

# Client Advisory

## “Vacated” Hedge Fund Adviser Registration Rule Still in Effect

June 28, 2006

This Client Advisory is a follow-up to the report in our *Corporate and Financial Weekly Digest* of [June 23, 2006](#).

### I. Current Status of the Rule

As reported, on June 23, 2006, in *Goldstein v. Securities and Exchange Commission*, the D.C. Circuit Court of Appeals vacated the rules recently promulgated by the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended, requiring certain investment advisers of private funds to count the investors in the funds as “clients” (the “Hedge Fund Rule”). The Court held that the requirement under the Hedge Fund Rule to count individual investors as clients only for the purposes of registration was an “arbitrary” departure from the SEC’s prior view that the fund itself was the adviser’s client. The Court found it counterintuitive and contrary to the plain meaning of the statute to consider the individual investors in a hedge fund as clients of the fund’s adviser. The Court noted that the definition of investment adviser in the Advisers Act involves a direct relationship with the client. According to the Court, a client relationship, in the context of hedge funds, exists between the adviser and the fund, but not between the adviser and the investors in the fund.

By Order issued on its own accord on June 23, the Court stayed the effectiveness of its decision until seven days after denial of any petition for rehearing. If the SEC does not file a petition for rehearing (which it must do by August 7, 2006), the effectiveness of the Hedge Fund Rule will expire by no later than August 14, 2006. The Hedge Fund Rule is still in effect.

### II. Post *Goldstein*

#### ***What are the deadlines for the SEC to appeal the decision?***

The SEC has until August 7th to request the Court to reconsider its ruling. The SEC has until the later of October 9th or 90 days after the Court of Appeals denies its petition for rehearing to file a petition for a writ of certiorari with the Supreme Court. Writs of certiorari are rarely granted by the Supreme Court. Moreover, appeals to the Supreme Court by a government agency can only be made with the consent of the Solicitor General, and not all such requests by the SEC have been granted.

#### ***Is the Hedge Fund Rule currently still in effect?***

Yes. On June 23 the Court, on its own motion, directed the Clerk of the Court not to issue the mandate until seven days after disposition of any timely petition for rehearing or petition for rehearing en banc. If no petition for rehearing is filed, the mandate can be issued no later than August 14, 2006.

### III. What’s Next?

Shortly after the decision, SEC Chairman Christopher Cox stated in a press release that the SEC would reevaluate its approach to hedge fund activity. He directed the SEC staff to evaluate the Court’s decision and provide alternatives for the SEC’s consideration. This could include additional rulemaking.

In light of the uncertainty as to what the SEC will or will not do, the fact that the SEC has until at least August 7 (or potentially October 9 or later) to take any action that would affect the Court's decision, and the Court's post opinion order, it may be advisable for a hedge fund manager to defer any action until a clearer picture emerges of the SEC's proposed course of action in this area.

As the Hedge Fund Rule is still in effect, the withdrawal of registration by a hedge fund adviser or elimination of a two-year and one-day lock up imposed by an adviser in order to avoid registration would constitute a violation of the Advisers Act and could expose the adviser to liability under the Advisers Act.

This is a developing situation and advisers should proceed only after careful consideration, given their own particular facts and circumstances.

## We Can Help

Katten Muchin Rosenman LLP has extensive experience in dealing with all aspects of investment adviser registration and regulation. We will be happy to discuss further with you the issues raised by the *Goldstein* ruling and their implications for your business. Please contact one of the following Katten Muchin Rosenman LLP attorneys:

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