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REGULATION BY EXEMPTION: THE CHANGING DEFINITION OF AN ACCREDITED INVESTOR

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I. INTRODUCTION

The Securities and Exchange Commission ("SEC") has preserved its jurisdictional grip and ideological purity with respect to the regulation of initial public offerings and the regulation of mutual funds by creating huge exemptions from its regulatory scheme. While these exemptions have been in response to push backs against a rigid and complex framework for the registration of public offerings and the governance of mutual funds, it has led to anomalies in the capital markets, arguably not in the interests of the retail investors the SEC endeavors to protect. The SEC exemptions have been achieved through the use of the "accredited investor" concept, injected into the Securities Act of 1933 ("Securities Act") in 1980 by a Congress impatient with the SEC's refusal to be more flexible in its interpretation of the private offering exemption.[1] This statutory amendment led to the enactment of Regulation D[2] and the SEC's definition of an "accredited investor."[3] This definition has become somewhat obsolete due to inflation

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1. *See* 15 U.S.C. §§ 77b(a)(15), 77d(6) (2000). The stated purpose for this amendment was "Congressional concern that small businesses should have an adequate market to raise capital and that investors should not be unnecessarily impeded from purchasing securities of small businesses." S. REP. NO. 96-958, at 45 (1980).
2. 17 C.F.R. §§ 230.501-.508 (2008).
3. 17 C.F.R. § 230.501(a) (2008).

and the passage of time, but recent proposals by the SEC to put a brake on the enormous private placement market that Regulation D and some related regulations spawned has been resisted by retail and other investors.[4] Part II of this article will explain the background to the promulgation of Regulation D and related rules, set forth the changes in the marketplace wrought by these regulations, and raise some questions as to how the SEC should respond to these developments in today's market climate.

A similar response to objections by foreign investors[5] to their problems with the SEC's Securities Act registration provisions[6] led to the development of another private placement exemption, Rule 144A.[7] More recently, the SEC has dealt with these problems by relieving foreign issuers of the need to reconcile their financial statements to U.S. Generally Accepted Accounting Principles ("GAAP"),[8] but the vigor of the exempt offshore market makes it questionable whether this change in the regulations for registered offerings will attract foreign investors who have been making offerings in the Rule 144A private placement market. These matters will be discussed in Part II of this article.

The U.S. system for the regulation of collective investment funds pursuant to the Investment Company Act of 1940 ("Investment Company Act")[9] is at odds with the regulation of such funds elsewhere,[10] but the SEC has found this regulatory system conducive to its views on corporate governance. Investors and fund managers have been less enamored of the complex regulation of funds in a corporate form with controls on leverage and advisor compensation. Since some forms of collective investment funds are exempt from SEC registration and regulation, these exempt pools—in the form of hedge funds and private equity funds—have grown exponentially in

4. *See* Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 3235, Investment Company Act Release No. 27,922, 72 Fed. Reg. 45,116 (Aug. 10, 2007) [hereinafter Regulation D Amendment Proposals].

5. Resale of Restricted Securities; Changes To Method of Determining Holding Period of Restricted Securities under Rules 144 and 145, Securities Act Release No. 6806, 53 Fed. Reg. 44,016, 44,020-44,023 (Nov. 1, 1988) (to be codified at 17 C.F.R. § 230).

6. Securities Act of 1933 § 5, 15 U.S.C. § 77e (2000).

7. 17 C.F.R. §230.144A (2008).

8. *See* Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP, Securities Act Release No. 8879, Exchange Act Release No. 57,026 (December 21, 2007) (to be codified at 17 C.F.R. §§ 210, 230, 239 and 249).

9. 15 U.S.C. § 80a (2000).

10. *See* DIV. OF INV. MGMT., SEC. & EXCH. COMM'N, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION 202-03 (1992) [hereinafter SEC, PROTECTING INVESTORS].

recent years.[11] Although the SEC has attempted to limit its long standing exemption of hedge funds from regulation under either the Investment Company Act or the Investment Advisers Act of 1940 ("Investment Advisers Act"),[12] this attempt was thwarted by a decision of the Court of Appeals for the District of Columbia Circuit.[13] The SEC has gone back to the drawing boards and attempted to fashion some different regulations aimed at closing the loophole in its coverage of collective investment funds, in part by proposing new "accredited investor" type definitions.[14] Part III of this Article will discuss these developments and suggest that a better approach would be a wholesale revision of the Investment Company Act.

Very generally, an accredited investor is an investor who is sufficiently sophisticated so as not to need the protections of the federal securities laws, but such an investor generally is defined in terms of wealth, on the theory that an accredited investor can hire knowledgeable and sophisticated advisors.[15] Finding this concept a useful way of dealing with claims of over-regulation, the SEC has fashioned a large number of accredited investor definitions for the purpose of structuring exemptions from the securities laws. The Securities Act currently defines "accredited investor" to mean: an insurance company, a registered Investment Company, a business development company, a Small Business Investment Company, or an employee benefit plan (all with certain qualifications); or "any person who, on the basis of such factors as financial sophistication, net worth, knowledge, and experience in financial matters, or amount of assets under management qualifies as an accredited investor under rules and regulations which the Commission shall prescribe."[16] This definition was intended to loosen the extremely restrictive interpretations of the private offering exemption in the Securities Act by some circuit courts and the SEC, so as to ease the capital raising burdens put on small business.[17]

The SEC's subsequent definition of "accredited investor" in Regulation D, the regulation interpreting the private offering exemption, was an important step in legitimizing the private placement market. This definition provides that the term "accredited investor" is any person within certain categories, namely:

11. *See infra* notes 92-93 and accompanying text.
12. 15 U.S.C. § 80b (2000).
13. Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006).
14. *See infra* notes 120-121 and accompanying text.
15. *See infra* notes 36-45.
16. 15 U.S.C. § 77b(a)(15) (2000).
17. *See infra* notes 33-35.

> (1) any bank [or other enumerated financial institution or pension fund with assets in excess of $5,000,000]; (2) any private business development company . . . (3) any [501(c)(3) organization] with total assets in excess of $5,000,000; (4) any director, executive officer or general partner of the issuer [or of the general partner of the issuer] of the securities being offered and sold . . . (5) any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000; (6) [a]ny natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year; (7) [a]ny trust, with total assets in excess of $5,000,000 . . . and (8) [a]ny entity in which all of the equity owners are accredited investors.[18]

As a result of the breadth of this definition, and in particular the inclusion of pension funds and individuals who were sufficiently wealthy in the accredited investor definition, the private placement market then grew dramatically over the years.[19] Also, in 1996, the National Securities Markets Improvement Act ("NSMIA") amended the Securities Act to pre-empt the power of the states to require registration of "covered securities"—basically securities traded on a national securities exchange—and this statute included an exemption for the sale of covered securities to "qualified purchasers."[20] Recently, in recognition of some of the problems that time has wrought with respect to the accredited investor definition, the SEC has proposed revisions to the accredited investor definition and also proposed a new category of the "large accredited investor."[21]

In the meantime, in response to demands by foreign issuers for an exemption from the Securities Act registration provisions when selling to institutional investors, the SEC developed Rule 144A, which allowed offerings to "qualified institutional buyers" generally defined as financial institutions that own more than $100 million worth of securities of unaffiliated issuers, and in the case of banks and savings and loan associations, has a net worth of at least $25 million.[22] This exemption led to

18. 17 C.F.R. § 230.501(a) (2008).

19. *See infra* notes 48-51 and accompanying text.

20. 15 U.S.C. §18 (2000). This statute did not particularly assist small issuers. *See* Rutheford B. Campbell, Jr., *The Impact of NSMIA on Small Issuers*, 53 BUS. LAW. 575, 581 (1998).

21. Regulation D Amendment Proposals, *supra* note 4.

22. 17 C.F.R. § 230.144A(7)(a)(1) (2008).

the growth of a very large market for Rule 144A stocks, obviating the need for many foreign issuers to become registered and reporting companies under the Securities Exchange Act of 1934 ("Exchange Act").[23]

In its efforts to revise its prior policies exempting hedge funds from regulation as either investment advisers or investment companies, the SEC also made use of the accredited investor concept. After failing to have a new rule re-defining the term "client" for purposes of the Investment Advisers Act upheld by the D.C. Circuit in *Goldstein*,[24] the SEC has proposed a definition of an "accredited natural person" to restrict the investors who would qualify to invest in certain private pooled investment vehicles.[25] Previously, for purposes of defining clients who may want to use performance fees in the management of client assets, the SEC defined the term "qualified purchaser" under the Investment Advisers Act.[26]

While each of these definitions may be for a different purpose in creating different exemptions from the securities laws, there is a certain intellectual incoherence in the proposal of so many different definitions for the same basic idea of an investor who does not need the protections of the securities laws and wishes to invest with a greater freedom than the SEC normally allows. This is far from principles-based regulation, but rather, it is bureaucratic rule-making that attempts to protect the SEC's regulatory jurisdiction in the face of opponents of the SEC's controls on access to capital and money management.

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23. 15 U.S.C. § 78 (2000). Any foreign issuer with $10 million in assets and 300 U.S. shareholders out of 500 shareholders is required to register under Section 12 of the Exchange Act but can apply for an exemption under Rule 12g-3(2)(b) if the issuer does not make a public offering in the United States or list on a U.S. securities exchange. 15 U.S.C. § 78l (2000); 17 C.F.R. § 240.12g3-2(b) (2008). Rule 144A thus obviates the need for Exchange Act registration for any issuer who wishes to tap U.S. investors but not become a registered and reporting company.

24. *See supra* note 13 and accompanying text.

25. *See* Prohibition of Fraud by Advisors to Certain Pooled Investment Vehicles; Accredited Investors in Certain Pooled Investment Vehicles, Securities Act Release No. 8766, Investment Advisers Act Release No. 2576, 72 Fed. Reg. 400 (Jan. 4, 2007) (to be codified at 17 C.F.R. §§ 230 and 275).

26. 17 C.F.R. § 275.205-3(d)(1) (2008); Defining the Term "Qualified Purchaser" Under the Securities Act of 1933, Securities Act Release No. 8041, 66 Fed. Reg. 66,839 (Dec. 27, 2001) (to be codified at 17 C.F.R. § 230).

II. THE ACCREDITED INVESTOR IN PRIVATE PLACEMENTS

Section 4(2) of the Securities Act exempts "transactions by an issuer not involving any public offering."[27] Congress included this exemption to avoid SEC registration requirements in situations involving isolated sales of securities or sales where there was no practical need for the Act's application.[28] In an early interpretation, the SEC found that an offering to thirty-five purchasers could not qualify for the private placement exemption.[29] In *SEC v. Ralston Purina Co.*,[30] the Supreme Court held that the number of purchasers is not determinative; rather, what matters is the investor's ability to fend for himself and have access to the kind of information that would be included in a registration statement.[31] Further, the burden of demonstrating the availability of the exemption is put on the person claiming it.[32] Some very restrictive interpretations of the private placement exemption in the Fifth Circuit led to the doctrines that all offerees must receive the same information a registration statement would provide, and must be sufficiently knowledgeable and sophisticated to assess such information.[33]

These interpretations made it very difficult for promoters to make private placements, and led to calls for reform by small businesses and their lawyers and other advisors. The SEC then promulgated Rule 146 under the Securities Act of 1933, attempting to achieve some objectivity with regard to the private placement exemption, and this rule for the first time put forward the concept of an accredited investor as a person who was wealthy or who had an offeree representative.[34] The small business lobby, dissatisfied with the

27. 15 U.S.C. § 77d(2) (2000).

28. *See* Wright v. Nat'l Warranty Co., 953 F.2d 256, 259-60 (6th Cir. 1992).

29. Letter of General Counsel Discussing the Factors to be Considered in Determining the Availability of the Exemption from Registration Provided by the Second Clause of Section 4(1), Securities Act Release No. 285, Fed. Sec. L. Rep. (CCH) ¶¶ 2,740-2,744 (Jan. 24, 1935).

30. 346 U.S. 119 (1953).

31. *Id.* at 126-27.

32. *See, e.g.*, Mary S. Krech Trust v. Lakes Apartments, 642 F.2d 98 (5th Cir. 1981).

33. *See* Doran v. Petroleum Mgmt. Corp., 545 F.2d 893 (5th Cir. 1977); SEC v. Cont'l Tobacco Co. of S.C., Inc., 463 F.2d 137, 160 (5th Cir. 1972); Henderson v. Hayden, Stone, Inc., 461 F.2d 1069 (5th Cir. 1972); Hill York Corp. v. Am. Int'l Franchises, Inc., 448 F.2d 680 (5th Cir. 1971).

34. Notice of Adoption of Rule 146 Under the Securities Act of 1933—"Transactions by an Issuer Deemed not to Involve any Public Offering," Securities Act Release No. 5487, 4 SEC Docket 154 (Apr. 23, 1974). Rule 146 was one of the rules promulgated in response to the Wheat Report, a study by an SEC commissioner urging that Securities Act exemptions be rationalized and made more objective. FRANCIS M. WHEAT, SEC. & EXCH. COMM'N,

pace of the SEC's reform of the private placement exemption then persuaded Congress to add section 4(6) to the Securities Act, prodding the SEC to further define an accredited investor and loosen the restrictions on private placements.[35]

The SEC's response was the promulgation of Regulation D, which set forth a definition of the "accredited investor" for a series of private placement exemptions.[36] The most important of these rules probably is Rule 506, which allows private placements without any limit on the aggregate offering price to no more than thirty-five non-accredited investors and any number of accredited investors.[37] Although certain specified financial information must be provided to purchasers who are not accredited, for accredited investors, access to information, rather than information as extensive as a prospectus in a registration statement is required.[38] Very importantly, liability for fraud in a Regulation D placement is pursuant to Section 10(b) and Rule 10b-5 under the Exchange Act rather than under Section 11 of the Securities Act.[39] In addition to including various financial institutions, and an issuer's officers and directors, within the definition of an accredited investor, the Regulation D definition includes:

> [A]ny natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000 [and] any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in

DISCLOSURE TO INVESTORS: A REAPPRAISAL OF ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 SECURITIES ACTS (1969), *available at* http://www.sechistorical.org/collection/papers/1960/1969_Wheat/.

35. S. REP. NO. 96-958, *supra* note 1, at 44. *See also* Mark A. Sargent, *The New Regulation D: Deregulation, Federalism and the Dynamics of Regulatory Reform*, 68 WASH. U. L.Q. 225 (1990).

36. 17 C.F.R. §§ 230.501-508 (2008).

37. 17 C.F.R. § 230.506 (2008).

38. 17 C.F.R. § 230.502(b) (2008).

39. Section 11 of the Securities Act applies only to registered, not exempt offerings. 15 U.S.C. § 77k (2000). The Supreme Court has interpreted Section 12 of the Securities Act, 15 U.S.C. § 77l (2000), also to apply to public, not private offerings. Gustafson v. Alloyd Co., 513 U.S. 561 (1995). There is no private right of action under Section 17(a) of the Securities Act. 15 U.S.C. § 77q (2000); *see* MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW § 904[C] (4th ed. 2007). Accordingly, a defrauded purchaser in a private action must prove a case under Section 10(b) of the Exchange Act which, among other things, requires proof of scienter. *See* STEINBERG, at § 8.01.

excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.[40]

Not only are Regulation D private placements exempt from SEC registration under the Securities Act, but sales to "qualified purchasers" of "covered securities" are pre-empted from regulation by state securities commissions.[41]

The private placement exemption is a transaction exemption for issuers. In order to make this a meaningful exemption, it was necessary for the SEC to create a regulation for resales of securities purchased in a private placement for investment and not with a view to distribution,[42] an undertaking every purchaser in a private placement must make in order to avoid violating the registration provisions of the Securities Act.[43] The SEC did so by promulgating Rule 144, defining certain types of resales made after a set holding period not to be distributions of securities.[44] This rule initially imposed a two year holding period on purchasers in private placements, but the rule has been liberalized over the years, and recently the SEC shortened the holding period for private placement purchasers to six months, and further loosened restrictions of the rule.[45]

The success of Regulation D and Rule 144 led the SEC to adopt Rule 144A in 1990 in order to provide a safe harbor exemption from the registration requirements of the Securities Act for resales of securities sold in private placements to "qualified institutional buyers."[46] The SEC regarded this rule as a step in achieving a more liquid and efficient institutional resale

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40. 17 C.F.R. § 2230.501(a)(5)-(6) (2008).

41. 15 U.S.C. § 77r(b)(3)-(4)(D) (2000).

42. In order not to be an underwriter under Section 2(a)(11) of the Securities Act, a purchaser in a private placement must take for investment and not "with a view to . . . distribution." 15 U.S.C. § 77b(a)(11) (2000).

43. Section 4(1) of the Securities Act provides an exemption from any seller who is not an issuer, underwriter or dealer. 15 U.S.C. § 77d(1) (2000). If a purchaser in a private placement did not take for investment and hold the purchased securities for some length of time, the purchaser would be an "underwriter" and therefore violate the law. *See* Gilligan, Will & Co. v. SEC, 267 F.2d 461 (2d Cir. 1959).

44. 17 C.F.R. § 230.144 (2008); Notice of Adoption of Rule 144 Relating to the Definition of the Terms "Underwriter" in Sections 4(1) and 2(11) and "Brokers' Transactions" in Section 4(4) of the Securities Act of 1933, Adoption of Form 144, and Rescission of Rules 154 and 155 Under That Act, Securities Act Release No. 5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep (CCH) ¶ 78,487 (Jan. 11, 1972). This rule also was a response to the Wheat Report. WHEAT, *supra* note 34.

45. Revisions to Rule 144 and 145, Securities Act Release No. 8869, 72 Fed. Reg. 71,546 (Dec. 17, 2007).

46. 17 C.F.R. § 230.144A (2008).

market for unregistered securities, particularly foreign securities.[47] Although the Rule 144A market grew slowly at first, it is now a robust sector of the global marketplace.

As a result of Regulation D and Rule 144, the private placement market in the United States grew quickly. After Regulation D was passed, the total amount of securities sold in private placements increased from $18 billion in 1981 to $139 billion in 1987 and then to $202 billion in 1988.[48] Further, there was a broadening in the type of institutional investor buying in this market.[49] Over the next two decades, in part because of the growth in Rule 144A offerings, this market became even bigger. In 2006, the total capital raised through Rule 144A deals was greater than the amount raised on the American Stock Exchange, the NASDAQ and the New York Stock Exchange combined.[50] According to NASDAQ, the amount of equity and debt capital raised using Rule 144A exceeded $1 trillion in 2006, and in the first half of 2007, global equity and debt capital raised in Rule 144A offerings was almost $1 trillion, a 43% increase over the year before.[51] Recently, NASDAQ has announced that a group of securities firms and NASDAQ intend to form The PORTAL Alliance, an industry standard facility designed to serve the market for 144A equity securities, which should serve to further develop this market.[52]

Although the SEC's facilitation of the growth of the private placement and 144A markets can be applauded, it probably has led to the increased institutionalization of the markets, possibly to the detriment of retail

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47. *See* Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 17,452, 55 Fed. Reg. 17,933 (Apr. 23, 1990).

48. Kellye Y. Testy, *The Capital Markets in Transition: A Response to New SEC Rule 144A*, 66 IND. L.J. 233, 242 (1990).

49. *Id.*

50. Lynn Cowan, *Banks to Share Platform for 144A Trades,* WALL ST. J., Nov. 12, 2007, at C3; *Public Versus Private Equity Markets – Is the Growth of Private Placements at the Expense of Public Equity Offerings in the US a Temporary Phenomenon or Does it Signal a More Significant Shift Away from Public Scrutiny?*, THE BANKER, Sept. 1, 2007.

51. *NASDAQ's Electronic Platform for the 144A Private Placement Market Begins Operation*, PrimeNewsWire, Aug. 15, 2007.

52. Cowan, *supra* note 50. The value of equity raised by foreign companies through 144A issues grew from $2.3 billion in 2003 to $5.5 billion in 2007. Peter Thal Larsen, *Facts and Figures: Non-US Companies Exploit Rule 144A*, FIN. TIMES, June 24, 2008, *available at* http://www.ft.com/cms/s/0/12e5e9ee-3f43-11dd-8fd9-0000779fd2ac.html.

investors.[53] Another route, which the SEC did not take, instead of creating huge exemptions from Securities Act registration, would have been to reform the registration provisions to make them more attractive to both domestic and foreign issuers. But the SEC has made these provisions ever more complex, and its reforms of the offering provisions, for example, are geared to helping large, world class issuers rather than smaller issuers.[54] Should the SEC continue to regulate by exemption in this fashion rather than alter its regulations so they are more user-friendly? What is the effect on retail investors who are unable to access private placements? Further, are the "accredited investor" definitions outdated so that some retail investors who are not really so rich or sophisticated are participating in private placements?[55]

Rather belatedly, the SEC seems to have recognized the wealth definitions enacted in 1982 have been superseded by inflation and has proposed that these definitions be indexed to inflation going forward.[56] Further, the SEC has proposed a new definition of a "large accredited investor" with significantly higher dollar amount thresholds which would enable promoters to engage in limited advertising of private placements. Legal entities that are considered accredited investors if their assets exceeded $5 million would be required to have $10 million in investments to qualify as large accredited investors. Individuals generally would be required to own $2.5 million in investments or have an annual income of $400,000 or $600,000 with a spouse to so qualify.[57] This is exactly the kind of regulation by exemption which is problematic. The SEC's offering rules which restrict advertising are completely outmoded and should be repealed and replaced by regulations that prohibit fraud in the offer of securities, rather than

53. *See* Brian G. Cartwright, General Counsel, Sec. & Exch. Comm'n, Speech by SEC Staff: The Future of Securities Regulation (Oct. 24, 2007) *available at* www.sec.gov/news/speech/2007/spch102407bgc.htm (discussing the "de-retailization" of the securities markets).

54. *See* Securities Offering Reform, Securities Act Release No. 8591, Exchange Act Release No. 52,056, Investment Company Act Release No. 26,993, 70 Fed. Reg. 44,722 (Aug. 3, 2005). The so-called "Aircraft Carrier" proposals which preceded the Offering Reform Rules were so complicated and prolix they fell of their own weight. *See* The Regulation of Securities Offerings, Securities Act Release No. 7606A, Exchange Act Release No. 40,632A, Investment Company Act Release No. 23,519A (proposed Nov. 17, 1998); *see also* EDWARD F. GREENE, U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVE MARKETS § 2.04 n.151 (7th ed. 2004).

55. *See* Marc Steinberg, *The "Accredited" Individual Purchaser Under Regulation D: Time to Up the Ante*, 29 SEC. REG. L.J. 93, 95-96 (2001).

56. Regulation D Amendment Proposals, *supra* note 4.

57. *Id.*

continuing to prohibit so-called "gun jumping" or public solicitation of private placements.[58] Yet, the SEC persists in clinging to old forms of its regulations instead of confronting the need for reform and has been able to do so by fashioning exemptions for those who complain that these regulations are impeding capital formation or U.S. market competitiveness.

III. THE HEDGE FUND EXEMPTION

For many years, hedge funds were exempt from SEC registration more through neglect than by intention. Functionally, a hedge fund or private equity fund is no different from a mutual fund in that all three vehicles are pooled investment funds managed by an investment adviser. A mutual fund generally is a public vehicle, regulated under the Investment Company Act, which forces the fund to operate as a corporation, advised by a separate entity, while a hedge fund or private equity fund generally is a limited partnership managed by a general partner, which has not made a public offering.[59]

Mutual funds are required to register with the SEC pursuant to the Investment Company Act,[60] in addition to having to register a public offering of their shares pursuant to the Securities Act.[61] Once registered, the Investment Company Act requires that 40% of the board be "independent" or "disinterested."[62] Interested directors are defined to include a long list of persons who have some business or professional relationship with the investment company or are affiliated with the adviser, underwriter or broker for the investment company.[63] The investment company's independent directors are given special statutory responsibilities with regard to the

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58. *See, e.g.*, Eric Chiappinelli, *Gun Jumping: The Problem of Extraneous Offers of Securities,* 50 U. PITT. L. REV. 457 (1989); Patrick Daugherty, *Rethinking the Ban on General Solicitation,* 38 EMORY L.J. 67, 103-22 (1989); *see also,* ADVISORY COMMITTEE ON SMALLER PUBLIC COMPANIES, SEC. & EXCH. COMM'N, FINAL REPORT OF THE ADVISORY COMMITTEE ON SMALLER PUBLIC COMPANIES TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION 5 (Apr. 23, 2006).

59. *See* SEC, PROTECTING INVESTORS, *supra* note 10, at 252.

60. Investment Company Act of 1940, § 8, 15 U.S.C. § 80a-8 (2000).

61. Securities Act 1933, § 5, 15 U.S.C. § 77e (2000).

62. Section 10(a) of the Investment Company Act requires that a registered investment company's board of directors may not consist of more than 60% "interested" persons. 15 U.S.C. § 80a-10(a) (2000). The SEC has mandated that more than 50% of an investment company board be composed of independent directors and has proposed that boards have a super majority of 75% independent directors. *See infra* notes 72-73.

63. Investment Company Act of 1940 § 2(a)(19), 15 U.S.C. § 80a-2(a)(19) (2000).

supervision of management and financial auditing. In particular, they have the duty of reviewing and approving the contracts of the investment company with its investment adviser and principal underwriter.[64]

Congress placed the disinterested directors in the role of independent watchdogs to act as a check on the management of the investment company. Therefore, even where state rather than federal law determines a conflict of interest issue such as the dismissal of a derivative suit, the policies of the Investment Company Act must be taken into consideration.[65] Yet, because an investment company is the creature of its sponsor/adviser, there have been persistent questions as to whether independent directors can provide effective oversight of the contractual relationship between the fund and the adviser.[66] Although the fund's directors can and do perform a watchdog function, they do not function like directors of an industrial or financial services company, participating in decisions about the fund's strategy or investment activities. Fund boards do not and cannot supervise the business and management of the firms that manage fund assets or distribute and market fund shares. Furthermore, investors care about the overall performance of the fund more than they care about the corporate governance of the fund. The SEC, however, has found its supervision of mutual funds a good vehicle for articulating its general views on corporate governance.[67]

The SEC has accomplished its corporate governance experiments over the years by conditioning a number of exemptive rules under the Investment Company Act upon review and approval by independent investment company directors. Because the Investment Company Act contains numerous sweeping prohibitions against transactions with affiliated entities which are, in fact, commonplace, reliance on these exemptive rules are necessary to permit investment companies to conduct business in many situations. The most important of these exemptions permit funds to purchase securities in a primary offering where an affiliated broker dealer is a member of the underwriting syndicate,[68] permit the use of fund assets to pay distribution expenses,[69] permit securities transactions between a fund and another client

64. 15 U.S.C. § 80a-15(c) (2000).

65. *See* Burks v. Lasker, 441 U.S. 471, 479 (1979).

66. SEC, PROTECTING INVESTORS, *supra* note 10, at 264-66.

67. *See generally* Roberta S. Karmel, *Realizing the Dream of William O. Douglas–The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79 (2005) (discussing the SEC's corporate governance agenda).

68. Rule 10f-3, 17 C.F.R. § 270.10f-3 (2008).

69. Rule 12b-1, 17 C.F.R. § 270.12b-1 (2008).

of the fund investment adviser[70] and specify conditions under which funds may pay commissions to affiliated brokers in connection with the sale of securities on an exchange.[71]

During the past few years the SEC has forced mutual funds to have boards of a majority of independent directors, rather than the 40% standard mandated by the Investment Company Act by conditioning important exemptions on the creation of a board with a majority of independent directors.[72] The SEC then passed a rule requiring any fund relying on any of its exemptive rules to have a board comprised of at least 75% independent directors and further requiring that the chairman of the board be an independent director.[73] This rule proved very controversial since approximately 80% of investment companies had a board chairman who was an officer of the fund's adviser. Two commissioners dissented from the adoption of the rule,[74] and an action was instituted against the SEC for a declaratory judgment declaring the rule invalid as beyond the SEC's statutory authority and in violation of the Administrative Procedure Act.[75] The D.C. Circuit Court held that the rule was within the SEC's authority, but invalidated the rule on the ground that the SEC had not conducted a proper cost-benefit analysis of the impact of the rule.[76] The SEC then hurriedly included such an analysis, but the Court of Appeals again remanded the rule-making to the SEC, based on Administrative Procedure Act violations.[77] As of yet, the SEC has been unable to adopt a final rule.[78]

70. *Id.*

71. Rule 17e-1, 17 C.F.R. § 270.17e-1 (2008). The other exemptive rules are 17 C.F.R. § 270.17a-8 (2008) (permitting mergers between certain affiliated funds); 17 C.F.R. § 270.15a-4(b)(2) (2008) (permitting boards to approve interim advisory contracts without shareholder approval); 17 C.F.R. § 270.17d-1(d)(7) (2008) (permitting funds and their affiliates to purchase joint liability insurance policies); 17 C.F.R. § 270. 17g-1(j) (2008) (permitting funds to maintain joint insured bonds); 17 C.F.R. § 270.18f-3 (2008) (permitting funds to issue multiple classes of voting stock); and 17 C.F.R. § 270.23c-3 (2008) (permitting the operation of interval funds by enabling closed-end funds to repurchase their shares).

72. Role of Independent Directors of Investment Companies, Securities Release No. 7932, Exchange Act Release No. 43,786, Investment Company Act Release No. 24,816, 66 Fed. Reg. 3734 (Jan. 16, 2001).

73. Investment Company Governance, Investment Company Act Release No. 26,520, 69 Fed. Reg. 46,378 (Aug. 2, 2004).

74. *Id.* at 46,390-93 (Glassman and Atkins, Commissioners, dissenting).

75. Chamber of Commerce of the United States v. SEC, 412 F.3d 133 (D.C. Cir. 2005).

76. *Id.* at 143-44.

77. Chamber of Commerce of the United States v. SEC, 443 F.3d 890 (D.C. Cir. 2006).

78. The SEC has requested further comments on the issues raised but has not taken action with respect to this rule-making. Investment Company Governance, Investment Company Act Release No. 27,395, 88 SEC Docket 622 (June 13, 2006).

Although the SEC has been very active in regulating investment companies, it has allowed hedge funds and private equity funds to escape registration under either the Investment Company Act or the Investment Advisers Act. Hedge funds are investment vehicles that hold a pool of securities, and perhaps other assets. Interests in hedge funds are not sold in a registered public offering, and they are not registered as investment companies under the Investment Company Act.[79] The classic hedge funds were formed for the purpose of hedging highly leveraged long positions by utilizing short sales and put and call options.[80] Today's hedge funds engage in a wider variety of investment strategies. Ever since hedge funds became participants in the securities markets, in the 1950s, they have endeavored to operate as unregulated entities and the SEC has been uncertain about how, if at all, to regulate them. Most hedge funds in the United States are formed as limited partnerships in order to obtain flow-through tax treatment.[81] Private equity funds are also unregistered investment vehicles in which investors pool money to invest in securities, but private equity funds typically are longer-term investments.[82] Venture capital funds, which provide seed money to start up businesses, are structurally similar.[83]

Although most hedge funds and private equity funds meet the definition of an investment company as being "engaged primarily . . . in the business of investing, reinvesting, or trading in securities,"[84] they fall within exceptions to that definition either because their securities are owned by not more than one hundred persons or their securities are owned "exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers," and they are not making or proposing to make a public offering of their securities.[85] For this purpose, a "qualified purchaser" is a natural person who owns not less than $5,000,000 in investment securities.[86]

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79. STAFF REPORT, SEC. & EXCH.COMM'N, IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS 3 (Sept. 2003) [hereinafter HEDGE FUND REPORT].

80. Ralph S. Janvey, *Hedge Funds* SEC. & COMM. REG. (STANDARD & POOR'S), June 8, 1988, at 91.

81. *Id.* Some overseas hedge funds are differently organized. *See* Iain Cullen, *Hedge Funds: Structure and Documentation*, *in* HEDGE FUNDS: LAW AND REGULATION (Iain Cullen & Helen Parry eds., 2000), at 1-4.

82. HEDGE FUND REPORT, *supra* note 79, at 7-8.

83. *Id.* at 8.

84. Investment Company Act § 3(a)(1)(A), 15 U.S.C. § 80a-3(a)(1)(A) (2000).

85. 15 U.S.C. § 80a-3(c)(1), (7) (2000).

86. 15 U.S.C. § 80a-2(a)(51)(A) (2000); *see also* 17 C.F.R. §§ 270.2a51-1(h), .2a51-2 (2008).

Similarly, the manager of a hedge fund or private equity fund falls within the definition of an investment advisor as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities . . . ."[87] However, an exemption from registration as an investment adviser exists for the small advisor who has had fewer than fifteen clients, does not hold himself out generally to the public as an investment adviser nor act as an investment adviser to any registered investment company.[88] The key to the long-time exemption for hedge funds and other private investment funds doing business as limited partnerships was that the managing partner was considered to have only one client—the limited partnership.[89] This safe harbor was adopted in 1985,[90] but the SEC recently attempted to eliminate it by changing the definition of the term "client."[91]

Hedge funds have grown in number and with regard to assets under management in recent years. In 1992, the SEC estimated that there were approximately 400 hedge funds in existence. In 2003, it was estimated that there were approximately 6,000 hedge funds operating in the United States with approximately $600 billion of assets under management.[92] In 2004, the SEC estimated that there were 7,000 hedge funds with approximately $870 billion of assets under management and these assets were approximately one-fifth the amount of assets under management by registered investment companies.[93] The SEC has repeatedly studied hedge funds over the years,[94]

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87. 15 U.S.C. § 80b-2(a)(11) (2000).

88. 15 U.S.C. § 80b-3(b)(3) (2000).

89. 17 C.F.R. § 275.203(b)(3)-1 (2008). The safe harbor provided for in this rule would also apply to private funds doing business as corporations, LLCs or trusts.

90. Definition of "Client" of an Investment Adviser for Certain Purposes Relating to Limited Partnerships, Investment Advisers Act Release No. 983, 50 Fed. Reg. 29,206 (July 18, 1985). The initial safe harbor was an effort to clarify that a general partner to a limited partnership was advising the partnership and not the partners individually.

91. *See infra* notes 101, 111 and accompanying text.

92. HEDGE FUND REPORT, *supra* note 79, at 1 n.2.

93. Registration Under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2333, 69 Fed. Reg. 72,054, 72,055-56 (Dec. 10, 2004) [hereinafter Hedge Fund Registration Rule]. In 2006, one reporter estimated that there were about 1,000 private equity firms and 6,000 hedge fund management firms, making it likely that the hedge fund markets would overwhelm the smaller private equity market. Edwin A. Goodman, *Convergence Could Hurt: Hedge Funds Might Swallow Private Equity Market,* PENSIONS AND INVESTMENTS, July 10, 2006, *available at* http://www.pionline.com/apps/pbcs.dll/article?AID=/20060710/PRINTSUB/607100722/1026/TOC.

94. *See* Hedge Fund Registration Rule, *supra* note 93, at 72,055.

but until recently did not make any attempt to bring them under the regulatory umbrella of either the Investment Company Act or the Investment Advisers Act. Among the reasons that hedge funds and other private investment vehicles have been reluctant to register with the SEC is that their managers typically charge a fee which is a percentage of profits, a practice generally unavailable to registered investment advisers,[95] and they use leverage to an extent prohibited by the Investment Company Act.[96] Registered investment companies also have less flexibility with regard to other investment strategies such as short selling.[97] In addition, hedge funds avoid the artificial and cumbersome structure of having a pool of assets in corporate form managed by an outside advisor.

The growth and size of the hedge fund and private equity market made the SEC concerned about its continued failure to regulate these investment vehicles in any way. Enforcement cases involving hedge funds made the SEC worry that hedge funds were being marketed to investors who were not sufficiently sophisticated to understand the risks they were taking. In addition, the SEC was concerned about systemic risks caused by the way in which hedge funds valued their portfolios.[98] The SEC probably also was concerned that its lack of regulatory authority over hedge funds imperiled its regulation of investment companies and investment advisers. If such a large proportion of managed pooled investments were occurring outside of the SEC's jurisdiction, the SEC could become marginalized, and investors and fund managers could begin to question why investment companies were so heavily regulated.[99]

Seeking to close the proverbial barn door after the horses ran away, the SEC issued a rule requiring each shareholder or beneficiary of a private fund (which would include all hedge funds, but curiously not private equity or

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95. *Id.* at 72,060. The SEC did pass Rule 205-3 which allows a fee based on a percentage of fund profits under certain circumstances, but the SEC generally disapproves of such fees. 17 C.F.R. § 275.205-3 (2008).

96. HEDGE FUND REPORT, *supra* note 79, at 37-39.

97. *Id.* at 39-43.

98. *Id.* at 76-87; *see also Recent Developments in Hedge Funds: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 108th Cong. 32-39 (2003) (testimony of William H. Donaldson, Chair., Sec. and Exch. Comm'n), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_senate_hearings&docid=f:92703.pdf.

99. In its Hedge Fund Report, the SEC staff rather timidly raised the issue of whether hedge fund strategies might be able to be deployed by open end investment companies. HEDGE FUND REPORT, *supra* note 79, at 106.

venture capital funds)[100] to be considered a separate client in counting the fifteen clients for an exemption under the Investment Advisers Act.[101] There were two dissents to the promulgation of this rule,[102] and the rule was struck down by the Circuit Court of Appeals for the District of Columbia in *Goldstein v. SEC.*[103]

The SEC's policy justifications for its rule requiring formerly unregulated hedge funds to register with the SEC were: the growth of hedge funds; the growth in hedge fund fraud; and the growing exposure of smaller investors, pensioners and other investors to hedge funds.[104] Professor Troy A. Paredes has suggested that political and psychological influences on the SEC rather than serious changes in the operation of hedge funds led to the hedge fund registration rule.[105] He notes that the SEC "did not want to get caught flat-footed" as it was after the Enron and WorldCom scandals, and that the SEC was worried about fraud on investors unable to truly fend for themselves.[106] Another commentator suggested that the circumstances surrounding the SEC's hedge fund registration rule were similar to the circumstances leading to the SEC's efforts in the 1980s to require banks engaging in securities activities to register with the SEC, an effort invalidated by the D.C. Circuit.[107] As was the case with that bank registration rule, other federal financial regulators disagreed with the SEC's determination that it should increase its regulatory authority over hedge funds.[108]

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100. This was accomplished through a definition that excluded funds which do not permit its owners to redeem any portion of their ownership interests within two years of the purchase of such interests. 17 C.F.R. § 275.203(b)(3)-1(d) (2008) (definition of "private fund").

101. Hedge Fund Registration Rule, *supra* note 93, at 72,070 n.183.

102. *Id.* at 72,090-98 (Glassman and Atkins, Commissioners, dissenting).

103. 451 F.3d 873 (D.C. Cir. 2006).

104. Hedge Fund Registration Rule, *supra* note 93, at 72,055-59.

105. Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission*, 2006 U. ILL. L. REV. 975 (2006).

106. *Id.* at 975-76.

107. Adam R. Bolter, Comment, *Regulation of Hedge Fund Advisers: A Valid Exercise of Rulemaking Authority or the Promulgation of New Law?*, 57 ADMIN. L. REV. 595, 606 n.64 (2005).

108. *Id.* at 615. Over half of the largest hedge funds are registered with the CFTC. *See* Comment Letter from Richard M. Whiting, Executive Dir. of the Fin. Servs. Roundtable to the Staff of the Sec. & Exch. Comm'n (Sept. 15, 2004) at n.5; Comment Letter from Sheila C. Bair, Professor, Univ. of Mass.-Amherst to the Staff of the Sec. & Exch. Comm'n (Sept. 15, 2004); Sharon Brown-Hruska, Acting Chairperson of the Commodity Futures Trading Comm'n, Opening Statement Before the CPO and Commodity Pool Roundtable (April 6, 2005), *available at* http://www.cftc.gov/opa/speeches05/opabrown-hruska-30.htm (claiming

Registration by hedge funds under the Investment Advisers Act is subject to a number of regulatory requirements: the filing of a Form ADV disclosing the fund's business practices and information about fund managers, the delivery of a basic information package to clients, the adoption of procedures regarding proxy voting, the adoption of a code of ethics, the development of a system of internal controls and compliance procedures, and the appointment of a chief compliance officer.[109] Despite these burdens, many hedge funds had voluntarily registered with the SEC prior to the SEC's adoption of its hedge fund registration rule.[110] The way in which the SEC changed its regulations to require Investment Adviser Act registration by hedge funds was by requiring investment advisers to count each owner of a private fund towards the threshold of fourteen clients for purposes of determining the private adviser exemption.[111] "Qualified clients"—"knowledgeable employees" or "qualified purchasers"—did not have to be counted, however.[112] The term "private fund" was defined to exclude funds which do not permit investors to redeem their interests within two years of purchase, a definition intended to exclude structured finance vehicles such as private equity funds and venture capital funds from the registration requirement.[113] There was a strong dissent from the promulgation of this rule by two commissioners on the grounds that there were viable alternatives to the rule that were not considered, that the justifications for the rule did not withstand scrutiny, and that SEC resources would be unnecessarily diverted.[114]

The D.C. Circuit struck down the SEC's hedge fund registration rule on the ground that it was an unreasonable interpretation of the term "client" in the Investment Adviser's Act.[115] According to the court, the SEC "failed adequately to justify departing from its own prior interpretation of § 203(b)(3)."[116] This decision left the SEC in the awkward position of being uncertain of its authority to bring anti-fraud actions against advisers where investors in a pool are defrauded by their adviser. Accordingly, the SEC proposed two new rules—one to prohibit advisers to pooled investment

that commodity pool operators, sponsors and advisors registered with the CFTC should not also have to register with the SEC).

109. Paredes, *supra* note 105, at 988-89.

110. HEDGE FUND REPORT, *supra* note 79, at 22 n.76.

111. Hedge Fund Registration Rule, *supra* note 93, at 72,070.

112. *Id.* at 72,070-71.

113. *Id.* at 72,074.

114.. *Id.* at 72,098-99 (Atkins and Glassman, Commissioners, dissenting).

115. *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006).

116. *Id.* at 883.

vehicles from making false or misleading statements or otherwise defrauding investors, and a second to revise the definition of "accredited investor" as it relates to natural persons.[117]

With regard to fraud on participants in pooled investment vehicles, the SEC proposed new Rule 206(4)-8 to apply to all investment advisers, whether or not registered or required to be registered with the SEC. The rule would prohibit advisors from making false or misleading statements or otherwise defrauding investors and prospective investors in pooled investment vehicles.[118]

Another proposed rule would change the definition of an "accredited investor" in Regulation D, solely for the purpose of categorizing investors in private investment vehicles[119] to mean any natural person who meets either the net worth or income requirements for the private placement exemption but in addition, owns, individually, or jointly with the person's spouse, not less than $2.5 million in investments at the time of purchase of securities issued by private investment vehicles under Regulation D or section 4(6). Residential real estate would be excluded from the definition of investments. Further, the $2.5 million requirement would be adjusted every five years for inflation.[120] This proposed new definition of an accredited investor would not be applicable to venture capital funds.[121]

In February 2007 the President's Working Group on Financial Markets, comprised of the Secretary of the Treasury, and the Chairs of the Federal Reserve Board, the SEC and the CFTC rejected more oversight of hedge funds, and instead agreed to principles and guidelines with respect to private pools of capital. These principles, which essentially say that investors should not take excessive risks and should carefully evaluate the strategies and management skills of hedge funds in which they invest, would not prevent the SEC's proposed rules from becoming effective.[122] Nevertheless, the thrust of this agreement is generally anti-regulatory, and both the American Bar Association Federal Regulation of Securities Committee and the New York State Bar Association Committee on Securities Regulation filed

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117. Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, Securities Act Release No. 8766, Investment Advisers Act Release No. 2576, 72 Fed. Reg. 400 (Jan. 4, 2007).

118. *Id.* at 401-03.

119. *Id.* at 414. Private investment vehicles are, essentially, unregistered investment companies.

120. *Id.* at 405.

121. *Id.* at 407-08.

122. *See* Stephen Labaton, *Officials Reject More Oversight of Hedge Funds*, N.Y. TIMES, Feb. 23, 2007, at A1.

comments in response to proposed Rules 509 and 216 suggesting that the SEC might not have adequate authority for the breadth of the rules and also suggesting that the new accredited investor definition is overly exclusive.[123] Particularly troublesome to commenters is a failure to grandfather investors who are already partners in hedge funds, but who do not meet the new accredited investor definition.

Whether the SEC's proposals will become final, or what form they will take if they do become final, is unknown at this time. But these new rule proposals exemplify the SEC's penchant for regulating by exemption. Having decided that many investors who now are able to become partners or other participants in hedge funds should be precluded from doing so, the SEC might now accomplish this goal by generating yet another accredited investor rule. Even if the SEC's objectives are laudable, is this a sound regulatory strategy?

IV. CONCLUSION

The problem with regulating by exemption is that it does not incentivize the SEC to adjust regulations that discourage capital market participants from entering a regulated system. Instead of reforming the registration provisions of the Securities Act to make such registration more user-friendly and less likely to result in after-the-fact lawsuits, the SEC fashioned private placement exemptions that have created a huge market for unregistered offerings. Instead of trying to reform the Investment Company Act and the Advisers Act to accommodate hedge funds and private equity funds, the SEC exempted them for many years, and then, becoming worried that a large part of the capital market had moved beyond its jurisdiction, tried to recapture jurisdiction over these investment pools.

One of the reasons that issuers prefer private offerings to registered offerings is that liability is based on Section 10(b) of the Exchange Act, instead of the virtually strict liability of Section 11 of the Securities Act. Further, foreign issuers prefer Rule 144A offerings to registered offerings because they are not then compelled to become registered and reporting companies under the Exchange Act. But perhaps better, and certainly less complex, regulation would flow from efforts to make the registration

123. Comment Letter from Keith F. Higgins, Chair, Am. Bar Ass'n, Section of Bus. Law, Comm. on Fed. Regulation of Sec. to the Staff of the Sec. & Exch. Comm'n (Mar. 12, 2007); Comment Letter from Jeffrey W. Rubin, Chair, N.Y. State Bar Ass'n, Bus. Law Section, Comm. on Sec. Regulation to the Staff of the Sec. & Exch. Comm'n (Mar. 14, 2007).

provisions easier to use and the Securities Act liability provisions less onerous and more suited to today's fast paced markets.

Similarly, if hedge funds are a threat to investors, why did the SEC allow them to remain exempt for so long and then attempt to exert jurisdiction over them through a controversial rule that was not upheld? Whether the SEC's new rule-making proposal will fare any better is unclear. The SEC's problem is that it has not made a good case for why it needs to take regulatory jurisdiction over hedge funds, having declined to do so for over fifty years. Although hedge funds may pose systemic risks to the market, other financial regulators with more direct responsibility for the stability of financial institutions need to be persuaded that improving investor protection for hedge fund investors is a solution to this threat.

The SEC has long been very clever at using its power to define terms to fill gaps or solve problems in the securities laws, but as the court pointed out in *Goldstein*, such an effort must be reasonable. In the case of dealing with the concept of the accredited investor perhaps the SEC has been too clever and not sufficiently coherent in defining its objectives and thinking through the consequences of its rule-making.