CLIENT UPDATE

SEC SANCTIONS PRIVATE FUND SPONSOR FOR USING UNLICENSED BROKER TO SELL PRIVATE FUND INTERESTS

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Is a person who solicits potential investors for a private fund required to register as a broker, and, if so, does he or she face consequences if he or she fails to register? And, does a private fund sponsor face any consequences for using an unregistered broker to solicit investors for the funds that it manages and advises?

In two companion enforcement actions earlier this month, the Securities and Exchange Commission ("SEC") made it clear that, in certain circumstances, the answer to these questions is "yes." The actions included disciplinary sanctions not only against the unlicensed broker, but also against the private fund sponsor and one of its employees, who failed to oversee the unlicensed broker's activities. Private fund sponsors should take this opportunity to review their arrangements with consultants, placement agents, "finders" and other persons involved in soliciting investors to ensure that these marketers are properly registered and that their activities are appropriate in scope.

IN THE MATTER OF WILLIAM M. STEPHENS
IN THE MATTER OF RANIERI PARTNERS LLC AND DONALD W. PHILLIPS

On March 11, 2013, the SEC announced that it had settled charges against Ranieri Partners LLC ("Ranieri Partners"), its former senior managing partner, Donald W. Phillips ("Phillips"), and an unregistered broker, William M. Stephens ("Stephens"), for violations of Section 15(a) of the Securities Exchange Act of 1934 (the "Exchange Act").[1] In the settlements, the SEC found that, between 2008 and 2011, Ranieri Partners established certain private investment funds for which it served as investment adviser. Phillips was tasked with fundraising for each fund. Phillips called upon his long-time friend Stephens to assist in the effort, despite being generally aware that Stephens had a disciplinary history with the SEC.

Phillips apparently instructed Stephens to limit his activities solely to arranging meetings with potential investors for Ranieri Partners personnel, presumably so that Stephens would be functioning as a "finder" rather than a "broker." Nevertheless, Stephens engaged in fairly typical solicitation efforts, which included (1) sending marketing materials, private placement memoranda and subscription documents to prospective investors (which he had specifically been instructed not to do), (2) giving presentations at meetings between Ranieri Partners personnel and prospective investors, (3) recommending that prospective investors invest in the funds, (4) urging at least one potential investor to adjust its portfolio allocation to make an investment in the funds and (5) providing confidential information, including due diligence materials, to prospective investors. For these services, Ranieri Partners paid Stephens transaction-based compensation (*i.e.*, a success fee).

The SEC found that, because of this conduct and his receipt of transaction-related compensation, Stephens should have been registered as a broker under Section 15(a) of the Exchange Act. This finding appears fairly uncontroversial under the facts, which seem to demonstrate that Stephens was engaged in the business of a broker, as defined by applicable law and long-standing SEC interpretations. In settling the enforcement action, Stephens was barred permanently from the securities industry. The SEC also ordered

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[1] Section 3(a)(4) of the Exchange Act defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others," subject to narrow exceptions. In general terms, Section 15(a) provides that it is unlawful for a broker who makes use of the mails or any other means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security unless registered with the SEC, subject to limited exceptions.

payment of disgorgement and prejudgment interest in excess of $2.8 million, but waived these monetary penalties due to Stephens' poor financial condition.

Of particular interest to private equity and hedge fund managers is the companion settlement relating to Ranieri Partners and Phillips. The SEC found that both the firm and Phillips, its senior managing partner, were aware of Stephens' brokerage activities and assisted him in those activities through the provision of the documents and information that he had sent to prospective investors. The SEC found, among other things, that Ranieri Partners and Phillips:

- Failed to adequately monitor and oversee Stephens' activities to ensure that he was not acting as an unregistered broker. Specifically, the order found that Ranieri Partners and Phillips did not limit Stephens' access to information, thereby allowing him to distribute materials to prospective investors.
- Did not scrutinize Stephens' requests for travel and entertainment reimbursements, which indicated that he was engaging in substantial contacts with prospective investors, above and beyond merely setting up meetings for Ranieri Partners' personnel. Phillips attended certain of these meetings.
- Did nothing to limit Stephens' activities once they understood the full extent of his solicitation efforts.

The SEC found that Ranieri Partners caused, and Phillips' actions aided and abetted, Stephens' violations of Section 15(a) of the Exchange Act. With this settlement, the SEC appears to be taking the view that a private fund sponsor has a duty to oversee the marketing efforts undertaken on its behalf by third parties — particularly unregistered finders. In effect, the SEC is saying that, if the fund sponsor becomes aware of a problem in the way in which a finder is fulfilling its mandate, the sponsor needs to know about it and take appropriate actions to stop it. Simply receiving a covenant from the finder that it will comply with applicable law does not discharge the sponsor's duties.

The sanctions imposed were significant. Ranieri Partners was ordered to pay $375,000, while Phillips was fined $75,000 and suspended from association in a supervisory capacity with any broker, dealer, investment adviser or other SEC-regulated entity for a period of nine months. The settlement order notes that Ranieri Partners implemented revised policies and enhanced procedures in 2011 and 2012 to address the conduct in question and that these remedial efforts were considered in determining to accept the settlement offer.

KEY TAKE-AWAY: KNOW YOUR MARKETERS

The *Ranieri Partners* settlement serves as a useful reminder to private fund sponsors to be attentive to the activities and people marketing interests in their funds, especially third parties. Fund sponsors should determine that persons marketing their funds are, in fact, registered as brokers if they are required to be so registered. Fund sponsors also should obtain customary representations, warranties and covenants concerning compliance with law by persons marketing the funds, including that such persons (1) are registered as required by the Exchange Act and state law and (2) will comply with applicable FINRA rules and regulations. In addition, fund sponsors should have and should follow compliance policies and procedures designed to ensure that persons marketing their funds are appropriately registered (if necessary) and that their activities are appropriate in scope and subject to oversight by fund sponsor personnel.[2]

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Please do not hesitate to contact us if you have any questions concerning the foregoing.

March 29, 2013

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[2] These steps are also important in the context of complying with the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act, and with state and non-U.S. securities laws applicable to the offering.