KIRKLAND**PEN**

June 27, 2006

Private Equity Newsletter

Appeals Court Throws Out SEC Rule Requiring Registration of Hedge Fund Advisers

PENpoints

On June 23, 2006, the U.S. Court of Appeals for the District of Columbia Circuit struck down as "arbitrary" the new SEC rule requiring most hedge fund advisers to register as an investment adviser with the SEC. Since its adoption, this rule has generated concern among both traditional hedge fund advisers and private equity fund sponsors, as private equity fund sponsors have shown increasing interest in forming private equity or hybrid funds that incorporate certain characteristics commonly associated with hedge funds, such as redemption rights. Private equity fund sponsors have been concerned that this new rule could require a fund's general partner and/or management company to register as an investment adviser. The Court of Appeals' decision throwing out the new rule in *Goldstein v. Securities and Exchange Commission* ("*Goldstein*") is the latest development in a recent string of successful attacks on SEC rulemaking affecting funds and fund sponsors.

Prior to December 2004, most private fund advisers could rely on the "fewer-than-15-client" exemption from investment adviser registration under Section 203(b)(3) of the Investment Advisers Act of 1940 ("Advisers Act"). Under this exemption, an adviser is not required to register if it:

- advises fewer than 15 clients during a 12 month period;
- does not hold itself out generally to the public as an investment adviser; and
- does not serve as an adviser to a registered investment company or business development company.

In December 2004, the SEC modified the client counting rule for purposes of the fewer-than-15-client exemption to require "private fund" advisers to look through the fund to its owners in counting clients. Under this rule, "private fund" was defined to include hedge funds but exclude traditional private equity funds, because a fund was a "private fund" only if it permitted investors to redeem any portion of their ownership interest within two years after investment. Because the rule required each investor in such a private fund to count as a separate client, many hedge fund advisers were forced to register as investment advisers with the SEC unless the adviser closed the fund to new investors or extended the fund's redemption period beyond two years. While not aimed at the sponsors of private equity funds, the rule was of concern to some private equity fund sponsors due to market developments in crossover and hybrid funds which may permit investors to redeem some portion of an investment.

In *Goldstein*, the Court of Appeals stated that, in treating individual investors in a hedge fund as "clients" of the private fund's adviser, the SEC's rule "appears completely arbitrary." The Court of Appeals latched on to prior SEC statements that an investment adviser's fiduciary duties are owed to the fund and not its investors and stated that the SEC failed to explain why "client" should mean one thing when determining fiduciary duty and another when determining whether an investment adviser must register under the Advisers Act, and did not adequately explain how the relationship between hedge fund investors and advisers justifies treating fund investors as clients.

SEC Chairman Cox issued a statement after the *Goldstein* decision indicating that going forward the SEC would reevaluate its approach to hedge fund activity. Chairman Cox stated that he has instructed the SEC's staff to evaluate the court's decision and to provide the SEC with alternatives for its consideration. Potential options include seeking a rehearing at the Court of Appeals level or filing an appeal request with the U.S. Supreme Court, which would require SEC action by the end of September. By subsequent order of the Court of Appeals, the SEC rule will remain in effect pending the disposition of any SEC petition for further hearing.

Private fund sponsors that registered with the SEC as investment advisers due to the new rule will want to monitor the SEC's actions over the course of the next several months and consider whether deregistration is viable. Should deregistration become an option, advisers will want to consider whether any post-registration marketing or other activities may be considered "holding out" as an investment adviser triggering continued registration obligations.

Should you have any questions about the matters addressed in this Kirkland PEN article, please contact the following Kirkland & Ellis authors or your regular Kirkland & Ellis contact.

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Amendments to the Publication Requirements for New York Limited Liability Entities

The State of New York requires each domestic and foreign limited liability company, limited partnership and limited liability partnership (collectively referred to as "limited liability entities") to publish notice of its formation or authorization to do business in the state in certain newspapers within 120 days of such event for a period of six weeks. Recent amendments, effective June 1, 2006, have created additional specifications with respect to the publication procedures and added a requirement that such publication be certified.

Applicability of the Amendments

The recent amendments to the publication requirements apply to limited liability entities formed in New York or doing business in the state after June 1, 2006. The revised publication requirements also apply to limited liability entities that were formed or doing business in New York between January 1, 1999 and June 1, 2006 if such limited liability entities had not been in compliance with the publication requirements in effect at such times. Limited liability entities formed or doing business in New York between January 1, 1999 and June 1, 2006 that had not complied with the then existing publication requirements will have until June 1, 2007 to comply with the amended publication requirements.

Penalties for Non-Compliance

Under the revised legislation, failure to comply with the amended publication requirements will result in the suspension of such non-complying entity's right to conduct business in New York. Such penalty is generally interpreted to incorporate the existing penalty for non-compliance, which was the loss of the right to commence any legal actions in the New York courts. While the exact severity of the heightened penalty has yet to be defined, the amendments do specify that the suspension of the right to conduct business will not result in any member, partner, manager or agent of a non-complying limited liability entity losing its limited liability status.

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Award for Excellence in Private Equity
Chambers USA Awards for Excellence 2006

Kirkland & Ellis partner Kevin R. Evanich was recognized by legal publisher Chambers & Partners with an Award for Excellence in Private Equity at the Chambers USA Awards Dinner in New York on June 1, 2006. Mr. Evanich was the first to be honored in this category at the inaugural USA Awards ceremony. He was selected from a list of highly qualified finalists nominated from more than 60 of the nation's leading firms.

Described by Chambers as a "first-class practitioner," Mr. Evanich is a senior member of Kirkland's corporate practice group, concentrating in mergers and acquisitions, leveraged buyouts and private equity fund formations. During a career spanning more than 25 years, Mr. Evanich has been recognized as a leader in the private equity field by numerous organizations. He has been listed in every edition of *Chambers Global, The World's Leading Lawyers for Business* since the first edition in 2000, and every edition of *Chambers USA, America's Leading Lawyers for Business* since the first edition in 2003.

The Chambers Awards for Excellence honor outstanding lawyers in the United States in the various disciplines of commercial law. The awards are based on research conducted over 12 months for *Chambers USA, America's Leading Lawyers for Business*, for which Chambers interviews thousands of sophisticated end-users of legal services, private practice attorneys and industry experts throughout the world. Chambers & Partners, the international legal publisher and research company, publishes guides to lawyers and law firms that are relied upon by business people worldwide. In 2005, Kirkland partner Jack S. Levin was recognized by Chambers & Partners with a Lifetime Achievement Award describing him as the "father of private equity."

Asian Expansion

Kirkland & Ellis is pleased to announce plans to open its first office in Asia. Pending regulatory approval, the firm will move into office space in Hong Kong later this year. The new office will initially focus on growth equity, buyout and other complex transactions for global and regional private equity funds.

David Patrick Eich will move from London to head up the office. "Greater China presents a very attractive opportunity for the Firm," Eich said. "Kirkland's deep experience in the most sophisticated, multi-jurisdictional transactions will allow us to provide superior service to financial sponsors and other clients investing in this high-growth and potentially vast but uniquely challenging marketplace."

In addition to Eich, Chuan Li and Tai Hsia will relocate to Hong Kong from the Firm's Chicago and London offices, respectively. Both are fluent in Mandarin Chinese and have substantial experience in private equity transactions. In addition, for several years, Kirkland has been cultivating and expanding its Asian practice with more than a dozen Asian lawyers in its U.S. and European offices.

Advertising & Trademark Law Seminar
August 8, 2006
Kirkland & Ellis LLP - Live in Chicago, videoconference to New York and Los Angeles

Kirkland intellectual property attorneys will highlight current legal developments in the advertising, marketing and promotions law areas. Topics will include sweepstakes laws, creative promotions, best defenses in trademark and advertising cases, counterfeiting and knock-offs, music in advertising, recent trademark and advertising court opinions and substantiation and trademark dilution. For more information about this full-day program, please contact Kara Underwood at kunderwood@kirkland.com.

Kirkland & Ellis LLP's Private Equity Practice

Kirkland & Ellis LLP's private equity and venture capital attorneys handle leveraged buy-outs, early-stage venture capital investments, later-stage growth capital transactions, recapitalizations and going private transactions. In addition, we have significant experience in the formation of private equity and venture capital funds. Kirkland represents more than 200 private equity firms from all industries in every major market around the world. Kirkland & Ellis was named by Chambers & Partners as the "International Private Equity Law Firm of the Year," the "USA Private Equity Law Firm of the Year" and first in Private Equity Fund Formation.

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