Proskauer

SEC Settles With Private Equity Fund Adviser Over Alleged Conflicts of Interest

The Capital Commitment Blog on **April 26, 2018**

As a sign that the SEC is continuing to actively pursue private equity fund advisers, on April 24, 2018, the SEC announced a settlement with private equity fund adviser WCAS Management Corporation (WCAS) related to allegations of undisclosed conflicts of interest. The specific conflicts resulted from an allegedly undisclosed contractual arrangement whereby a portion of fees received by a group purchasing organization (GPO) for services it provided to WCAS funds' portfolio companies would be paid to WCAS. In settlement of the allegations, WCAS agreed to disgorgement of $688,819.78 and a civil monetary penalty of $90,000, as well as a cease and desist and censure.

Arrangement with the GPO

According to the SEC's Order, the GPO was an organization that aggregated certain items of vendor spending, such as office supplies and car rentals, in order to provide group purchasing discounts to participating companies. At issue were the arrangements entered into between the GPO and WCAS with respect to services rendered to portfolio companies of two WCAS-managed funds formed in 2005 and 2008.

In early 2011, the GPO and a WCAS employee began negotiating a services agreement, whereby WCAS would receive a fee equal to 25% of the net revenue the GPO received from vendors based on the purchasing activity of the portfolio companies owned (and in some cases previously owned) by the WCAS funds. From September 2012 through December 2016, WCAS allegedly received $623,035 pursuant to the WCAS services agreement. The SEC alleged that WCAS did not disclose its right to receive, or actual receipt of, the GPO fees in its PPM, LPAs, management agreements.

Moreover, while the organizational documents for the two WCAS funds provided that a group of limited partners unaffiliated with WCAS was to approve in advance "any transactions that give rise to potential conflicts of interest," WCAS allegedly did not seek that prior approval in breach of its fiduciary obligations. The SEC further alleged that WCAS had an undisclosed incentive to recommend the GPO's services to the funds' portfolio companies because WCAS stood to receive a share of revenue generated for the GPO.

Takeaways

In response to this latest settlement, advisers should take note of several key points:

- First, despite its expressed retrenchment with respect to the protection of retail investors, the SEC remains focused on areas of disclosure and potential conflicts of interest in the private fund space.
- Second, private fund advisers must remain vigilant to any activities or arrangements which could be perceived as creating potential conflicts of interest between a management company and its affiliates, and the funds that are advised.
- Third, where such potential conflicts exist, advisers must review their funds' organizational and governance documents to determine whether:
    - the potential conflict has been adequately disclosed prior to investors' commitment of capital to the funds;
    - notice of the potential conflict must be provided to the fund and its beneficial owners;
    - consent to engage in the arrangement or activity at issue must be obtained from an advisory board, or the applicable agreement should be amended with the requisite limited partner consent; or
    - the potential conflict is of such a nature that abstention is the most prudent course.

As always, the best way to avoid conflict of interest and related disclosure issues is to adopt and implement written policies and procedures reasonably designed to identify, analyze and address potential conflicts of interest as soon as they arise.

View Original

- **Mike Hackett**
  Partner