



KIRKLAND & ELLIS LLP

Private Equity Newsletter

“Pay-to-Play” Arrangements and Placement Agent Involvement with Public Pension Funds Subject to Nationwide Investigations

PENpoints

Recent investigations into and indictments for alleged “pay-to-play” activities have brought scrutiny upon the relationship between placement agents and state pension and other public plan investors.

Private investment fund sponsors, institutional investors, broker-dealers and other participants in the private funds industry are facing uncertainty and new concerns as a result of the industry-wide investigations into so-called “pay-to-play” arrangements and the use of placement agents or finders in connection with obtaining investments from state pension and other public plan investors.

The recently announced investigations by the New York State Attorney General (NYAG) and the SEC are increasing scrutiny on the relationship between placement agents and state pension and other public plan investors. Up to 36 states are considering a new joint task force created this month to probe pension fund abuse and placement agent arrangements, supplementing a number of existing investigations, subpoenas and indictments at the state and federal levels. The scope of these actions is growing on an almost daily basis.

New York Investigations

The NYAG has indicted or garnered guilty pleas from several individuals in connection with an alleged “pay-to-play” scheme involving designated “finders” who purported to secure private fund investments by the New York State Common Retirement Fund (NYSCRF), including the former Chief Investment Officer of the New York State Comptroller’s Office and a founding partner of the advisory firm Aldus Equity. The Aldus founder was charged with state securities fraud for allegedly paying kickbacks to a top political adviser to the former New York State Comptroller in exchange for

business with NYSCRF. The New York State Comptroller separately filed a civil lawsuit against Aldus seeking damages and the return of more than \$5 million in management fees paid in respect of \$375 million in capital commitments made by NYSCRF to a fund-of-funds known as the “Aldus/NY Emerging Fund.” The NYAG also issued more than 100 subpoenas to private fund sponsors and other private equity industry participants seeking information about placement agents used in connection with investments by NYSCRF and the five New York City pension plans.

In addition, a new New York State Comptroller policy prohibits NYSCRF from investing in private funds using placement agents or other third parties to “assist” in obtaining an investment by NYSCRF. Because the language of the ban is ambiguous, NYSCRF may be prohibited from making investments in private funds using a placement agent for any purpose.¹ The New York State Comptroller has concluded that private fund sponsors do not need placement agents because all private fund sponsors will be afforded “open access” to the NYSCRF investment staff and placement agents are not part of NYSCRF’s investment decision-making process. In order to secure NYSCRF as an investor, private funds sponsors must make legal representations that a placement agent was not used and grant NYSCRF withdrawal rights that may be exercised if such representations include a material misstatement or omission.

Federal Response

The SEC is coordinating its placement agent investigations with the NYAG, and has filed civil charges against Aldus Equity, its founding partner and others seeking permanent injunctions against future federal securities law violations, fines and disgorgement of ill-gotten gains (with interest). The SEC also announced it intends to reissue its proposed rule from the late 1990s banning “pay-to-play” political contributions by investment managers.² In addition, the FBI recently questioned New Mexico investment fund officials, including the State Investment Council’s (SIC) director of private equity, regarding potential placement agent abuses. The questioning focused in part on how the SIC conducted transactions, Aldus’ role in SIC investments and SIC’s actions after learning of the NYAG investigation.

Other States Follow Suit

Several other states with investment plans holding large alternative investment portfolios (e.g., California, Illinois, New Mexico, Texas and Connecticut) have also increased their scrutiny of placement agent arrangements. Examples of this enhanced focus include:

- Formal inquiries and requests for information regarding use of placement agents and the terms of such arrangements;
- Explicit bans on or suspensions of the use of placement agents (e.g., Illinois and New Mexico);
- New or enhanced disclosure requirements;
- Registration of placement agents; and
- Termination or official review of contracts with public plans’ private equity advisors.

On May 11, CalPERS adopted an extensive placement agent disclosure policy that applies to all new commitments as well as to prior commitments for which the term of the agreement is extended, the CalPERS’ commitment is increased or there is an amendment to the substantive terms (e.g., fees or compensation to fund sponsor).

In contrast, several other state pension and

public plan investors have made an initial assessment of these events and, in response, have announced publicly that they will not take (e.g., Massachusetts, Pennsylvania and Washington) or will delay taking (e.g., Maryland and New Jersey) action with regard to their placement agent policies.

Key Areas of Investigative Focus

To date, the investigations are largely focused on non-disclosure or inadequate disclosure of the use of placement agents; placement agents using fees to make improper “kickback” payments; actual or apparent conflicts of interests between placement agents and public pension fund decision-makers; use of unregistered broker-dealers; and improper influence over public officials through contributions to charities, political campaigns or other parties.

To acquire the information necessary to address these issues, the queries from government officials largely follow a common pattern focusing on:

- Which private fund sponsors used which placement agents, for what reason and in what manner?
- What fees were paid to placement agents and for what services?
- How did private fund sponsors come to retain certain placement agents?
- Did private fund sponsors conduct adequate due diligence regarding placement agents?
- When and how were payments to placement agents disclosed to investors?

Managing Your Response

In connection with these investigations, fund sponsors and investment managers may receive subpoenas, investigatory inquiries and other requests for information, as well as questions from investors or the media. If you receive a subpoena or investigative inquiry or otherwise become aware that you may be involved in a placement agent investigation, then it is important to quickly and thoughtfully assess how to respond. In addition to formulat-

ing a strategy for processing specific inquiries, key issues to consider include:

- Preservation and production of documents and assessment of whether documents may become subject to disclosure laws;
- Assessment of potential liability and other exposure;
- Development/enhancement of internal and external communication strategies, including specific on-topic responses;
- Analysis of adequacy of internal compliance policies and procedures;
- Review of status of potential changes in state laws applicable to your firm; and
- Determination of level of engagement in public discussion over policy and regulatory changes.

¹ In response to the New York State Comptroller's action and as a result of the use of "finders" by private funds in which New York City pensions previously invested, two of the five New York City pension plans have "suspended the use" of placement agents, firms and middlemen in investments by the pension plans; however, it is unclear what the suspensions encompass and details have not been made available.

² If the new rule is similar to the SEC's previous proposal, it would prohibit investment managers and their employees who recently contributed to an elected official from providing any investment advisory services to a public plan connected to such official, including managing such pension or other public plan money in a private fund.

If you have any questions about the matters addressed in this Kirkland PEN article, please contact the following Kirkland authors or your regular Kirkland contact.

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EPA Offers Enhanced Incentives to Encourage Self-Reporting by Purchasers

The U.S. EPA recently announced an expansion of its so-called "Audit Policy" to encourage new owners of regulated facilities to voluntarily disclose and correct environmental violations in exchange for reduced penalties. Notably, eligible "new owners" include not only buyers of assets but also buyers of stock, so long as there is no significant overlapping ownership between the buyer and seller. Enhanced incentives for new owners include a waiver of a broader range of penalties (including not only penalties based upon the gravity of the violation but also upon the economic benefit received by the transgressor as a result of the violation), coverage for an increased number of violations and additional time to identify and self-report violations after the closing of a transaction.

The new policy offers a significant new opportunity for buyers of businesses and regulated facilities to resolve environmental issues and mitigate their exposure, but it also presents new challenges for transactions in which a buyer wishes to make use of it. For example, while the new policy encourages buyers to report violations committed by sellers, it does not offer sellers a "safe harbor" or other protection from prosecution. Consequently, a seller may seek to restrict by contract a buyer's right to self-report, or require a buyer to indemnify the seller in the event a buyer does self-report.

To learn more about the EPA's new Audit Policy, please see our recent [Kirkland Alert](#).

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PENpoints

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“What’s It All About, TALFie?”

Chicago, Illinois

New York, New York *(videoconference)*

Los Angeles, California *(videoconference)*

London, England *(videoconference)*

San Francisco, California *(videoconference)*

May 19, 2009

This Kirkland seminar, held in our new Chicago office, with videoconferencing to New York, London, Los Angeles and San Francisco, will provide an overview of the TALF program. Kirkland partner Kenneth P. Morrison, other Kirkland securitization, tax and investment management attorneys, and professionals from Barclays Capital and RBS Securities will discuss the impact of the TALF program and lead breakout sessions on special issues regarding TALF for investors, including private equity and hedge funds, and sponsors and issuers. A teleconferencing option will also be available. For more information, please visit: www.kirkland.com/files.TALF_Seminar.htm.

Secondary Private Equity: A Growing Source of Returns and Liquidity in the Private Equity Ecosystem

New York, New York

May 19, 2009

At this event, sponsored by Columbia Business School’s Alumni Club of New York, and hosted by Kirkland’s New York office, panelists will discuss how secondary private equity aids asset managers and investors and what impact the current environment has on this asset class now and in the future. Kirkland partner Michael D. Belsley will participate in this seminar.

IMN’s U.S. Real Estate Opportunity and Private Fund Investing Forum

New York, New York

June 11-12, 2009

The 10th annual Real Estate Opportunity and Private Fund Investing Forum will focus on the opportunities that distressed real estate and frozen capital markets have created as well as effectively managing troubled legacy assets. Kirkland partner Stephen Tomlinson will chair a session on the future of the real estate fund industry, partner Robert Buday will participate in a panel discussing infrastructure investments, partner Nat Marrs will participate in a panel on distressed debt funds and partner Michael Belsley will participate in a panel on fund share liquidity.

Infrastructure to the Future: How an Emerging Asset Class will Change Wall Street and Main Street

New York, New York

June 17, 2009

Kirkland partner Sean Patrick Maloney will be a panelist at this program. The program will also feature Hon. H. Carl McCall, chair of the New York State Asset Maximization Commission, Ben Heap, managing director, Infrastructure Asset Management, UBS Global Asset Management (Americas) Inc., Mark Murtagh, a principal with 3i North America and Trent Vichie, senior managing director of The Blackstone Group. It will be held at Kirkland’s New York office. For more information, please contact Arleen Buckley at Arleen.B@peimedia.com.

Private Equity Forum 2009

New York, New York

July 13-14, 2009

A panel at the 10th annual Private Equity Forum 2009 will cover topics such as structuring private equity investments and private equity funds, dealing with fund sponsor issues, current regulatory, legislative and tax issues and how private equity funds are addressing issues raised by the current environment, including fund and investor liquidity issues. Kirkland partner Mark Mifsud will speak on EU regulatory developments in a panel titled “Implications of the New Regulatory Environment.”

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Kirkland & Ellis LLP's Private Equity Practice

Kirkland & Ellis LLP's private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 200 private equity firms in every major market around the world.

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