SEC Charges KKR With Misallocating Broken Deal Expenses

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Washington D.C., June 29, 2015 — The Securities and Exchange Commission today charged Kohlberg Kravis Roberts & Co. (KKR) with misallocating more than $17 million in so-called “broken deal” expenses to its flagship private equity funds in breach of its fiduciary duty.

KKR agreed to pay nearly $30 million to settle the charges, including a $10 million penalty.

The SEC Enforcement Division’s Asset Management Unit has been scrutinizing the private equity industry to make sure that fund managers aren’t misallocating or unfairly charging fees and expenses to investors. An SEC investigation found that during a six-year period ending in 2011, KKR incurred $338 million in broken deal or diligence expenses related to unsuccessful buyout opportunities and similar expenses. Even though KKR’s co-investors, including KKR executives, participated in the firm’s private equity transactions and benefited from the firm’s deal sourcing efforts, KKR did not allocate any portion of these broken deal expenses to any of them for years. KKR did not expressly disclose in its fund limited partnership agreements or related offering materials that it did not allocate broken deal expenses to the co-investors.

“This is the first SEC case to charge a private equity adviser with misallocating broken deal expenses,” said Andrew J. Ceresney, Director of the SEC Enforcement Division. “Although KKR raised billions of dollars of deal capital from co-investors, it unfairly required the funds to shoulder the cost for nearly all of the expenses incurred to explore potential investment opportunities that were pursued but ultimately not completed.”

The SEC’s order instituting a settled administrative proceeding also finds that KKR failed to implement a written compliance policy governing its fund expense allocation practices until the end of the six-year period in 2011.

“KKR’s failure to adopt policies and procedures governing broken deal expense allocation contributed to its breach of fiduciary duty,” said Marshall S. Sprung, Co-Chief of the SEC Enforcement Division’s Asset Management Unit. “A robust compliance program helps investment advisers ensure that clients are not disadvantaged and receive full disclosure about how fund expenses are allocated.”

KKR consented to the entry of the SEC’s order finding that the firm violated Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7. KKR agreed to pay more than $14 million in disgorgement ($3.26 million was previously refunded to clients) as well as more than $4.5 million in prejudgment interest and the $10 million penalty. KKR neither admitted nor denied the SEC’s findings.

The SEC’s investigation was conducted by Vincenzo A. DeLeo and Brian E. Fitzpatrick of the Asset Management Unit with the assistance of James E. Addison of the New York Regional Office. The case was supervised by Panayiota K. Bougiamas of the Asset Management Unit. The SEC examination that led to the investigation was conducted by Edward R. Perkins, Francine P. Catapano, Syed Husain, and Tracy O’Sullivan.

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Related Materials

- SEC order