

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 4529 / September 14, 2016**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17538**

**In the Matter of**

**FIRST RESERVE  
MANAGEMENT, L.P.,**

**Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTION 203(k) OF THE INVESTMENT  
ADVISERS ACT OF 1940, MAKING  
FINDINGS, AND IMPOSING A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), against First Reserve Management, L.P. (“First Reserve” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### SUMMARY

1. This matter concerns certain financial conflicts of interest on the part of private equity fund advisory firm First Reserve that were not adequately disclosed to its private equity fund clients (the "Funds") or to investors in the Funds.

2. At various times between approximately 2010 and 2015, First Reserve allocated the following expenses to the Funds without making appropriate disclosures or receiving effective consent:

- (i) certain fees and expenses of two entities formed as advisers to a Fund portfolio company that was a pooled investment vehicle, enabling First Reserve to avoid incurring certain expenses in connection with providing advisory services to the Funds; and
- (ii) certain premiums for a liability insurance policy covering First Reserve for risks not entirely arising from its management of the Funds, where the Funds' governing documents provided that the Funds only would pay insurance expenses relating to the affairs of the Funds.

3. In addition, First Reserve negotiated a legal fee discount from a law firm for itself for certain services based on the large volume of work the law firm performed for the Funds, while the Funds did not receive a discount on the same services. Because of the conflict of interest First Reserve faced as the beneficiary of the discount, First Reserve could not consent on behalf of the Funds to First Reserve's practice of accepting the discount.

4. Based on the foregoing conduct, First Reserve violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

5. First Reserve also violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent the above violations of the Advisers Act.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

## RESPONDENT AND OTHER RELEVANT ENTITIES

### Respondent

6. **First Reserve Management, L.P.** (“First Reserve” or “Respondent”) is a Cayman Islands limited partnership with a principal place of business in Greenwich, Connecticut. First Reserve has been registered with the Commission as an investment adviser since March 2012. Founded in 1983, First Reserve advises approximately twenty private fund clients. As of December 31, 2015, it reported assets under management of over \$12 billion.

### Other Relevant Entities

7. **First Reserve Fund X, L.P., First Reserve Fund XI, L.P., First Reserve Fund XII, L.P., First Reserve Fund XII-A Parallel Vehicle, L.P., and First Reserve Fund XIII, L.P.** (respectively, “Fund X,” “Fund XI,” “Fund XII,” “Fund XII-A,” and “Fund XIII,” and collectively, and together with other private funds managed by First Reserve, the “First Reserve Funds” or “Funds”) are among private funds managed by First Reserve that are the subject of this proceeding.

8. **First Reserve Momentum L.P.** (“FRM”) is a private fund that is a portfolio company of Fund XII and Fund XII-A.

9. **First Reserve Momentum (US), LLC** (“FRM US”) is a Delaware limited liability company with a principal place of business in Houston, Texas. FRM US has been registered with the Commission as an investment adviser since October 2014. During the relevant period, FRM US reported approximately \$200 million in assets under management in one discretionary account (*i.e.*, FRM).

10. **First Reserve Momentum LLP** (“FRM UK”) is a foreign adviser not registered with the Commission and is the parent company of FRM US. Both FRM US and FRM UK are subsidiaries of FRM and provide advisory services solely to FRM.

## FACTS

### Background

11. First Reserve provides investment advisory services to the Funds, which make investments primarily in companies in the energy and natural resources industries. First Reserve markets itself as the largest and longest-running private equity firm to focus exclusively on energy-related investments and touts its specialized knowledge of the energy industry as a competitive advantage. First Reserve further promotes its management team’s vast experience in energy investing, as well as the firm’s history of diversifying investments across different segments of the energy industry, as factors contributing to its ability to predict market trends, thereby leading to its success in selecting investments. First Reserve also claims, in certain marketing and fundraising materials, that its extensive knowledge of the energy industry and familiarity with industry players allows it to access promising deal avenues and to recruit top managers for portfolio companies.

12. The Funds are each organized as limited partnerships. A First Reserve affiliate serves as the general partner of each of the Funds and has authority to make all decisions for, and act on behalf of, the Funds. A First Reserve affiliate also serves as the investment adviser to each of the Funds. The terms of each Fund's operations, including provisions concerning expenses, are set forth in each Fund's governing documents, including a limited partnership agreement ("LPA"). The terms of the investment advisory services that First Reserve or its affiliate provides to each of the Funds, and the management fee that First Reserve or its affiliate receives from each of the Funds for such services, are set forth in the LPA for each of the Funds as well as in an investment advisory agreement ("IAA") that First Reserve or its affiliate enters into with each of the Funds.

13. Beginning in late 2014, staff of the Commission's Office of Compliance Inspections and Examinations ("OCIE") conducted an examination of First Reserve and, in 2015, raised concerns about certain expenses that First Reserve's general partner affiliate had allocated to the Funds. During and after the examination, First Reserve voluntarily reimbursed certain expenses and made other payments to the Funds, as described herein.

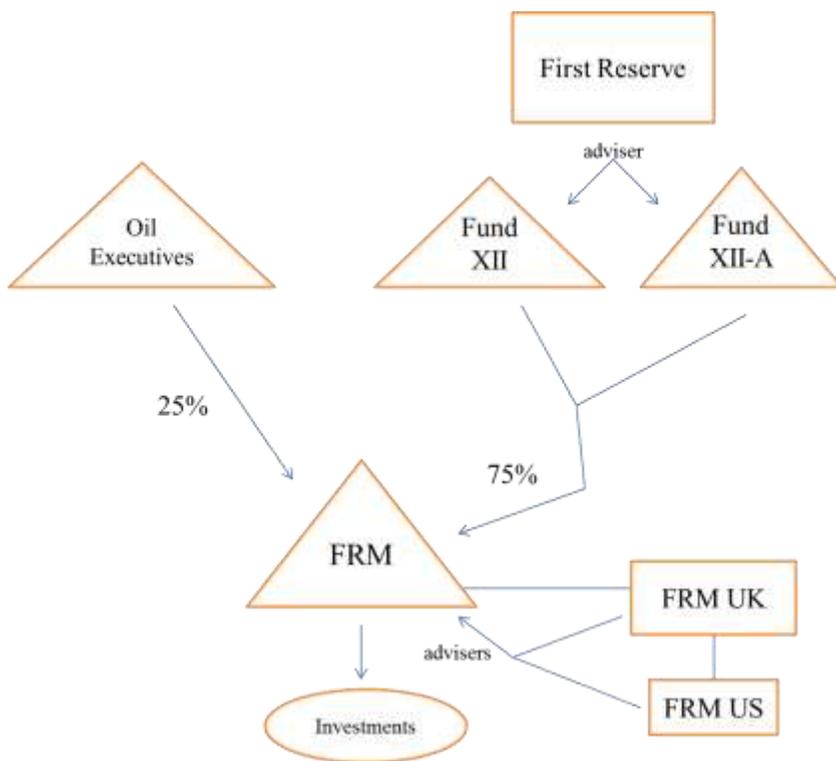
### **Fees and Expenses of Two Entities Formed as Advisers to a Portfolio Company**

14. In late 2013, First Reserve's general partner affiliate caused Funds XII and XII-A to make an investment in FRM, which itself is a pooled investment vehicle. Funds XII and XII-A provided seed capital to FRM for the purpose of funding investments by FRM. In particular, First Reserve formed FRM for the purpose of seeking out and making investments on behalf of Funds XII and XII-A in small oil field equipment and services companies in the energy industry, and FRM made investments in two such energy companies in 2014. Investments in pooled investment vehicles such as FRM are not expressly prohibited by the LPAs for Funds XII and XII-A. However, the LPAs for Funds XII and XII-A state that Funds XII and XII-A will make investments "solely in companies involved in the energy and natural resources industries." With the exception of FRM, Funds XII and XII-A invested directly in companies involved in the energy and natural resources industries and did not invest in any other pooled investment vehicles.

15. Funds XII and XII-A collectively own approximately 75% of FRM, while a group of current and former executives of a multinational oil field services company owns approximately 25% of FRM. FRM's owners (including Funds XII and XII-A, and consequently First Reserve's general partner affiliate) retain investment discretion over the assets of FRM.

16. First Reserve and the multinational oil field executive group formed and organized FRM UK and FRM US as subsidiaries of FRM to provide investment management services to FRM. FRM UK and FRM US were formed solely for the purpose of employing the management team that provides investment management services to FRM. FRM UK and FRM US provide services only to FRM and do not have any other business (for example, FRM is FRM US's only advisory client). FRM's management team is composed of different individuals than First Reserve's management team, but certain First Reserve employees serve on the board of FRM's general partner and as members of the Investment Advisory Committee of FRM UK, and, by virtue of Fund XII and XII-A's indirect ownership of FRM UK and FRM US, First Reserve essentially exerted control over the members and employees of FRM UK and FRM US. The

following is a simplified illustration of the FRM ownership and management structure described above.



17. First Reserve caused Funds XII and XII-A to enter into a limited partnership agreement as to FRM with the other partners of FRM, which permitted FRM UK to call capital from Funds XII and XII-A for their approximately 75% pro rata share of FRM UK’s organizational and start-up expenses. First Reserve also caused FRM’s general partner and FRM UK to enter into an advisory agreement, pursuant to which FRM UK would be paid, at a minimum, an annual fee of 2% of committed capital amounts, plus any additional fees to which the parties later agreed. There was no cap on the total payment of fees to FRM UK (which could then be passed on to FRM US).

18. Beginning in late 2013, a proportionate share of the Fund XII and XII-A combined investment in FRM was used to pay the formation and various operation expenses of FRM UK and FRM US. Through mid-2015, more than \$7 million of the Funds’ approximately \$40 million combined capital contribution to FRM, or more than 15% of the Funds’ investment in FRM through that time, paid for the Funds’ proportionate share of expenses related to FRM UK and FRM US. Because Funds XII and XII-A are only entitled to receive their proportionate share of any proceeds that FRM may generate upon the realization of its investments, Funds XII and XII-A may not achieve a return on the amounts they paid in respect of expenses of FRM UK and FRM US. The amounts Funds XII and XII-A paid in respect of expenses of FRM UK and FRM US were used for, among other things, general office operating costs, such as rent, utilities, and salaries, as well as costs related to the formation of FRM UK and FRM US as investment advisory entities, including regulatory registration costs.

19. First Reserve's decision to make the investment in FRM, and to structure the investment such that FRM (and ultimately Funds XII and XII-A) paid the expenses of FRM UK and FRM US, enabled First Reserve to avoid incurring certain administrative expenses and certain expenses in connection with providing investment advisory services to the Funds. First Reserve did not disclose to Funds XII and XII-A or their advisory boards, or to investors in Funds XII and XII-A, neither prior to the commitment of capital nor prior to the expenses being incurred, that capital contributed to FRM by Funds XII and XII-A would be used to pay the significant costs and fees of establishing and operating FRM UK and FRM US as investment advisory entities to FRM. Because of the relationships between and among First Reserve, FRM, FRM UK, and FRM US, the capital contributed to FRM by Funds XII and XII-A that was used to pay fees to FRM UK and FRM US gave rise to a financial conflict of interest that First Reserve did not disclose.

20. The LPAs for Funds XII and XII-A further provide a mechanism by which First Reserve can present potential conflicts of interest for review and approval to an Advisory Board comprised of investors in the Funds. The LPAs also provide that, if First Reserve consults with the Advisory Board concerning a potential conflict of interest and discloses all relevant facts to the Advisory Board, and the Advisory Board waives or approves a course of action as to any conflict, then First Reserve can proceed to take actions without exposing itself to any potential liability to Funds. Here, however, First Reserve did not consult the Advisory Board concerning any potential conflict of interest arising from the use of any portion of the capital contributed to FRM by Funds XII and XII-A for the formation and operation costs of FRM UK and FRM US.

21. In June 2015, following the OCIE staff examination, First Reserve voluntarily reimbursed a total of \$7,435,737 to Funds XII and XII-A, representing the proportionate share of Fund XII and XII-A's combined investment in FRM that paid the expenses of FRM UK and FRM US. In the process of reimbursing Funds XII and XII-A, First Reserve provided written notice to the investors in Funds XII and XII-A of the nature of the reimbursement as well as its planned practice as to these expenses going forward. First Reserve has voluntarily undertaken to revise its expense allocation practices concerning FRM such that, going forward, First Reserve or its general partner affiliates will bear the costs of FRM UK and FRM US attributable to Fund XII and XII-A's proportionate share of their combined ownership interest in FRM.

### **Insurance Premiums**

22. The Funds' LPAs provide that the Funds will bear the out-of-pockets costs of any insurance "relating to the affairs of" the Funds.

23. Beginning in at least 2008, First Reserve caused the Funds to pay 100% of the premiums for a liability insurance policy covering First Reserve for various risks, some but not all of which arise out of First Reserve's management of the Funds.

24. In 2013, First Reserve retained a third party to conduct a periodic compliance review, which resulted in a recommendation for First Reserve to reconsider its insurance premium allocation practices.

25. As a result of the review, First Reserve revised its practice such that First Reserve prospectively will bear the portion of the insurance premiums attributable to risks that do not directly arise from its management of the funds. By previously allocating all insurance premiums to the Funds and no portion to itself, First Reserve acted in contravention of the Funds' governing documents.

26. First Reserve also retroactively reimbursed the applicable Funds for First Reserve's share of insurance premiums for prior coverage periods. First Reserve reimbursed a total of \$733,012 to various Funds (including Funds X, XI, XII, XII-A, and XIII), representing its share of past premiums. In the process of reimbursing these amounts to the Funds, First Reserve provided written notice to the applicable Funds' investors of the nature of the reimbursements as well as its revised practice.

### **Legal Fee Discount**

27. Between at least 2010 and 2014, an outside law firm (the "Law Firm") provided legal services to each of First Reserve and various Funds. First Reserve arranged for and coordinated all legal services that the Law Firm performed for both First Reserve and the Funds. During and before the relevant period, the Law Firm performed a substantially greater volume of services for the Funds than for First Reserve and consequently generated significantly more legal fees in connection with services it provided to the Funds. The disparity in the quantity of the Law Firm's services and fees for Fund-related work versus adviser-related work was known to First Reserve, and indeed is common and expected based on the differing nature of the legal services each type of entity typically needs in connection with its particular business and operations. Based on the high volume of Fund-related work, First Reserve asked whether it could receive any discount from the Law Firm. As a result, the Law Firm offered and First Reserve accepted a discount on the Law Firm's fees for certain services for First Reserve, but the Funds did not receive any discount for the same services (although the Funds received certain discounts on other types of services). First Reserve accepted the benefit of the recurring disparate discount from the Law Firm for itself and did not negotiate or attempt to negotiate a similar, or any, discount for the Funds for the same services (although the Funds received certain discounts for other services).

28. Beginning in early 2013, after capital was already committed to the Funds, First Reserve disclosed in its Form ADV the possibility that it could receive service provider discounts that might be more favorable than those received by the Funds. However, First Reserve did not disclose to the Funds or investors in the Funds at any time that First Reserve in fact received a discount on certain services from the Law Firm while the Funds did not receive a discount on the same services. Because of its conflict of interest as the beneficiary of the discount, First Reserve could not effectively consent on behalf of the Funds to First Reserve's acceptance of the discount while First Reserve knew the Funds did not also receive the same discount.

29. In November and December 2014, following the OCIE staff examination, First Reserve voluntarily paid to the applicable Funds their pro rata share (based on committed capital during each calendar year) of the amount of the discount that First Reserve received from the Law Firm during the relevant period. First Reserve paid a total of \$179,466 attributable to the legal fee discount to various Funds (including Funds X, XI, XII, XII-A, and XIII). In the process of paying

these amounts to the Funds, First Reserve provided written notice to the Funds' investors of the nature of the payments as well as its planned practice going forward. First Reserve plans to pass on any future discounts it receives from the Law Firm to any active Funds pro rata based on committed capital during the period of any discount.

### **Compliance Policies and Procedures**

30. As a registered investment adviser, First Reserve is subject to Advisers Act rules, including the requirement to adopt and implement written policies and procedures that are reasonably designed to prevent violations of the Advisers Act and its rules, and that are, per the rule's adopting release, tailored to the risks arising from its advisory business.

31. The nature of First Reserve's business as a private equity fund adviser involves the allocation of expenses as between itself and its fund clients. Despite the potential risks of allocating such expenses inconsistently with disclosures to fund clients, First Reserve did not adopt and implement any written policies and procedures reasonably designed to prevent the above violations of the Advisers Act or its rules.

32. The nature of First Reserve's business as a private equity fund adviser involves the use of certain common service providers by both it and its fund clients. Despite the potential risks surrounding the acceptance and disclosure of disparate service provider discounts, First Reserve did not adopt and implement any written policies and procedures reasonably designed to prevent violations of the Advisers Act or its rules.

### **VIOLATIONS**

33. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, Respondent violated Section 206(2) of the Advisers Act.

34. Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to "[m]ake any untrue statement of a material fact or, omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading to any investor or prospective investor in the pooled investment vehicle" or "engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle." Proof of scienter is not required to establish a violation of Section 206(4) of the Advisers Act; a showing of negligence is sufficient. *Steadman*, 967 F.2d at 647. As a result of the conduct described above, Respondent violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

35. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. Proof of scienter is not required to establish a violation of Section 206(4) of the Advisers Act. *Steadman*, 967 F.2d at 647. As a result of Respondent's failure to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act or its rules arising from the conduct described above, Respondent violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

### **REMEDIAL EFFORTS AND COOPERATION**

36. In determining to accept the Offer, the Commission considered the remedial efforts undertaken by the Respondent as described herein and the cooperation the Respondent provided to the Commission staff during its investigation and the preceding examination, including, prior to any contact by Commission investigative staff, voluntarily committing in the Respondent's response to the OCIE examination findings letter to reimburse and/or pay the amounts described herein to the Funds, promptly making such reimbursements or payments to the Funds, and revising its practices and disclosures as described herein.

### **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 203(k) of the Advisers Act, Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder.

B. Respondent shall, within ten (10) business days of the entry of this Order, pay a civil money penalty in the amount of \$3,500,000 to the Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Securities Exchange Act of 1934. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert B. Baker, Assistant Regional Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 24th Floor, Boston, MA 02110.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, Respondent shall not argue that Respondent is entitled to, nor shall Respondent benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that Respondent shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

D. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of \$3,500,000 based upon Respondent's cooperation in a Commission investigation. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission, or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Brent J. Fields  
Secretary