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SEC Censures Private Equity Fund Manager Over Transaction and Other Fees; Requires Broker-Dealer Registration

June 2, 2016 – The SEC yesterday made it clear that routine historical business practices in the private equity community will need to change ... quickly.

In a 12-page consent order, the SEC censured and imposed more than $3 million in disgorgement, penalties, fines and interest against fund manager Blackstreet Capital Management, LLC and its principal, Murry N. Gunty. The funds managed by Blackstreet had a combined AUM of approximately $153 million.

Among the key findings in the consent order were:

- In connection with sourcing, financing, acquiring and disposing of portfolio companies, and by taking transaction-based compensation in performing those functions, Blackstreet unlawfully acted as an unregistered broker-dealer in violation of the Securities Exchange Act; and

- In taking operational monitoring fees from the portfolio companies, and causing the funds to pay portions of travel and entertainment expenses benefitting the fund manager, in each case without explicit authorization in the fund governing documents or explicit prior disclosure to and consent by the fund's limited partners, Blackstreet was in conflict with the interests of its clients, the funds, and thereby violated the Investment Advisers Act.

The Commission also objected to various actions taken by the manager or its principal Mr. Gunty relating to repurchasing or redeeming portfolio company or fund interests in a manner that deviated from procedures outlined in the fund's limited partnership agreement.

Finally, in something of a catch-all, the Commission concluded that the manager had violated the Advisers Act by failing to have in place policies and procedures that would have prevented the offending conduct from occurring.

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The receipt of transaction and monitoring fees are, of course, fairly common business practices in the world of private equity, although to be sure, as we have previously reported, the Commission has gone on record in recent years with fairly strong hints that it would no longer look past these practices (see: *http://www.morrisoncohen.com/news-page?itemid=165*) and has issued guidance that it would focus its compliance examinations on ferreting out any deviations between fund governance documents and the types and amounts of fees fund managers received in conducting their ordinary operations. *(See:http://www.morrisoncohen.com/news-page?itemid=220).*

What appears particularly notable about this consent order, however, is the seeming banality of the offending conduct, considered individually and collectively. Since the Commission provided no guidance in the order regarding just what LPA disclosures, if any, would have been sufficiently explicit to pass muster, the order should give a PE fund manager reason to pause and explore carefully exactly what fees it receives, in exchange for what services, and what level of disclosure it has given to (or consent it has received from) its LPs about the fees it charges.

With PE fund managers squarely in the SEC's enforcement sights, it seems likely that additional enforcement actions and consent orders will follow as it processes the results of all of the compliance audits it conducted in 2015. We will be following developments in this area closely. In the interim you should contact your attorney at Morrison Cohen to discuss further any of these issues or their implications.