Private Equity Regulatory Update

April 30, 2021

COVID-19 Update

Litigation

- SEC Settles with Investment Adviser Principals Responsible for Alleged Misstatements and Omissions Regarding Due Diligence, Valuation, and Conflicts of Interest

COVID-19 Update

Please refer to Davis Polk's "**Coronavirus Updates**" webpage for content related to the outbreak.

Litigation

SEC Settles with Investment Adviser Principals Responsible for Alleged Misstatements and Omissions Regarding Due Diligence, Valuation, and Conflicts of Interest

On March 24, 2021, the SEC issued three orders (the "**Foundry Orders**") instituting and settling cease-and-desist proceedings against Troy E. Marchand, Scott T. Wolfrum, and Tyler C. Sadek, principals and an owner of the Foundry Capital Group ("**FCG**"), an investment adviser to the Foundry Mezzanine Opportunity Fund ("**FMOF**"), a private fund. Sadek and Marchand were allegedly responsible for misstatements made to investors of FMOF regarding the fund's investments and due diligence; Wolfrum, allegedly directed his advisory clients to FMOF without adequately disclosing his interests in FMOF or that FMOF invested in companies in which he had a financial interest.

According to the Foundry Orders, Marchand and Sadek founded FCG in 2015; Marchand acted as the portfolio manager for FMOF. Wolfrum, a representative of a broker and a registered investment adviser, acquired 100% of FCG by July 2018.

FCG launched FMOF in 2015; FMOF's strategy was described as investing in "high yield private loan investments with complementary short-term liquidity plays." FMOF's communications with investors stated that the fund's portfolio would be independently valued by a valuation firm, and that FCG undertook a "rigorous due diligence approach" when selecting investments.

The SEC alleges that FCG failed to obtain independent valuations of the fund's holdings or to perform due diligence in accordance with its statements to investors. According to the Foundry Orders, Marchand allegedly chose not to obtain an independent valuation of the fund after a valuation firm verbally told Marchand that the fund would have to write down the value of certain holdings. Marchand also allegedly failed to conduct "any independent due diligence" in one FMOF investment, failed to investigate whether another FMOF investment would be able to make principal and interest payments on a loan that FMOF made, and failed to determine whether the felony conviction and $1.5 million in outstanding liabilities of a personal guarantor on a third investment would have an impact on FMOF's investment.

The SEC further alleges that Marchand and Sadek were responsible for misleading investor newsletters. While certain companies in which FMOF was invested were performing poorly and, in one instance, contemplating bankruptcy, FMOF's investor newsletters allegedly failed to disclose negative information and, instead, predicted positive investment returns and future growth.

FCG and Wolfrum expected Wolfrum to serve as the primary source of FMOF investors. In 2016, Wolfrum and FCG entered into arrangements whereby Wolfrum obtained 50% of FCG's management fees and 80% of FCG's performance fees attributable to investments from investors directed to FMOF. In addition, Wolfrum allegedly received finder's fees from two companies in connection with loans from FMOF to those companies. According to the Foundry Orders, the "specified details" of Wolfrum's compensation were not disclosed to investors, though investors were told that Wolfrum "would benefit financially from the activities of the fund." Wolfrum's interests in the companies in which the fund invested, and his receipt of finders' fees in connection with those investments were not disclosed to fund investors.

Each of Marchand, Sadek, and Wolfrum agreed to be censured. Marchand agreed to an industry bar, subject to the right to reapply after five years. Sadek agreed to pay a civil monetary penalty of $30,000; Wolfrum agreed to pay disgorgement of $140,125 and prejudgment interest of $21,354, plus a civil monetary penalty of $75,000. No civil monetary penalty was imposed on Marchand on account of his financial condition.

- **See a copy of the Marchand Order**
- **See a copy of the Sadek Order**
- **See a copy of the Wolfrum Order**
- **See a copy of the SEC Press Release regarding the Foundry Orders**

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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