and securities. These clients' qualified custodians send trade confirmations and account statements directly to the separately managed accounts' beneficial owners. Separately managed account owners should carefully review these statements and compare them to any account statements or other information that we provide to them.

## **Investment Discretion**

Our firm has discretion to invest our private fund clients' assets as we believe is appropriate and in the funds' best interests. Before accepting their subscriptions for interests, we provide all investors in our clients with offering documents that set forth, in detail, the relevant client's investment strategy and program. By completing our subscription documents to acquire an interest in one of our private funds, investors give us complete authority to manage their investments in accordance with the offering documents they each received.

With respect to separately managed accounts, the terms of their advisory contracts generally grant us discretionary trading authority. Granting us discretionary trading authority often requires a client to execute a limited power of attorney.

## **Voting Client Securities**

We typically have the authority to vote proxies on behalf of the client accounts that we manage. Pursuant to Rule 206(4)-6 under the Investment Advisers Act of 1940, our firm has adopted written policies and procedures governing our proxy voting practices. Among other things, these policies and procedures call for our Chief Compliance Officer and our Portfolio Managers to work together to determine appropriate ways in which to vote client securities.

If a conflict of interest arises between our firm and our clients in connection with a proxy vote, we will seek to vote the proxy in the way that favors the interests of our clients. Our Chief Compliance Officer may consult with outside legal counsel regarding the appropriate response to proxies that pose material conflicts of interest.

Current and prospective clients and investors can receive information about our proxy voting policies and procedures by contacting our Chief Compliance Officer, Bob Thompson, at (203) 862-6200. Clients and investors may also obtain information about the ways in which we voted their respective proxies by contacting Mr. Thompson.

## **Financial Information**

Our firm has never filed for bankruptcy and we are not aware of any financial condition that is expected to affect our ability to manage client accounts.