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Investment Management Alert

September 15, 2026

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One Manhattan West
New York, NY 10001
212.735.3000

42/F, Edinburgh Tower, The Landmark
15 Queen's Road Central, Hong Kong
852.3740.4700

Izumi Garden Tower, 37th Floor
1-6-1 Roppongi
Minato-ku, Tokyo 106-6037, Japan
81.3.3568.2600

Fund Expenses: Differentiating Approaches to Expenses for Japan PE/VC Funds

Executive Summary

- **What's new:** Japan's Ministry of Economy, Trade and Industry revised the Japan model limited partnership agreement in June 2025, expanding the fund expenses provision considerably to be more aligned with the global standard, including items such as broken-deal and abort costs and subscription line facility costs.
- **Why it matters:** As global capital continues to flow into Japan PE and VC markets, Japan GPs face a growing need to adopt policies and procedures around how they allocate fund expenses. Underdeveloped expense governance can leave them exposed to LP questions, reputational damage and even potential regulatory violations.
- **What to do next:** Japan GPs should recognize that expense allocation is an increasingly critical governance issue with real legal and commercial consequences, and should build institutional knowledge and good practice accordingly

Introduction: An Evolving Landscape for Japan GPs

Japan fund managers face a dilemma when determining whether certain cost items should (or shouldn't) be borne by their managed private equity (PE) or venture capital (VC) fund. On the one hand, the domestic Japan funds market has a long history and tradition around the treatment of certain costs as expenses of the fund (and borne by the fund's investors), and other costs as expenses of the general partner (GP) (and borne by the GP from management fees and other sources of income), such as fees paid to directors of its fund's GP. In reliance on such tradition, domestic Japan funds' governing documents often list out certain general principles but are otherwise light on details.

On the other hand, the fund expense allocation practices of global managers follow global standards, which have been shaped by hard lessons formed over time by way of countless GP-LP discussions and by regulatory investigations and enforcement actions of applicable regulators (including those of the U.S. Securities and Exchange Commission (SEC)). In particular, the SEC has undertaken significant enforcement actions against major PE sponsors for unauthorized, undisclosed or misallocated fund expenses under the fund documentation. As a result, the governing documents of global funds often contain pages-long disclosure of what is or is not permitted as a fund expense, and in addition, global fund managers typically adopt comprehensive internal policies and procedures to process such expenses and ensure compliance.

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Fund Expenses: Differentiating Approaches to Expenses for Japan PE/VC Funds

As Japan PE and VC markets continue to attract more global capital and attention, there is a growing need for Japan fund managers to understand the differences in fund expense practices in the domestic Japan funds market versus the global funds market, and to adopt internal governance policies that better cater to those differences.

Fund Expense Compliance: A Two-Fold Exercise

Fund expense compliance is a two-fold exercise. The first part is disclosure — whether the limited partnership agreement (LPA) clearly and sufficiently articulates what expenses may be charged to the fund and, ultimately, to limited partners (LPs). The second part is practice — whether the GP actually operates in line with what the LPA says. The SEC enforcement wave not only shows that regulators increasingly pay attention to the gap between what the LPA says and what the GP does, but has also led LPs to ask due diligence questions about fund expense allocation. It is equally important that the GP has procedures to *vet and enforce* actual compliance.

A fund manager should have a robust understanding of both parts in order to ensure its systems comply with applicable law and global investor expectations. The next two sections discuss this two-fold exercise in turn.

Part I: Detailed LPA Disclosure Is Defense, Not Nuisance

Offshore Fund LPAs: A Detailed, Highly Granular Model

A typical fund expenses provision in offshore fund LPAs runs three pages, sometimes more, and stretches across dozens of separate categories covering the fund's investments, operations, reporting, governance, wind-down, etc. For example, to illustrate the level of granularity involved, while a Japan domestic fund LPA may simply describe investment-related costs as being fund expenses, the offshore fund LPA will typically cover a long list of itemized costs. See the following example:

Japan fund LPA:

- 組合財産の取得、投資先事業者等における合併、株式交換、株式移転、会社分割、事業提携その他の組織再編行為、並びに、組合財産の処分等に要する費用（事業調査に係る弁護士、公認会計士、税理士その他の専門家に対する報酬を含む。）

  (English translation: Expenses incurred in connection with the acquisition of fund assets, merger, stock exchange, stock transfer, company split, business alliances or other reorganization of portfolio companies of the fund, and disposition of the fund assets (including fees for attorneys, certified public accountants, tax accountants and other professionals who are involved in due diligence investigations).)

Offshore fund LPA:

- All "investment expenses," which shall include but are not limited to (i) fees, costs, interest and other expenses and other liabilities or obligations resulting from, related to, associated with, arising from or incurred in connection with the sourcing, structuring, organizing, negotiating, bidding on, consummating, acquiring, subscription, financing, refinancing, diligence (including any subscriptions to any periodicals, databases and/or research services), hedging, managing, maintaining, monitoring, developing, owning, operating, holding, valuing, restructuring (including through single-investment vehicles and/or specific-investment vehicles), trading, taking public or private, selling or proposed selling, winding up, liquidating or other disposal of any investment(s) (including any specific potential investments, whether directly or through specific investment vehicles (including continuation funds)) and/or interest in any portfolio company, temporary investments and bridge financings, including financial advisory fees, pricing and valuation (including appraisal), bank charges, investment banking, deposits, consent, all abort costs, special fees paid to advisors and third parties as incurred to obtain investment opportunities, any borrowing (including interest expense thereto) and any travel expenses (and related meals, accommodations and entertainment expenses incurred in connection thereto), whether or not such sourcing, acquisition, financing, refinancing, hedging, sale or other disposal or any other aforementioned activities, or borrowing is completed, (ii) any legal, tax, accounting, auditing, travel, consultant, financial or other professional advisors, independent directors, brokerage and registration fees and expenses in relation to any investment or proposed investment, to the extent they are not reimbursed by a portfolio company (whether or not capitalized as part of the acquisition costs), in each case including the reimbursement of any out-of-pocket expenses incurred by any such party (and any service providers of or which support an investment or portfolio company) as determined by the GP and (iii) any special fees paid to consultants, advisors and third parties as incurred to obtain investment opportunities or who provide services to or in respect of the fund or its operating entities, or other subsidiaries or related portfolio

companies (including with respect to potential investments related to, among other things, (a) conducting due diligence or analysis on industrial, geopolitical or other operational issues and (b) operational improvement initiatives relating to such entities, and developing and implementing such initiatives.

Other examples of the level of detail in offshore fund LPAs include items that reach into less obvious territory, such as the following:

- Regulatory compliance fees and filing costs (*e.g.*, Form D, Form ADV).
- Fees for fund administrator, custodians, independent directors or compliance personnel.
- The costs of interpreting and following LPA and side letter terms in connection with the fund's investments.
- The costs of pursuing co-investment (and co-investors) that do not ultimately consummate.
- Certain costs related to or incurred by the GP's employees for providing certain advice to the portfolio companies.

This high level of detail is a direct result of the SEC's close attention to fund expense allocation and related enforcement actions over the past decade. Starting in the early 2010s, the SEC brought a series of cases against major PE fund managers. The cases involved expenses that their LPAs did not clearly authorize. By way of example:

- In 2015, a major PE fund manager paid about $29 million for failing to allocate co-investors' share of broken-deal expenses to co-investors. As a result, the fund LPs bore a disproportionate share that was not disclosed in the LPA.
- In 2018, another major PE fund manager paid about $2.7 million for charging its funds the full compensation of platform employees, even though those employees also did unrelated work and the LPA only covered the part of their costs attributable to work for the funds.
- In 2021, a prominent infrastructure fund manager was fined $4.5 million for failing to apply a portfolio company fee offset required by the LPA.
- In 2022, a leading fund manager in the energy sector paid a $1 million penalty, and voluntarily repaid $3.3 million to the fund, for a side arrangement with co-investors that had left the fund bearing credit facility expenses not properly disclosed or allocated under the LPA.
- More recently, the SEC has expanded its regulatory attention to various midsize and lower-middle-market fund managers as well.

These enforcement actions share one common principle: If an expense is not expressly disclosed in the LPA, then it is possible that a regulator later challenges whether or not such costs can be charged to LPs. Consequently, U.S. sponsors now extensively disclose in order to protect themselves, listing as many expense categories as can be imagined upfront rather than risk having an allocation later questioned over something that is not expressly mentioned in the LPA.

For a worked example illustrating the complexity of expense allocation in practice, see the Addendum to this article.

Japan Domestic Fund LPAs: A Leaner Model

As mentioned above, Japan domestic fund LPAs tend to follow a different approach than those of offshore funds. The fund expenses provision as prescribed in the Japan model LPA issued by Japan's Ministry of Economy, Trade and Industry, for example, is a fraction of the length of its offshore fund counterpart. Since the Japan model LPA is prescribed by a government authority, many Japan PE/VC sponsors adopt the Japan model LPA closely with limited customization. Further, in areas where the Japan model LPA is silent, some GPs would simply choose to absorb an unmentioned expense item themselves, adopt a very low-level expense in such areas or simply avoid incurring such costs entirely even where it is prudent to do so.

Notably, among other changes, the Japan model LPA was revised in June 2025, expanding the fund expenses provision considerably to be more aligned with the global standard. The revised provision now includes more detailed items, such as broken-deal and abort costs and the costs of subscription line facilities. How such changes will play out in practice remains to be seen. However, the more immediate issue for Japan GPs is building the institutional knowledge to understand the rationale behind each item in the expanded provision and to translate that understanding into consistent internal practice.

Part II: Real Compliance Lies in Internal Controls

Even a carefully drafted LPA is only half the job. Actual compliance depends on a comprehensive expense allocation policy that combines clear allocation rules with the internal controls needed to enforce them consistently. In practice, global PE/VC fund managers typically have internal systems that include most or all of the following:

- **Multiperson vetting:** A person (or group of persons, such as a C-level executive or the most senior investment professional on a project) would be responsible for approving the overall expense item, while another person (or group of persons, such

as the internal legal or accounting team) validates the proof of the cost-spend before reimbursement, and sometimes a third person (or group of persons, such as the finance team or comptroller) processes the actual payment, with no single person approving, instructing the payment and actually paying.

- **Specified project codes:** For every external expense to be allocated to one or more funds or a specific deal, the policy should require that the expense be tagged to a specific project code (for example, an existing portfolio company, a prospective investment, an LP or LPAC meeting or fund administration) reasonably promptly after the expense is incurred.
- **Defined limits and documentation for travel, entertainment and gift expenses:** These are the categories where business purpose and personal benefit are hardest to disentangle, so a robust policy should require that each claim state a specific primary business purpose and be supported by proof, such as a properly selected expense/project code, an accurate expense description and supporting documentation such as receipts and emails, and should also set clear dollar limits for detailed subcategories of expense items (*e.g.*, meals, gifts, air travel, lodging). The absence of strict requirements regarding supporting documentation and/or defined limits is often what allows personal expenses to be disguised as legitimate business costs for years before detection.
- **Periodic sample checks, annual certification and regular training:** A designated team (*e.g.*, finance or compliance team) should run periodic sample checks, paired with an annual staff certification that expense allocations comply with policy, with false certifications treated as a serious disciplinary matter. Regular training should be provided to ensure all relevant personnel are kept up to date on best practices, while providing a platform for relevant personnel to ask questions.

For many Japan GPs, their internal controls may be set up to formally follow the hierarchy of authority with less separation of powers. For example, the company CEO or a senior investment managing director may be able to incur expenses and seek reimbursement from the fund for an expense where the internal project code has not been procedurally approved. By way of another example, where a certain expense item covers both a professional purpose as well as a personal purpose, the entirety of such expense may be treated as a fund expense rather than a prorated portion only.

Recently, it was reported in July 2026 that a well-known Japan PE firm opened an investigation into a senior investment professional over alleged misuse of business expenses running to tens of millions of yen, and that the original launch of this PE fund manager's next fund in 2026 is now likely to be delayed. The compliance risk of an underdeveloped expense allocation practice in the Japan market is no longer a mere hypothetical; it is already playing out, at a firm with strong track record. Keeping such compliance risk unchecked can leave Japan GPs exposed to LP questions, reputational damage and even potential regulatory violations.

To properly establish the policy and empower a fund operations team to monitor the procedures is an important step in the right direction. At the end of the day, however, formal written policies and the internal controls included therein are only effective to the extent they are actually complied with and enforced by all firm personnel. Japan GPs can learn from the hard lessons of an SEC settlement with a major PE fund manager in 2016, which further showcases exactly how a firm may fall foul of its own formal written policies in practice.

In that SEC case, a senior partner of the sponsor repeatedly mischaracterized personal expenses as legitimate business costs over several years, presenting personal grooming and social trips as client meetings, team dinners or networking opportunities. On one occasion, he charged a Super Bowl weekend trip to a specific deal project code as a networking opportunity, which the court later found to not have involved any work relating to the relevant portfolio company. On another occasion, he charged over $10,000 in airfare, hotel and car service costs for a trip to Brazil to a specific portfolio company's project code, even though the portfolio company's CEO described the visit as "purely social." Despite the sponsor's extensive written policies and despite the senior partner's obvious bad behavior, the court found that the sponsor itself had responsibility to ensure its written policies were being complied with, and to ensure that its employees were aware of its policies and effectively trained to understand them.

The case above is a reminder that paying lip service to formal written policy is not enough. It is crucial for a firm to build a culture of compliance where all employees are aware of the policies and the consequences of noncompliance, regardless of seniority or position.

Conclusion

As global capital continues to flow into the Japan PE and VC markets, it is increasingly expected that quality Japan GPs continuously adapt to conform with international standards regarding disclosure and process around the expensing of costs to the funds. Against this backdrop, Japan GPs should recognize that expense allocation is an increasingly critical governance issue with real legal and commercial consequences, and should build institutional knowledge and good practice accordingly. Skadden routinely advises Japan clients on expense allocation issues that global institutional investors may require, including advising on requisite LPA disclosures and building formal written policies.

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Addendum

Worked Example: Expense Allocation Across Multiple Funds and Co-Investors

Assumption: AA Capital manages Fund III and Fund IV.

- Fund III made a minority investment of ¥1,000 in Portfolio Company X. Three years later, Portfolio Company X is raising another round. AA Capital has the right to invest another ¥300, but the company is performing well and AA Capital would like to invest ¥500 in this round.
- Fund III's investment period has ended, and AA Capital is currently investing out of Fund IV. AA Capital considered investing the full ¥300 from Fund III using recycled capital, but ultimately invested ¥150 from Fund III and ¥150 from Fund IV due to the availability of funds.
- AA Capital also brought a co-investor into this round. The original discussion was to offer the co-investor up to ¥400 of the total ¥500 allocation, but the co-investor ultimately invested only ¥200.
- AA Capital incurred ¥15 in expenses relating to discussions with the co-investor (and other potential co-investors that did not invest), and ¥10 to process the ¥500 investment in Portfolio Company X. AA Capital therefore incurred ¥25 in total expenses relating to the investment and co-investment process.

How should AA Capital allocate these expenses among the co-investor, Fund III, Fund IV and, if applicable, the GP?

Option 1: The co-investor should ideally bear ¥15 + 40% × ¥10 = ¥19 because it invested 40% of the total ¥500 allocation. Fund III would bear ¥3 and Fund IV would bear ¥3.

However, in the negotiation with the co-investor, it was agreed that the co-investor's maximum expense would be ¥10 for reasons acceptable to both parties. For example, some of the ¥15 may have been incurred in processing other potential co-investors that did not invest.

Option 2: The co-investor bears ¥10, Fund III bears ¥7.5 and Fund IV bears ¥7.5. This approach frequently occurs in the market.

Option 3: The co-investor bears ¥10, Fund III bears ¥11.5 and Fund IV bears ¥3.5. Depending on the facts, it may be reasonable for Fund III to bear up to 76.7% (¥1,150/¥1,500) of the ¥15 in excess costs if a significant portion of those costs relates to supporting Fund III's original ¥1,000 investment. This is more likely if Fund III holds a control position in Portfolio Company X rather than a minority position.

Option 4: The co-investor bears ¥10, Fund III bears ¥5 and Fund IV bears ¥10. Under this approach, Fund IV pays all of the ¥5 in excess co-investment expenses. Depending on the facts — especially if all of the co-investors are potential LPs of Fund IV — it may be reasonable to view the creation of co-investment opportunities for Fund IV's LPs as a benefit of Fund IV that should be paid by Fund IV. This is especially so if one realistic outcome would have been for Fund IV to invest ¥350 rather than ¥150.

Option 5: The co-investor bears ¥10; AA Capital, as GP, bears ¥5; Fund III bears ¥5; and Fund IV bears ¥5. Under this approach, AA Capital bears all of the ¥5 in excess co-investment expenses. Although this is a possible allocation, it places on the GP what is effectively a broken-deal cost and may reduce the GP's willingness to create co-investment opportunities for LPs. This approach has historically occurred in the domestic Japan market, which may help explain why some GPs are cautious about international investors seeking co-investments.

These examples show that there are at least five common approaches to allocating these expenses. While offshore fund LPAs would permit all of the options described above, a fund manager would need clear internal guidelines to allocate such expenses among its managed funds.

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Contacts

Geoffrey Chan
Partner / Hong Kong
852.3740.4880
geoffrey.chan@skadden.com

Akira Kumaki
Bengoshi Partner / Tokyo
81.3.3568.2448
akira.kumaki@skadden.com

Brian Wong
Counsel / Hong Kong
852.3740.4719
brian.wong@skadden.com

Xinnuo Zhao
Registered Foreign Lawyer (New York) / Hong Kong
852.3740.4779
xinnuo.zhao@skadden.com