Private Equity Manager Settles SEC Proceeding over Accelerated Monitoring Fees and Other Practices

As part of the SEC's continued focus on private equity manager fee and expense practices,[1] the SEC recently settled another accelerated monitoring fee proceeding[2] against four affiliated private equity fund managers, alleging that the acceleration of monitoring fees and certain other practices were inconsistent with Advisers Act fiduciary and other obligations. According to the Consent Order:

- Each private fund manager entered into monitoring agreements with portfolio companies that permitted it to accelerate monitoring fees upon either the sale or initial public offering ("IPO") of the portfolio company and covering periods beyond the relevant fund's complete exit of the portfolio company and the cessation of monitoring services. Although the manager had made some related disclosures of these practices in distribution notices, reports to the relevant fund advisory boards and IPO filings for certain portfolio companies, the SEC noted a lack of pre-commitment disclosure to fund investors.[3]

- The SEC also alleged (1) a fund financial statement disclosure inadequacy related to a fund general partner tax loan's interest treatment and (2) a lack of adequate manager supervision when a former senior employee of the manager, in instances over a multi-year period, improperly charged personal expenses to the manager's private funds and fund portfolio companies in violation of the manager's compliance policies. While the manager had informally reprimanded the employee, and in each instance received reimbursement from the employee, the manager took no additional formal remedial or disciplinary steps.

After considering the firm's remedial acts and cooperation, including its initiative in reviewing improper expenses and self-reporting to the SEC staff, the SEC required that the manager pay $40.3 million of disgorgement and prejudgment interest relating to accelerated monitoring fees and $12.5 million in civil penalties.

In light of the SEC's ongoing and detailed focus on private equity managers and their fee and expense practices, managers should continue to review their practices against the disclosures made to investors at the time of commitment, and to consider carefully appropriate remedial steps in cases of personnel non-compliance, particularly for repeat violations.

1 Previously discussed in a *KirklandPEN*, October 13, 2015.

2 See Press Release and Consent Order, August 23, 2016.

3 The monitoring fees were offset partially against the funds' management fees. In simultaneously granting the firm's application for public company regulatory relief (see No-Action Letter), the SEC appears not to object to the manager's receipt of accelerated monitoring fees in the absence of pre-commitment disclosure if (1) the manager obtains prior approval from the relevant fund's authorized limited partner advisory committee or (2) the relevant limited partnership agreement provides for a 100% management fee offset.

If you have any questions about the matters addressed in this *Kirkland AIM*, please contact the following Kirkland attorneys or your regular Kirkland contact.

Tier 1 Investment Fund Formation and Management: Private Equity Funds

The Legal 500 US, 2016

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