

# Financial Services

## Hedge Fund Alert

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### U.S. Circuit Court of Appeals Vacates Hedge Fund Regulation Ruling

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On June 23, 2006, a three judge panel of the U.S. Circuit Court of Appeals for the D.C. Circuit vacated the controversial hedge fund registration rule passed by the U.S. Securities and Exchange Commission. In a harshly worded 19 page decision, the Circuit Court stated that the Commission's decision to require advisers to count individual investors as clients rather than the funds themselves was "arbitrary" and inconsistent with its prior view of counting funds as clients for registration purposes. As such, it ruled that the Commission's revised definition of what constitutes a client under the Hedge Fund Registration rule was not reasonable and was beyond the scope of what Congress intended.

SEC Chairman Christopher Cox was quick to respond to the Court's ruling, asking that the staff re-evaluate its approach to the regulation of hedge funds. He also asked the staff to review possible plans of action for the future regarding the rule. These alternatives include: the possibility of appeal to the entire D.C. Circuit Court of Appeals; rewriting the rule to meet the dictates of the Circuit Court; or asking Congress for explicit authority to regulate the hedge fund community.

It is unclear whether or not Chairman Cox, a pro-business Republican, will have the Commission appeal the rule, which was passed by a narrow 3-2 decision. Commissioners Atkins and Glassman were staunch opponents of the new rule, although Commissioner Glassman may not be in place if the rule is redrafted and repropose.

Some Democrats in Congress have already started drafting legislation to give the Commission this authority and had promised to introduce such legislation before the July 4th holiday. However, Senator Richard Shelby, Chairman of the Senate Banking Committee, has already stated that he does not believe it is necessary to pursue such hedge fund regulation. As a result, it is unclear how soon Congress would consider, let alone pass, such legislation.

The Court specifically stayed its mandate and gave the SEC until August 7, 2006 to decide on whether or not to appeal its decision. It is also possible that the SEC could appeal the matter to the Supreme Court directly. In the meantime, the rule itself remains in effect and all registered advisers are still subject to the rule. Because of this, any adviser who wishes to de-register would need to meet the exemptions defined in the rule (i.e. imposing a two year and a day lockup on investors) until the Commission takes further action with the Court or be in violation of the Investment Advisers Act. Current active examinations of recently registered hedge fund advisers will continue but the SEC has not decided whether or not it will initiate any new examinations of these advisers in this interim period.

For additional information please call Rick Irvine at (441) 299-7136 or your PricewaterhouseCoopers advisor.

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