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A legal update from Dechert's Financial Services Group

## Court Overturns SEC Hedge Fund Rule

On June 23, 2006, the United States Court of Appeals for the D.C. Circuit overturned the controversial SEC rule requiring hedge fund managers with 15 or more investors to register as investment advisers.

The SEC rule at issue changed the definition of a "client" of a hedge fund adviser from the fund itself to the underlying investors in the advised fund, thereby largely eliminating the statutory exemption for advisers with fewer than 15 clients. The Court held that the SEC rule was arbitrary and an unreasonable interpretation of the Investment Advisers Act of 1940. The Court vacated and remanded the rule to the SEC for reconsideration.

In a separate order issued the same day, the Court, on its own motion, stayed its decision from taking effect to provide the SEC time to decide whether it will pursue additional hearings. The SEC could, for example, seek a rehearing or a rehearing en banc by the entire D.C. Circuit or seek to petition for review by the U.S. Supreme Court. The implication of this delay is that the rule will remain in effect until at least August 7, 2006, unless the SEC decides sooner not to seek a rehearing or appeal. In addition, U.S. House of Representatives Democrats, spearheaded by Massachusetts Rep. Barney Frank, unveiled a bill on June 29, 2006 aimed to give the SEC the authority to require the registration of hedge fund advisers.

Given the uncertainty of potential further proceedings, many in the hedge fund industry are taking a cautious approach and are waiting to see what the SEC decides to do next.

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