

SEC Enters Into First Deferred Prosecution Agreement with an Individual

The U.S. Securities and Exchange Commission (“SEC” or “Commission”) announced on Tuesday that it entered into its first Deferred Prosecution Agreement (“DPA” or “Agreement”) with an individual in connection with a possible enforcement action. The Agreement is part of the SEC’s recent use of alternative enforcement tools to encourage voluntary disclosure of securities law violations, a trend begun when Ropes & Gray negotiated the first Non-Prosecution Agreement (“NPA”) for its client Carter’s Inc. in 2010.

According to SEC documents, Connecticut accountant Scott Herckis was retained in 2010 by Berton M. Hochfeld—manager of Heppelwhite Fund—to serve as the Heppelwhite Fund’s administrator. Over the course of two years, Herckis purportedly complied with Hochfeld’s instructions to transfer a total of \$1.5 million from the fund to accounts Hochfeld controlled, despite the fact that the fund’s limited partnership agreement prohibited the fund from making loans to Hochfeld.

Herckis resigned in September 2012, based on his growing concern about Hochfeld’s improprieties. He contacted the authorities and provided “immediate and complete cooperation” with the SEC’s resulting investigation. The SEC took special note that Herckis’s “proactive” cooperation allowed the SEC to initiate an emergency action to freeze more than \$6 million of Hochfeld’s and the fund’s assets. Ultimately, Hochfeld pleaded guilty in a criminal case filed by the Department of Justice (“DOJ”) and consented to a judgment in a civil case filed by the SEC.

Herckis’s cooperation earned him a DPA with the SEC, the Commission’s first with an individual. According to Scott W. Friestad, an associate director in the SEC’s Division of Enforcement, Herckis received “significant credit for reporting the fraud and providing full cooperation.”

Under the terms of the Agreement, the SEC will not bring an enforcement action against Herckis in connection with his actions at the fund, and in return Herckis agreed to provide continued cooperation and admitted that he aided and abetted Hochfeld’s fraud, including the specific acknowledgement that he knew or was reckless in not knowing that the money transfers and his statements in investor documents were improper. Herckis also agreed to pay approximately \$50,000 total in disgorgement plus interest and agreed not to associate with an investment advisor or administer a hedge fund for a period of five years. Should Herckis breach the agreement, the SEC may use his admissions against him in an enforcement action and seek additional financial penalties and other remedies.

DPAs are one of a number of tools the federal government has at its disposal for facilitating and rewarding cooperation. Indeed, the DOJ has successfully used DPAs and NPAs for years in criminal investigations. Many institutional clients have found these types of agreements useful in criminal matters to address historic misconduct while at the same time avoiding the often draconian penalties authorities have at their disposal, including debarment, exclusion, and significant financial penalties.

The Herckis Agreement represents an extension of the SEC’s use of DPAs with individuals—though the SEC has already entered into similar arrangements with corporate entities. The first such agreement involved children’s clothing marketer, Carter’s Inc., after it discovered that an officer of the company had engaged in financial fraud. Acting on behalf of Carter’s, Ropes & Gray negotiated an NPA with the SEC in which, in exchange for Carter’s cooperation with the SEC’s investigation and any related enforcement proceedings, the

SEC agreed not to charge Carter's with violations of the federal securities laws or otherwise commence any enforcement action against Carter's. Significantly, Carter's was not required to pay a financial penalty nor was it required to admit to any misconduct.

The SEC's Agreement with Herckis is the latest confirmation that the Commission is serious about its cooperation initiatives. It, along with the SEC's highly publicized whistleblower program, signals the SEC's resoluteness in relying on "insider" reports of securities law violations.

As the SEC's use of DPAs and NPAs continues to expand, the incentives to proactively report securities law violations will only increase for companies and funds that seek to simultaneously root out noncompliance and avoid the often serious long-term consequences that accompany civil enforcement actions.

If you have questions about these recent enforcement trends, or how they relate to your securities law compliance, please contact the Ropes & Gray attorneys with whom you regularly work.