

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4896 / April 24, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18449

In the Matter of

**WCAS MANAGEMENT
CORPORATION,**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 203(e) AND
203(k) OF THE INVESTMENT ADVISERS
ACT OF 1940, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against WCAS Management Corporation (“WCAS” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

SUMMARY

1. This matter concerns an investment adviser's disclosure failure regarding conflicts of interest between the adviser and its private equity fund clients and fund investors in connection with an agreement (the "WCAS Services Agreement") between the adviser and a group purchasing organization (the "GPO"). WCAS is the investment adviser to various private equity funds which owned portfolio companies that used the GPO, which is a company that aggregates companies' spending to obtain volume discounts from participating vendors. Under the WCAS Services Agreement, the GPO paid WCAS compensation based on a share of the fees the GPO received from vendors as a result of the WCAS portfolio companies' purchases through the GPO. WCAS did not disclose the conflicts of interest associated with the WCAS Services Agreement, and could not effectively consent on behalf of its private equity fund clients. By virtue of this conduct, WCAS breached its fiduciary duty to its private equity fund clients in violation of Section 206(2) of the Advisers Act, and also violated 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

RESPONDENT

2. **WCAS Management Corporation** is a Delaware corporation and an investment adviser registered with the Commission. It is the adviser to several private equity funds and is headquartered in New York, New York. As of March 29, 2016, WCAS had approximately \$7.7 billion of regulatory assets under management.

OTHER RELEVANT INDIVIDUALS AND ENTITY

3. **Welsh, Carson, Anderson & Stowe X, L.P. ("Fund X")** and **Welsh, Carson, Anderson & Stowe XI, L.P. ("Fund XI")** and, together with Fund X, the "**WCAS Funds**"), are Delaware limited partnerships and private equity funds that were formed on May 27, 2005 and June 2, 2008, respectively. During all times relevant to the findings herein, WCAS served as investment adviser to the WCAS Funds and affiliates of WCAS served as their general partners.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

FACTS

A. Background

4. The investors in the WCAS Funds (each, a “Limited Partner”) made a commitment to contribute approximately \$7 billion to the private equity funds for the purpose of making control position investments primarily in healthcare and information technology companies (collectively, the “WCAS Portfolio Companies”). WCAS seeks to generate capital appreciation of the WCAS Portfolio Companies, including via the improvement of the companies’ operations.

5. Investments in the WCAS Funds are governed by three sets of documents: Private Placement Memoranda, Limited Partnership Agreements, and Management Agreements (collectively, the “Organizational Documents”). Investors in the WCAS Funds include government pensions, colleges and universities, institutional investors, and charitable endowments.

6. The Organizational Documents for the WCAS Funds provide for the creation of an Investment Review Committee (the “LP Committee”) comprised of Limited Partners that are not affiliated with WCAS to “approve in advance any transactions that give rise to potential conflicts of interest” between WCAS and its affiliates, on the one hand, and the WCAS Funds, on the other hand.

7. Under the Organizational Documents, WCAS and its affiliates were entitled to certain enumerated compensation from the WCAS Funds and the WCAS Portfolio Companies, including carried interest, management fees, and other fees that are subject to offset against the management fees.

B. Agreements with the GPO and GPO Affiliate

8. Beginning in 2008, certain WCAS Portfolio Companies began to use the services of the GPO, a company that aggregates companies’ spending on certain items, such as office supplies and car rentals, in order to provide group purchasing discounts to participating companies.

9. In connection with the relationship, starting in 2008, a WCAS employee with experience in group purchasing and procurement (the “WCAS Employee”), whose responsibilities included advising the WCAS Portfolio Companies on their purchasing activities, provided certain services for the benefit of the GPO. The WCAS Employee was not part of WCAS’s senior management.

10. In addition, since 2006, an affiliate of the GPO (“GPO Affiliate”) had an agreement (the “Portfolio Company Services Agreement”) with a particular WCAS Portfolio Company (“Portfolio Company A”) whereby the GPO Affiliate directly provided services to Portfolio Company A and not through the arrangement between WCAS and the GPO.

11. Beginning in early 2011, Portfolio Company A, with the participation of the WCAS Employee, and representatives of the GPO Affiliate began discussing renewing the Portfolio

Company Services Agreement. The GPO and the WCAS Employee also simultaneously began negotiating the WCAS Services Agreement, which was an agreement between WCAS and the GPO whereby the GPO would provide WCAS with a share of the GPO's revenue generated by fees paid by the vendors to the GPO based on all WCAS Portfolio Companies' purchasing. The WCAS Services Agreement provided that the payments were made in consideration for the WCAS Employee's services to the GPO.

12. In October 2011, a GPO Affiliate employee emailed the WCAS Employee to suggest that the WCAS Services Agreement would be approved by the GPO when Portfolio Company A executed the Portfolio Company Services Agreement with the GPO Affiliate.

13. WCAS and the GPO entered into the WCAS Services Agreement on June 11, 2012. Portfolio Company A and the GPO Affiliate renewed the Portfolio Company Services Agreement on August 1, 2012.

14. Under the WCAS Services Agreement, WCAS received a "Professional Services Fee" equal to 25% of the net revenue the GPO received from vendors based on the purchasing activity of the WCAS Portfolio Companies owned (and in some cases previously owned) by the WCAS Funds. The WCAS Services Agreement did not provide for a set payment amount per annum; rather, the more purchasing done by WCAS Portfolio Companies through the GPO, the larger the Professional Services Fee WCAS would receive.

15. From September 2012 through December 2016, WCAS received \$623,035 pursuant to the WCAS Services Agreement.

16. WCAS did not seek prior approval from the LP Committee for the conflicts of interest in connection with the WCAS Services Agreement as required by the Organizational Documents and in breach of its fiduciary obligations to its clients, the WCAS Funds. First, WCAS's receipt of the Professional Services Fee in 2012 through 2016 was not disclosed in the WCAS Funds' Organizational Documents (which had been drafted in 2005 and 2008, respectively). Second, after execution of the WCAS Services Agreement, WCAS had an incentive to recommend the GPO's services to the WCAS Portfolio Companies because it stood to receive a share of revenue generated for the GPO by the WCAS Portfolio Companies' purchasing activity. Third, following the GPO employee's offer set forth in Paragraph 12, WCAS had an incentive to encourage Portfolio Company A to enter into the Portfolio Company Services Agreement as WCAS stood to receive the Professional Services Fee pursuant to the WCAS Services Agreement. Accordingly, WCAS could not effectively consent to the WCAS Services Agreement on behalf of the WCAS Funds.

C. SEC Investigation

17. After the staff of the Commission's Division of Enforcement contacted WCAS and raised concerns about the WCAS Services Agreement, WCAS voluntarily stopped receiving the Professional Services Fee under the WCAS Services Agreement in May 2017.

VIOLATIONS

18. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, WCAS willfully violated Section 206(2) of the Advisers Act.²

19. Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to "[m]ake any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle" or "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 investment vehicle." Proof of scienter is not required to establish a violation of Section 206(4) of the Advisers Act. *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992). As a result of the conduct described above, WCAS willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act with respect to WCAS, it is hereby ORDERED that:

Respondent WCAS cease and desist from committing or causing any violations and any future violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

² A willful violation of the securities laws mean merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Respondent WCAS is censured.

Respondent WCAS shall, within fourteen (14) days of the entry of this Order, pay disgorgement of \$623,035 and prejudgment interest of \$65,784.78 and a civil money penalty in the amount of \$90,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Securities Exchange Act of 1934. If timely payment of the disgorgement and civil penalty is not made by the required payment date, additional interest shall accrue pursuant to SEC Rule of Practice 600 and/or 31 U.S.C. 3717.

Payment shall be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at www.sec.gov/about/offices/ofm.htm; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying WCAS Management Corporation as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Dabney O'Riordan, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA 90071.

Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private

damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary