Overview

This Securities and Exchange Commission ("SEC") whistleblower filing describes how a private equity firm, Riverside Partners L.L.C. ("Riverside") has admitted, in its 2014 and 2015 Form ADV filings, to violations of its limited partnership agreement. This conduct is flagrant, given that SEC officials, most notably former Director of the Office of Compliance Inspections and Examinations Andrew Bowden, in his May 6, 2014 speech, "Spreading Sunshine in Private Equity," have made clear it clear that that they regard merely taking advantage of ambiguities in limited partnership agreements as problematic and potentially a violation of securities laws.

Riverside admits to conduct that is not simply in a grey area of vagueness and opacity, but actually contrary to the terms of the limited partnership agreement ("LPA"), as well as expectations created by Riverside itself.

Riverside Form ADV Statements

Riverside's 2014 Form ADV, under Item 5, "Fees," contains this text on pages 7 and 8:

> Additionally, as described more fully in the applicable Memorandum, under specific conditions, certain Riverside employees may provide services to portfolio companies on a one-time or more substantive basis, that typically could be otherwise performed by third-party consultants or other service providers. In connection with such services, the applicable Management Companies may be reimbursed for these costs by such portfolio companies, including reimbursement for the salary and bonus of a Riverside employee working (i) full time as a portfolio company executive, (ii) providing legal services to the portfolio company or (iii) providing Asian sourcing advice, as such applicable Partnership Agreement may permit. Such reimbursements will generally not offset against the management fee, as described in by [sic] the applicable Partnership Agreement. However, any such reimbursed costs that are not permissible under the terms of the applicable Partnership Agreement may, in many cases, offset all or a portion of the Management Fees paid by the Funds.

Riverside's 2015 Form ADV contains the same paragraph (see Section 5, "Fees," on page 9), with the only change being that the last sentence now reads; "However, any such reimbursed costs that are not contemplated under the terms of the applicable Partnership Agreement may, in many cases, offset all or a portion of the Management Fees paid by the Funds." Thus, "not permitted" has been replaced with the legally-equivalent "not contemplated." For purposes of this discussion, we will treat this section of the 2014 and 2015 Forms ADV as identical in substance.

The section above makes the following admissions:

1. Riverside is in some cases charging the cost of employees that provide the services described in (i) through (iii) when they are "not permissible under the terms of the applicable Partnership Agreement." This admission is significant because one of the elements of due diligence performed by investors when deciding whether to invest in a particular fund is to look at the number and mix of employees at the general partner relative to the level of management fees. The understanding or the limited partners is that the costs of operating the general partner, including that of compensating its employees, comes out of the management fee and any profit share earned by the general partner (the "carry fee").

2. Those impermissible charges also are not always, and may not even often be rebated against the management fee, as is typically stipulated for specified fees, such as transaction fees and monitoring fees. The use of "may, in many cases" can be inferred to mean in less than a majority of cases; "in many cases" would presumably not be the formulation if "in most cases" were true; the preceding "may" weakens the statement even further. Indeed, this "may, in many cases" formulation is so strained that it is arguably accurate even if Riverside never credited a portion any of the impermissible costs. Moreover, it would be a mistake to believe that crediting impermissible fees back to investors in the form of a management fee offset cures the impermissible act of taking the fees in the first place, since the ADV clearly states that, "in many cases" LP investors only receive "a portion" of these fees as credits, suggesting that Riverside itself keeps some amount.

   Investors would expect that any effort devoted of the type described in ADV disclosure clauses (i) through (iii) by general partner employees on behalf of portfolio companies would be covered by the monitoring fees that Riverside charges to portfolio companies, as mentioned earlier in the same section ("Riverside Partners and/or its affiliates generally have discretion over whether to charge transaction fees, monitoring fees, or other compensation to portfolio companies, as if so, the rate, timing, and amount of such compensation.") The fact that Riverside admits charges were impermissible despite such broad latitude having been granted by the limited partners, and then describes them in the Form ADV as "costs," indicates that they were mischaracterized fees designed, contrary to investor expectations and disclosures, to shift general partner overheads to portfolio companies. The fact that Riverside "may" have rebated a portion of these fees does not make the practice any more permissible.

3. Riverside is not a law firm, yet under (ii) it admits to receiving compensation for providing legal services to portfolio companies. In every state, it is a violation of

bar association rules for legal fees to be shared with parties that are not attorneys. While our understanding is that this is not, in and of itself, a securities law violation, limited partner investors would have clear grounds for relying on the legal proscription against sharing legal fees as a further basis, over and above its plain language, for believing that the LPA prohibits Riverside from charging legal fees to portfolio companies.

Possible Securities Law Violations

We respectfully suggest that the fact that Riverside has admitted that it extracts reimbursement of some of its firm's overhead in violation of its LPA, and compounds that violation by failing to reimburse a portion of those charges as investors would expect, represent clear-cut violations of the following securities laws:

1. Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder;

2. Section 17(a) of the Securities Act of 1933

3. Sections 206 and 207 of the Investment Advisers Act of 1940

4. Section 36(b) of the Investment Company Act of 1940

We also ask the SEC to consider whether the amount and frequency of these impermissible charges also constitutes a violation of Riverside's fiduciary duties under Section 36(b) of the Investment Company Act of 1940.

Potential Avenues of Investigation

If the SEC were to pursue this matter, it would be fruitful to focus on the following issues:

1. What is the extent of Riverside's shifting of employee costs onto portfolio companies?

2. What portion, if any, of these costs to limited partners were reduced by offsets to management fees or any other means?

The following documents would appear to be among the ones the SEC would need to obtain to conduct an investigation:

1. Unredacted copies of the relevant limited partnership agreements

2. Access to the accounting records of all portfolio companies to review expense reimbursements and fees paid to Riverside to identify the impermissible charges

3. All IRS W-2s and K-1s filed by Riverside (note that it is possible that Riverside charged the employees out to the portfolio companies at levels that exceeded their pro-rata compensation. That raises the issue that the characterization in the Form ADV of these charges as “costs” is also misleading and may constitute an additional disclosure violation)