Proskauer

Fund Sponsor's Fee Calculation Mistake Leads to SEC Enforcement

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A settlement last week involving a private equity fund sponsor is a reminder that compliance with fee calculation provisions and valuation policies and procedures are crucially important for fund managers. Even when an error is the result of simple negligence, the SEC will take enforcement action when fee calculations do not strictly comply with the governing documents, especially where investments are overvalued.

ECP Manager LP is a private equity fund adviser that served as the manager of ECP Africa Fund PCC (the "Fund"), among other private equity funds. The manager collected management fees from the Fund based on its total invested capital contributions, but under the Fund's Shareholders Agreement, could not take fees for investments that had been written down or written off. In 2010, the Fund obtained warrants on the common stock of an African mining company, attributing $3.41 million of invested capital contributions to the warrants. However, by March 2014, the Fund had valued these warrants at zero, and shortly thereafter the warrants expired with no value. Nonetheless, in 2014 and 2015, ECP Manager included the full $3.41 million when calculating its management fees on invested capital. The SEC did not identify any individuals responsible for the error, and did not explain how the error occurred. The SEC estimated the Fund's shareholders overpaid $102,304 in management fees due to ECP Manager's mistaken fee calculations attributable to the warrants.

On September 27, 2019, the SEC issued a Cease-and-Desist Order and imposed sanctions based on ECP Manager's violation of the Advisers Act Section 206(2) and Section 206(4) and Rule 206(4)-8 for fraudulent or deceptive conduct (these provisions only require negligent conduct). The SEC ordered ECP Manager to disgorge approximately 122,000 in fees and prejudgment interest, and imposed a $75,000 penalty.

We have added this settlement to our Private Equity SEC Enforcement database, which can be accessed here.

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