PUBLICATIONS

Fund Manager to Disgorge $1 Million for Charging Management Fees Inconsistent with Fund Documents

SRZ Private Funds Regulatory Update

November 2020

On Oct. 22, 2020, the SEC settled fraud charges with a private equity fund adviser in an enforcement case that demonstrates the SEC's continued focus on management fees and expenses.[1]

The relevant limited partnership agreement ("LPA") provided for a 1.5% management fee on all invested capital but required that amount to be reduced in the event of a write down of portfolio securities. According to the SEC, five different securities were subject to write-downs during a three-year period. The adviser, however, did not reduce its management fees at any time. The SEC found the adviser's failure to take into account the write-downs of the portfolio securities in accordance with the LPA caused the fund and its limited partners to overpay $901,760.91.

The SEC charged the adviser with violations of Section 206(4) and Rule 206(4)-8, which make it unlawful to "engage in any act, practice, or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in the pooled investments vehicle." Although fraud typically requires a finding of intent, negligence is sufficient to establish a violation of these provisions. The adviser was required to pay approximately one million dollars in disgorgement and prejudgment interest.

This case is a good reminder of the need for fund managers to review their governing documents, Form ADV Part 2A and due diligence questionnaire responses to ensure they are actually doing what their disclosures say.

This article appeared in the November 2020 edition of SRZ's Private Funds Regulatory Update. To read the full Update, click here.

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[1] *In re EDG Management Co., LLC*, SEC Admin. Proceeding No. 3-20133 (Oct. 22, 2020).

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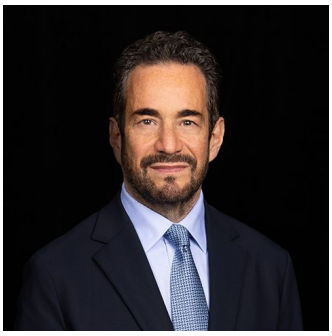

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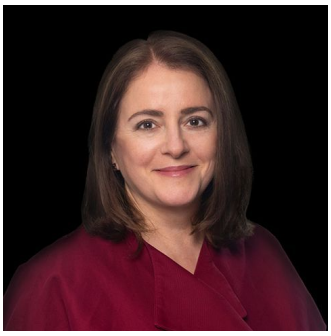

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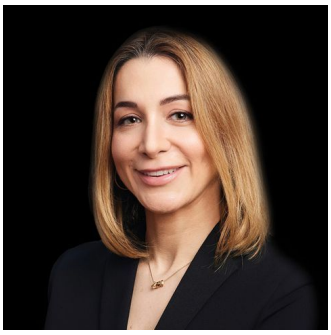

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