SEC Brings Enforcement Action for Adviser Charging Registration and Compliance Expenses to Private Fund

Continuing the trend of SEC enforcement actions relating to private fund adviser fee and expense practices, the SEC recently entered into a consent order against two affiliated registered private fund advisers based on their allocation of Advisers Act registration, compliance, examination and enforcement inquiry costs to the private funds they advised. According to the SEC order:

- the advisers incurred consulting and legal expenses relating to their Advisers Act registration and related compliance, as well as preparation for their routine SEC examination and subsequent enforcement proceeding, and required the funds to bear these expenses.

- although the funds' operating agreements provided that the funds would bear expenses that "in the good faith judgment of the general partner arose out of the operation and activities of the Funds," the SEC did not find there to be sufficient specific disclosure to pass through the advisers' registration, compliance and related costs.[1]

The SEC brought the proceeding notwithstanding that the advisers had already reimbursed the full amount of these expenses (approximately $455,698) to the funds. The consent order assessed a $100,000 penalty and subjected the advisers to a cease and desist order.

In light of the SEC's increasing focus on the allocation of expenses between a registered adviser and its private funds, private fund advisers should carefully evaluate the authority for charging expenses to its private funds and related disclosures made to investors, particularly for expenses that benefit the adviser. Recent enforcement actions stress the SEC's view that in instances resulting in such an adviser benefit, general authorization and disclosure[2] may not be adequate to permit the adviser to charge the private fund.

1 The SEC found, among other violations, that the advisers violated the antifraud provisions of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8, which make it unlawful for any fund adviser to make any false or misleading statement of material fact to any fund investor or prospective investor or to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any fund investor or prospective investor. Such violations may rest on a finding of simple negligence.

2 Recent enforcement cases also stress the importance of pre-investment disclosure for private equity and other long-term committed funds.

If you have any questions about the matters addressed in this *Kirkland AIM*, please contact the following Kirkland attorneys or your regular Kirkland contact.

Norm Champ, P.C.
norm.champ@kirkland.com
+1 212 446 4966

Kevin R. Bettsteller
kevin.bettsteller@kirkland.com
+1 415 439 1427

Michael Chu
michael.chu@kirkland.com
+1 312 862 2101

Jaime D. Schechter
jaime.schechter@kirkland.com
+1 212 446 4979

Robert H. Sutton
robert.sutton@kirkland.com
+1 212 446 4897

Josh Westerholm
joshua.westerholm@kirkland.com
+1 312 862 2007

Scott A. Moehrke, P.C.
scott.moehrke@kirkland.com
+1 312 862 2199

Lisa Cawley
lisa.cawley@kirkland.com
+44 20 7469 2140

Matthew Cohen
matthew.cohen@kirkland.com
+1 415 439 4706

Aaron Schlaphoff
aaron.schlaphoff@kirkland.com
+1 212 446 4996

Jamie Lynn Walter
jamie.walter@kirkland.com
+1 202 879 5069

Corey Zarse
corey.zarse@kirkland.com
+1 312 862 2033