September 15, 2004

Via E-Mail

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Investment Advisers Act Release No. 2266 (File No. S7-30-04): Registration under the Advisers Act of Certain Hedge Fund Advisers

Dear Mr. Katz:

My name is Adam Bolter and I am a CPA and second year law student at American University Washington College of Law. I am currently in the process of writing a law review comment for the *Administrative Law Review* and as such, would like to share a few of the more significant concerns my paper raises regarding the statutory authority of the SEC to promulgate this rule. I submit these comments as further support of the conclusion made in a public comment dated September 8, 2004 by Wilmer Cutler Pickering Hale and Dorr LLP.

Interestingly, the legislative history behind Rule 203(b)(3) explicitly leaves unanswered the question as to whether shareholders, partners, or beneficial owners of entities other than business development companies are entitled to the no "look-through" provision in counting clients.[1] Without specific legislative intent, a reviewing court will need to address the question of whether Congress ever intended to regulate privately placed investment pools, such as hedge funds. In trying to ascertain Congressional intent, a review of the numerous exemptions carved out of the Investment Advisers Act of 1940 (Advisers Act), The Securities Act of 1933 ('33 Act), and The Investment Company Act of 1940 ('40 Act) seem to suggest Congressional intent to regulate public offerings, *not* those targeted towards private groups of sophisticated investors.

This conclusion is further supported by the SEC's historical application of the "look-through provision." For example, consider Rule 205(a)(1) of the Advisers Act that generally prohibits a registered investment adviser from entering into performance-based fee agreements. The SEC used its rulemaking authority to create an exemption for advisers if the client was "qualified." Moreover, Rule 205-3(b) requires the adviser to "look-through" to the equity owners of a 3(c)(1) fund (not 3(c)(7) funds) when identifying "qualified" clients. These rules demonstrate the SEC's furtherance of Congressional intent by supporting the distinction between "qualified" investors and those investors deemed less "sophisticated" and in need of the SEC's protection. Furthermore, the SEC utilized the "look-through" provision by focusing on investors in 3(c)(1) funds where there is potential for circumventing the purpose of the rule, as opposed to the "qualified " investors in 3(c)(7) funds. Shouldn't the SEC's rule proposal focus more on the distinction between sophisticated and unsophisticated investors, thereby remaining consistent with long-standing Congressional intent and its own historical rulemaking?

With respect to the '33 Act, the Supreme Court spoke in *SEC v. Ralston Purina Co.*, holding that the private offering exemption does not turn on a purely numerical calculation, but instead upon the knowledge of the offeree and the need for protections afforded through registration.[2] Interestingly, the

[1] *See* H.R. Rep. No. 1341, 96th Cong. at 62 (1980).
[2] *See* SEC v. Ralston Purina Co., 346 U.S. 119, 125-27 (1953).

SEC's proposed rule requires essentially all hedge fund managers to register based on a purely numerical calculation, without regard to Congressional intent or judicial interpretation suggesting that private offerings focus on investor sophistication.

Moreover, the '40 Act provides for two heavily relied-upon exemptions in Section 3(c)(1) (generally exempting issuers whose outstanding securities are beneficially owned by not more than 100 persons) and 3(c)(7) (generally excluding from the definition of an investment company any issuer whose securities are owned exclusively by "qualified purchasers"). These exemptions, similar to Section 4(2) of the '33 Act, provide clear evidence of Congressional intent to allow certain "private offerings," especially those including only "sophisticated" investors, to operate in an unregulated environment. If the SEC now seeks to reverse this trend, should Congress not play a part when the effect of such a rule is essentially to create new law?

Another area of concern is the SEC's use of the "look-through" provision in a manner inconsistent with its historical application. Under these circumstances, a reviewing court will reject the general deference given to agency rulemaking in favor of a more scrutinizing analysis.[3] Congress enacted the "look-through" provision in Section 3(c)(1)(A) of the '40 Act as a mechanism to prevent circumvention of a rule's purpose. The purpose behind the "look-through" provision was reiterated by the SEC when it amended Section 3(c)(1)(A) to exclude operating companies from the Rule.[4] This treatment is clearly at odds with the SEC's current proposal that attempts to use the "look-through" provision *not* as a means to cure a loophole currently being exploited by advisers, but as a mechanism to effectively create new law.[5]

Should the SEC finalize this rule, a reviewing court might very well set aside this rule as unlawful and in excess of the SEC's statutory authority. The general deference that a reviewing court gives to an agency's ability to promulgate rules would likely give way under circumstances where the SEC not only reverses its own historical application, but creates a rule that seemingly operates contrary to Congressional intent. Moreover, a Congressional mandate seems more appropriate in a case such as this, where tremendous implications will result should this rule be finalized.[6]

Thank you for the opportunity to comment on such an important issue and I look forward to the Commission's responses to the many thought-provoking issues raised during this comment period.

Respectfully Submitted,

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[3] *See* Natural Res. Def. Council, Inc. v. SEC, 606 F.2d 1031, 1050 (DC Cir. Court of Appeals) (finding that a more searching analysis is justified where the presumption of agency regularity has been rebutted, as where an agency departs from its consistent and longstanding precedents or has a history of inconsistent judgments).
[4] *See Private Investment Companies*, 61 Fed. Reg. 68100, 68102 (1996).
[5] *See Registration Under the Advisers Act of Certain Hedge Fund Advisers*, 69 Fed. Reg. 45172, 45199 (proposed July 28, 2004) (to be codified at 17 C.F.R. pt. 275 & 279).
[6] *See* SEC v. Sloan, 436 U.S. 103, 112 (1978) (finding that a Congressional mandate or clear statutory authority is required when the implementation of a rule has a devastating impact).