

## Private Fund Manager Settles SEC Enforcement Case for Accelerated Monitoring Fees and Service Provider Discounts

### PENpoints

*This settlement reflects a continuation of the focus of the SEC on practices it believes may be a conflict of interest in private equity, particularly in the context of fees and expenses, and how such issues may be addressed by up-front disclosure.*

Recently, the Securities and Exchange Commission entered into a consent order<sup>1</sup> with a large private equity fund manager addressing SEC allegations that the fund manager under-disclosed to its investors that it was (i) receiving accelerated portfolio company monitoring fees and (ii) paying lower rates for manager-related legal services than the rates paid by the manager's private funds for fund-related legal services.

#### Accelerated Monitoring Fees

As to monitoring fees, the consent order described the following:

- The manager had entered into long-term (e.g., 10-year) monitoring agreements with certain portfolio companies providing for annual fees for consulting and other advisory services. The related fund agreements usually provided that management fees payable to the fund manager would be reduced by 50 percent of the monitoring fees received by the manager. In general, the monitoring fees charged by the fund manager generally were authorized by both the fund agreements and the portfolio company monitoring agreements and were disclosed to fund investors.
- However, under the terms of some of its agreements with the portfolio companies, the manager was entitled to accelerated monitoring fees (e.g., a payment equal to the present value of future payments for a specified period, such as the balance of the term) as termination payments upon (i) a private company sale, or (ii) an IPO. For private portfolio company sales, the manager often ceased performing services for the company upon sale, and for IPOs the manager often continued to perform post-IPO services, but the service period may not have fully matched the payment terms for the accelerated monitoring fees. As to the acceleration of fees, the SEC alleged that the fund manager should have obtained specific authorization to

receive the accelerated payments, and should have specifically disclosed the nature of the accelerated payments in the fund offering materials. The SEC did indicate that the fund manager had changed some of these practices in recent years.

#### Service Provider Discounts

As to certain discounts, the consent order stated that, prior to 2011, the manager and its principal law firm had an arrangement on fees that led to a greater discount from the law firm for certain of the fund manager's own legal fees than the discount the same law firm charged the manager's funds generally (despite the fact that the funds used a greater amount of services than the manager). The manager had not disclosed the different discounts to its investors.

#### Disgorgement and Penalties

To avoid the time and cost of contesting the allegations, the manager (without admitting or denying the findings) agreed to:

- disgorge \$26.2 million of accelerated payments, to compensate the funds for the undisclosed accelerated monitoring fees, plus pay prejudgment interest of \$2.6 million, and
- pay a \$10 million civil penalty.

The SEC's press release and order specifically highlighted the manager's remedial actions prior to the commencement of the SEC's investigation and its voluntary and prompt cooperation with the SEC.

This settlement reflects a continuation of the focus of

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the SEC on practices it believes may be a conflict of interest in private equity, particularly in the context of fees and expenses, and how such issues may be addressed by up-front disclosure. It also underscores

the importance of analyzing and addressing potential conflicts as they are identified prior to launch and during the life of a private fund, and prior to an SEC examination.

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<sup>1</sup> See [Press Release](#) and [Consent Order](#), October 7, 2015.

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

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## PENnotes

**PLI Understanding the Securities Laws Fall 2015  
Chicago, October 27-28 2015**

This program will provide an overview and discussion of the basic aspects of the U.S. federal securities laws by leading in-house and law firm practitioners and key SEC representatives. Emphasis will be placed on the interplay among the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act, the Dodd-Frank Act, the JOBS Act and related SEC regulations, and on how securities lawyers can solve practical problems that arise under them in the context of public and private offerings, SEC reporting, mergers and acquisitions and other common corporate transactions. Kirkland partner Ted Peto will speak at the event. Click [here](#) for more information.

**PLI Securities Regulation Institute (47th Annual)  
New York, October 28-30, 2015**

PLI presents its annual review of the current state of securities regulation and corporate law and practice. This year's Institute will bring together the nation's leading securities and corporate legal experts to deliver practical insights and real-world strategies and solutions to many of today's challenges. Click [here](#) for more information.

**2015 Registered Adviser Seminar & CCO Summit  
New York, October 29, 2015  
Chicago, November 3, 2015  
San Francisco, November 11, 2015  
Los Angeles, December 2, 2015**

As the SEC continues its focus on private fund managers registered as investment advisers, firms must be familiar with the evolving regulatory environment. This seminar is designed specifically for private fund manager CCOs, general counsel and other senior executives. Click [here](#) for more information.

**Structuring and Negotiating LBOs  
New York, November 3, 2015**

This biennial event, chaired by Kirkland partner Jack Levin, focuses on the legal, tax, structuring and practical negotiating aspects of buyouts and other complex private equity deal-doing. Click [here](#) for more information.

**Securities Filings 2015: Practical Guidance in a Changing Environment  
Chicago, November 12-13, 2015**

This program will analyze in detail the principal forms used for filings with the SEC under the Securities Act of 1933, and the Securities Exchange Act of 1934, with particular emphasis on the mechanics of and timing for assembling particular filings. Recent legislation and SEC rule changes affecting disclosure obligations, in particular those resulting from the JOBS Act, will be woven within the topics covered. Kirkland partner Carol Anne Huff will speak at the event. Click [here](#) for more information.

**10th Annual Kirkland Real Estate Private Equity Symposium  
New York, November 12, 2015**

Please save the date for the 10th Annual Kirkland Real Estate Private Equity Symposium, titled "10 Years Later: A Look Back and Into the Future." Barry Sternlicht, Chairman and CEO of Starwood Capital Group, and Neil G. Bluhm, Managing Principal at Walton Street Capital, will join us on a keynote panel moderated by Roy March, CEO of Eastdil Secured, to discuss trends and developments over the last 10 years in the real estate private equity space. Click [here](#) for more information.

# Private Equity Practice at Kirkland & Ellis

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Kirkland & Ellis' nearly 400 private equity attorneys have handled 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 400 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Private Equity Group of the Year" in 2012, 2013 and 2014 by *Law360* and was commended as being the most active private equity law firm of the last decade in *The PitchBook Decade Report*. Kirkland was named "Law Firm of the Year in Mergers and Acquisitions Law" by U.S. News Media Group and Best Lawyers in its 2014 "Best Law Firms" rankings. The Firm was named "Best M&A Firm" at *World Finance's* 2014 Legal Awards, "North American Law Firm of the Year: Fund Formation" and "North American Law Firm of the Year: Transactions" at *Private Equity International's* 2014 Private Equity International Awards and "Private Equity Deal of the Year" at the 2014 IFLR Americas Awards.

In 2012, 2013 and 2014, Chambers and Partners ranked Kirkland as a Tier 1 law firm for Investment Funds in the United States, United Kingdom, Asia-Pacific and globally. The Firm was ranked as the #1 law firm for both Global and U.S. Buyouts by deal volume in Mergermarket's *League Tables of Legal Advisors to Global M&A for Full Year 2011, 2012, 2013 and 2014*, and has consistently received top rankings among law firms in Private Equity by The Legal 500 and IFLR, among others.

*The Lawyer* has recognized Kirkland as one of its "Transatlantic Elite" every year since 2008, having noted that the Firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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