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# Valuation in Times of Market Disruption

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Valuation practices will continue to be the subject of disputes. Particularly in times of economic disruption and market volatility, buyers and sellers are more likely to have substantial differences of opinions on valuation, which often lead to the use of earn-outs and resulting post-closing disputes. Use of a cost basis for recently acquired assets may also lead to disputes regarding valuation, because using cost alone may be incompatible with the concept of fair value, which should take into account recent changed circumstances. We also expect increased scrutiny on valuations in connection with Manager/GP-led secondary transactions where the Manager/GP is often conflicted by virtue on being on both sides of the transaction.

From a regulatory perspective, valuation is a perennial SEC priority for private fund managers, and this year will be no different. The SEC Division of Examinations' June 2020 Risk Alert for private fund managers (and a later risk alert) noted common adviser deficiencies in valuing assets in accordance with stated valuation processes or as disclosed to clients, potentially leading to inflated fees and carried interest. With the SEC's recent adoption of a new regulatory framework for valuation practices for registered funds and BDCs, the SEC may want to test and validate compliance with the new principles. The SEC has also shown over the last year (see here and here) that it will pursue enforcement actions focused on valuation against credit managers, as well as private equity fund managers. Fund sponsors should be prepared for SEC investigations or enforcement actions related to the valuation of portfolio companies (particularly when interim values are used in fundraising) as well as follow-on inquiries from or disputes with unsatisfied fund investors.

Read more of our Top Ten Regulatory and Litigation Risks for Private Funds in 2021.

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