



November 18, 2010

*Via electronic mail delivery (rule-comments@sec.gov)*

Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

**Re: File Number S7-25-10, Proposed Rule to Define “Family Offices”**

Dear Ms. Murphy:

The Alliance Defense Fund (“ADF”) appreciates the opportunity to respond to your request for comment on the Proposed Rule defining “family offices.”<sup>1</sup> ADF is a non-profit public interest law firm that exists to educate the public and the government about important constitutional liberties. When necessary, we litigate to secure our clients’ constitutional rights. Our experience includes questions regarding permissible definitions of “spouse” and “spousal equivalent” under the Federal Defense of Marriage Act (DOMA), 1 U.S.C. § 7 (2010).

Proposed rule 202(a)(11)(G)-1(d)(3) includes “spousal equivalents” in its definition of “family member.” You specifically requested comments regarding the inclusion and definition of “spousal equivalents.” Our analysis demonstrates that the inclusion of “spousal equivalents” in the definition of a family member is inconsistent with the overall purpose of the family office exemption from the Advisers Act<sup>2</sup>, creates definitional uncertainty, and—most importantly—violates federal law. Accordingly, we urge you to remove “spousal equivalents” from the definition of “family member” for purposes of defining a “family office.”

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<sup>1</sup> Family Offices, 75 Fed. Reg. 63,753, 63,753 (proposed Oct. 18, 2010) (to be codified at 17 C.F.R. pt. 275).

<sup>2</sup> 15 U.S.C § 80b (2010).



**I. Expanding the definition of “spouse” to include “spousal equivalents” is inconsistent with the “family office” exemption’s purpose because it permits a broader group of non-family members to invest with an unregistered “family office.”**

As noted in the explanation of the proposed rules, the family office exemption strives to protect the public by only allowing offices that advise close family members to be exempted from registration as an investment adviser. A family office should not advise a larger, public group of investors. For example, a “family office” is very different from a “family-run office,” which, while “owned and controlled by a single family, provides advice to a broader group of clients.”<sup>3</sup> To date, the Commission’s exemption orders have reflected its policy of investor protection by maintaining that a client base that extends beyond a core family unit resembles the client base of a small investment adviser firm. As a result, a “family-run office” serving extended family and selected friends merits registration and oversight by the Commission. But a “family office” is exempted from registration because it serves a very limited client base of core family members. In order to serve that policy purpose, the definition of family members must also be carefully limited.

The definition of a “family member” should, however, be much broader in other contexts to serve different policy purposes. The proposed rules reference the definitions used in the auditor independence rules<sup>4</sup>—but the auditor independence rules serve a very different policy that requires a very broad application. The auditor independence rules were designed to provide investors with financial information that has been “subjected to a rigorous examination by an *objective, impartial*, and skilled professional.”<sup>5</sup> Objective impartiality requires independence both in fact and appearance.<sup>6</sup> As a result, it is entirely appropriate to include anyone who might reasonably be perceived as affecting an auditor’s objectivity or bias, such as a cohabiting person, in the list of individuals who

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<sup>3</sup> Family Offices, *supra* note 1, at 63,754.

<sup>4</sup> *Id.* at 63,756.

<sup>5</sup> Revision of the Commission’s Auditor Independence Requirements, 65 Fed. Reg. 76,008 (Dec. 5, 2000) (to be codified at 17 C.F.R. pt.s 210, 240) (emphasis added).

<sup>6</sup> *Id.*



may impair an auditor's independence.<sup>7</sup> It is not, however, appropriate to include that same broad base of individuals in a family office context because a family office should not be open to anyone that might influence a family member. Instead, a family office should serve a very limited group. Accordingly, the broad definitions used in the auditor independence rules are not a useful source of definitions when defining family members for the very different purpose of the limited "family office" exemption.

The "family office" exemption also furthers the policy of protecting a family's privacy in the case of investor disputes.<sup>8</sup> Theoretically, family investors have a private forum for recourse through "state courts under laws specifically designed to govern family disputes."<sup>9</sup> But recourse is only available if the Commission's definition of a family member corresponds with the definition used by family courts. And very few family courts are likely to recognize a "spousal equivalent." Nearly every state limits non-custodial family court jurisdiction to married family members, and does not provide a forum to resolve disputes with unmarried cohabitants.<sup>10</sup> As a result, allowing the

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<sup>7</sup> 17 C.F.R. § 210.2-01, (f)(9), (f)(13) (2010); Revision of the Commission's Auditor Independence Requirements, *supra* note 5, at 76,061 (defining "spouse" as a married "husband or wife, whether by marriage or under common law" and also including "spousal equivalent," defined as a "cohabitant occupying a relationship generally equivalent to that of a spouse" in the definition of "close family members"). The ambiguous definition of "spousal equivalent" raises many questions of who might be a "spousal equivalent" for purposes of the auditor independence rules, which mirror the questions raised in Section II of our discussion. The purpose of the auditor independence rules might be better served by replacing the ambiguous "spousal equivalent" term with "cohabitant." In the context of auditor independence, either broad term arguably enhances the process of identifying individuals who are likely to impair independence. But the "family office" exclusion is not enhanced by opening the door to all cohabitants.

<sup>8</sup> Family Offices, *supra* note 1, at 63,754.

<sup>9</sup> *Id.*

<sup>10</sup> *See, e.g., Burns v. Burns*, 560 S.E.2d 47, 47 (Ga. Ct. App. 2002); *In re Marriage of Tara Ranzy & Larissa Chism*, No. 49D12-0903-DR-014654, slip.op. at 3 (Ind. Super. Ct., Marion County Sept. 4, 2009); *O'Darling v. O'Darling*, 188 P.3d 137 (Okla. 2008); *Kern v. Taney, et al.*, 11 Pa. D. & C. 5th 558 (Pa. Com. Pl. 2010); *Chambers v. Ormiston*, 935 A.2d 956, 963 (R.I. 2007); *In re Marriage of J.B. and H.B.*, No. 05-09-001170-CV, 2010 WL 3399074, at \*12 (Tex. App. Dallas 2010); (all denying jurisdiction over couples that were not married under local laws); *see also Hennefeld v. Twp. of Montclair*, 22 N.J. Tax



family office exemption to apply to investor groups that are broader than the generally-accepted definition of family members within the local jurisdiction deprives those investors of the Commission’s oversight with no private, family court alternative.

## **II. The ambiguous and evolving concept of “spousal equivalent” opens the door for uncertainty and undesirable exploitation of the “family office” exemption.**

In addition to running contrary to the policy behind the “family office” exclusion, the inclusion of “spousal equivalent” in the definition of family members for this purpose also introduces profound uncertainty regarding who might be eligible for this characterization. In at least thirty-four states where a “spouse” is the only legally-recognized family relationship between cohabitating adults,<sup>11</sup> the generally-accepted definition of “spouse” is just that—an opposite-sex husband or wife. So what, exactly, is generally equivalent to a spouse?

For example, does the proposed definition mean that any person currently cohabiting with a family member is a spousal equivalent? Or, consistent with the limited inclusion of divorced spouses as family members,<sup>12</sup> do all people who have previously cohabitated with a family member receive a comparable former spousal equivalent status? In the case of multiple cohabitants, can more than one person claim spousal

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166, 184 (N.J. Tax Ct. 2005) (prohibiting recognition of spousal equivalence until same-sex relationship was registered under local rules).

<sup>11</sup> See Ala. Const. art. I, § 36.03(g); Alaska Const. art. 1, § 25; Ariz. Const. art. XXX § 1; Ark. Const. amend. 83, § 1-3; Fla. Const. art. I § 27; Ga. Const. art. I, § IV; Idaho Const. art. III, § 28; Kan. Const. art. 15, § 16; Ky. Const. § 233A; La. Const. art. XII, § 15; Mich. Const. art. I, § 25; Miss. Const. art. 14, § 263A; Mo. Const. art. I, § 33; Mont. Const. art. XIII, § 7; Neb. Const. art. I, § 29; N.D. Const. art. XI, § 28; Ohio Const. art. XV, § 11; Okla. Const. art. II, § 35; S.C. Const. art. XVII, § 15; S.D. Const. art. XXI, § 9; Tenn. Const. art. XI, § 18; Tex. Const. art. I, § 32; Utah Const. art. I, § 29; Va. Const. art. I, § 15-A; Del. Code Ann. tit. 13, § 101(a) and (d); 750 Ill. Comp. Stat. Ann. 5/212; Ind. Code Ann. § 31-11-1-1; Minn. Stat. Ann. § 517.03; N.C. Gen. Stat. Ann. § 51-1.2; 23 Pa. Cons. Stat. Ann. § 1704; W. Va. Code Ann. § 48-2-603; Wyo. Stat. Ann. § 20-1-111 (expressly limiting spouses to husband and wife with no recognition of other types of unions). In addition, New Mexico and Rhode Island do not provide any form of state recognition to non-husband and wife relationships.

<sup>12</sup> Family Offices, *supra* note 1, at 63,757.



equivalency? Or is legal recognition of the relationship—such as a domestic partnership or civil union—necessary to be a spousal equivalent? If so, how would unmarried opposite-sex individuals who are not eligible for a domestic partnership or civil union be affected? How are individuals who reside in the thirty-four states that provide legal recognition only to spousal relationships between one man and one woman classified?<sup>13</sup>

Because these questions have no clear answers, they are very likely to generate uncertainty. Those uncertainties may be exploited as a loophole, allowing unintended individuals to participate in an exempted family office. We recommend that the Commission cure this ambiguity by eliminating the indefinable term “spousal equivalent.”

### **III. Expansion of the definition of “spouse” to include “spousal equivalents” violates federal law.**

Even if the inclusion of “spousal equivalents” aligned with the “family office” policy, its expanded definition of a spouse violates federal law. DOMA restricts the definition of “spouse” to “a person of the opposite sex who is a husband or a wife.”<sup>14</sup> That definition applies “[i]n determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States.”<sup>15</sup> In section 409 of the Dodd-Frank Act, Congress instructed the Commission to define exempted family offices “consistent with the previous exemptive policy” of the Commission.<sup>16</sup> Surely Congress also intended for the Commission to define “spouse” consistent with 1 U.S.C. § 7 (DOMA), as is required of all federal entities. And surely Congress did not expect the Commission to contradict DOMA when the Commission’s previous exemptive policy has never done so.<sup>17</sup>

The Commission must define family members in a manner that is consistent with federal law. Using a separate term—“spousal equivalent”—does not validly circumvent DOMA. The proposed definition of a spousal equivalent uses the circular definition of

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<sup>13</sup> *Supra* note 11.

<sup>14</sup> 1 U.S.C. § 7 (2010).

<sup>15</sup> *Id.*

<sup>16</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376.

<sup>17</sup> Family Offices, *supra* note 1, at 63,762.



someone who is “generally equivalent to that of a spouse.”<sup>18</sup> Thus, the proposed rule essentially expands the definition of “spouse” in direct violation of DOMA.

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Because the inclusion of “spousal equivalents” violates federal law, is inconsistent with the policy objectives of the proposed rules requiring a carefully limited definition of the family unit, and introduces complexity in its enforcement, we strongly recommend that the Commission eliminate proposed § 275.202(a)(11)(G)-1(d)(7) from the final rules. As your discussion of the proposed rule notes, family offices that wish to advise a group of individuals who do not fall into the definition of “family members” are still able to seek a Commission exemptive order.<sup>19</sup> And while the Commission has never received a request to include a spousal equivalent in a family office exemption, upon receipt of a specific request the Commission may evaluate the risk to investors based on the facts presented.

We are available to discuss our comments and answer any questions that the Committee or the Commission may have. Please do not hesitate to contact Holly L. Carmichael or Dale Schowengerdt at (480) 444-0020 regarding our submission.

Respectfully submitted,

ALLIANCE DEFENSE FUND

s/Holly L. Carmichael, J.D., C.P.A.

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<sup>18</sup> *Id.* at 63,756.

<sup>19</sup> *Id.* at 63,765.