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Hedge Fund Adviser Sanctioned for Breaching Fiduciary Duty to Fund by Participating in Undisclosed Principal Transaction

On September 18, 2013, the Securities and Exchange Commission charged Shadron L. Stastney with breaching his fiduciary duty to the hedge fund he advised by engineering an undisclosed principal transaction in which he had a financial conflict of interest, thereby violating Sections 206(2) and 206(3) of the Investment Advisers Act of 1940. The case represents a strong statement by the SEC that failure of advisers to disclose material conflicts of interest will not be tolerated.

In late December 2007 and early January 2008, Shadron L. Stastney, a founder and partner at the investment advisory firm Vicis Capital LLC ("Vicis Capital"), authorized a client hedge fund to pay approximately \$7.5 million to purchase a basket of illiquid securities from Stastney's personal friend and outside business partner, who was hired by Vicis Capital as a managing director. Stastney required his friend to divest these personal securities holdings when he came on board at Vicis Capital because they overlapped with securities in which the hedge fund also was invested. Stastney failed to tell the client hedge fund or any other Vicis partners or management that he had a financial stake in some of the same securities sold into the fund. Stastney personally benefited from the sale: after the hedge fund purchased the conflicted securities, Stastney's friend wired Stastney more than \$2 million of the sales proceeds to his personal savings bank account.

The SEC's action against Stastney was premised on the fact that the sale of securities in which Stastney possessed an ownership interest were principal

transactions that required full disclosure and written client approval as provided in Sections 206(2) and 206(3) of the Investment Advisers Act of 1940. In a principal transaction, an adviser acting for its own account buys a security from a client account or sells a security to a client account. Principal transactions can pose potential conflicts between the interests of the adviser and the client, and therefore advisers are required to disclose in writing any financial interest or conflicted role when advising a client on the other side of the trade. They also must obtain the client's consent.

The SEC set forth an order instituting a settled administrative proceeding. The order requires Stastney to pay disgorgement of \$2,033,710.46, prejudgment interest of \$501,385.06, and a penalty of \$375,000. Stastney is also barred from association with any investment company, investment adviser, broker, dealer, municipal securities dealer, or transfer agent for at least eighteen months. In 2009, losses and investor redemptions forced Stastney and his partners to wind down their funds; pursuant to the SEC's order, Stastney will be permitted to finish winding down the fund under the oversight of an independent monitor, payable at his own expense. Stastney will also be able to continue running OptimizeRx, a penny stock for which he is currently the chief executive officer. Stastney consented to the issuance of the order without admitting or denying any of the findings and agreed to cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(3) of the Investment Advisers Act of 1940.