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Do you recall Alice's meeting with the maddening Humpty Dumpty? It went like this:

"There's glory for you!"

"I don't know what you mean by 'glory,'" Alice said.

Humpty Dumpty smiled contemptuously. "Of course you don't—till I tell you. I meant 'there's a nice knock-down argument for you!'"

"But 'glory' doesn't mean 'a nice knock-down argument,'" Alice objected.

"When *I* use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean—neither more nor less."

"The question is," said Alice, "whether you *can* make words mean so many different things."

"The question is," said Humpty Dumpty, "which is to be master—that's all."

Recently, I was surprised to learn that Humpty Dumpty's great great grandson, Bumpty Dumpty is a senior staff attorney at the SEC in the Division of Investment Management's Office of Expediency. And he is intimately involved in the Commission's initiative to register hedge fund advisers. It's true! I ran into him the other day at a plush Georgetown watering hole. The conversation went something like this:

PG: I read the Commission's release and it said the word "client" is not defined in the Advisers Act. I run a hedge fund and I always thought the hedge fund was my client. Isn't that right?

BD: That depends.

PG: On what?

BD: The context. The fund alone used to be your client. And, you still have a fiduciary duty to the fund. But when it comes to counting clients, we now think each investor in the fund is also a "client." As I said, it depends on the context.

PG: Do I have a fiduciary duty to each investor or to the hedge fund itself?

BD: Good question. Both, I suppose.

PG: But, what I have a conflict of interest?

BD: Give me an example.

PG: Well, say I am considering buying a tax-free bond. If someone invests his IRA in the hedge fund, it probably would not make sense for him to own a tax-free bond in his IRA. But, retirement accounts make up only a small percentage of

the fund's assets. How should I deal with that?

BD: Hmm. Well, to be honest, we have not thought about such things. Our goal is just to redefine "client" so that most hedge fund advisers have to register.

PG: My, you are clever. Your great great granddad would be proud.

BD: Thank you.

PG: Just curious. Until now, the hedge fund alone was the client, right?

BD: Right.

PG: How long has that been the case?

BD: Since the Advisers Act was adopted. Sixty-four years.

PG: And now you want to change that?

BD: Right.

PG: Why?

BD: We found out some hedge fund advisers did bad things.

PG: You never knew that? Anyway, what does that have to do with the definition of "client?"

BD: Well, we think if Congress had known back in 1940 that hedge fund advisers would do bad things, they would have wanted them to register. We can honor Congress' will by redefining "client" so that almost all hedge fund advisers will now have to register.

PG: Well, how sure are you about what Congress really intended back in 1940?

BD: Frankly, we don't know. What are we supposed to do, get that guy on television, John Edward, to contact them?

PG: But how prevalent is misbehavior by hedge fund managers?

BD: That's the problem. We just don't know and only 40% of them have registered voluntarily. But, even one case of fraud is too much.

PG: So what have you learned about the advisers who have registered voluntarily?

BD: We have too busy with rulemaking to look at their operations.

PG: Well, it seems like you should analyze the information you already have before proposing more regulation. After all, some of the registered hedge fund advisers may be doing bad things right now.

BD: Thanks. When we want your opinion, we'll give it to you.

PG: How much does Eliot Spitzer have to do with all these new rules?

BD: Who is he?

PG: Forget it. You know Alan Greenspan. He said, "Rules cannot substitute for

character.”

BD: We believe it is just the reverse. Greenspan must be getting senile.

PG: Let me ask you a question. If you are not sure what Congress’ intent was in 1940, why doesn’t the SEC ask Congress to pass a law requiring hedge fund advisers to register? After all, wouldn’t that eliminate any doubt?

BD: Sure. But, did you see what a hard time they gave Chairman Donaldson when he testified in front of that Senate committee? What a hassle!

PG: Yes, but it still seems that legislation is the right way to make significant policy changes. Didn’t the SEC do that back in 1970 when it convinced Congress to eliminate the registration exemption for advisers of mutual funds?

BD: Yes, but Congress is so unreliable. What if they sit on it? We figure if we can get what we want without involving Congress, isn’t that more efficient? That is why we formed the Office of Expediency in the first place.

PG: But, shouldn’t the SEC be consistent?

BD: As Emerson said: “A foolish consistency is the hobgoblin of little minds.”

PG: Can you really adopt a rule based on speculation about what Congress intended?

BD: We think so. In a case we love to cite, *Chevron v. NRDC*, the Supreme Court said we could interpret the law anyway we want as long as we are reasonable. That gives us lots of leeway to make, uh -- I mean, reinterpret the law to meet changed circumstances.

PG: I think the Court also said that once it decides what the law is, an agency has to abide by that?

BD: I don’t recall that. But, so what?

PG: Check footnote 9 in *Chevron*. Anyway, in another case, *Lowe v. SEC*, the Supreme Court went into great detail about the legislative history of the Advisers Act and especially as to what an adviser is and the relationship between an adviser and a client. However, I didn’t see *Lowe* mentioned in the SEC’s release. How come?

BD: We don’t put much credence in *Lowe*.

PG: Why not?

BD: We lost that case.

PG: I think you have to follow it anyway. In *Lowe*, the court said that “the legislative history plainly demonstrates that Congress was primarily interested in regulating the business of rendering personalized investment advice” and “the kind of fiduciary, person-to-person relationships that were discussed at length in the legislative history of the Act and that are characteristic of investment adviser-client relationships.” So, how can a hedge fund adviser’s client be someone with

whom he has no direct relationship whatsoever?

BD: As I said, we don't pay much attention to *Lowe*.

PG: Somehow, that just doesn't seem right. But let me ask you something else.

BD: Shoot.

PG: Are the investors in a hedge fund also clients of the fund's lawyer or independent accountant?

BD: I don't think so.

PG: Why not?

BD: Well, we recently adopted a release that specifically said that when a lawyer advises a company, the company is the client, not the investors. I assume the same principle applies to an outside accountant.

PG: So, what about an investment adviser to a hedge fund?

BD: That's different. As I said, in certain contexts, each investor is a client.

PG: Huh? Why is there a double standard for different service providers to hedge funds? Why is legal advice treated differently than investment advice?

BD: Maybe because there are lots of lawyers at the SEC and no hedge fund managers. The bar association would go bonkers if we tried to make each investor in a company a "client." Also, there are lots of lawyers in Congress. Anyway, lawyers and accountants are already regulated.

PG: And haven't they cost investors at Enron and other companies, not to mention employees and creditors, a lot more money than hedge fund managers?

BD: What's your point?

PG: Maybe more regulation is not such a good way to prevent fraud. Maybe rewarding whistle blowers is better.

BD: Maybe you should wash your mouth out with soap.

PG: What if the same person gives legal advice and investment advice to a hedge fund? Who is his client?

BD: Are you trying to confuse me?

PG: Who, me? By the way, when I discussed the SEC's proposal with my lawyer, I think I saw dollar signs in his eyes. Just curious, do you have any plans after you leave the SEC?

BD: Oh, I will probably join some prestigious law firm's investment management and regulatory group. You know, advising mutual funds and hedge funds on regulatory matters.

PG: Could that have anything to do with the SEC's proposal?

BD: What do you mean?

PG: Well, more rules and regulations mean more lawyering is needed to deal with them. Isn't that what you will be doing?

BD: I resent the implication that I might be thinking about my own interests when I prepare rulemaking initiatives!

PG: You mean it hasn't crossed your mind? Do you deny it?

BD: I said I resent it.

PG: How so?

BD: Everyone at the SEC is only interested in one thing – protecting investors. We love investors. We worship investors. It is guys like you that we have to protect them from. Like Chairman Donaldson said, anyone who objects too vigorously to this proposal probably has something to hide. Am I getting warm?

PG: Now that I resent.

BD: So, why don't you want to register? Really?

PG: You know that song by Billy Joel, "Allentown?" "Out in Bethlehem they're killing time, Filling out forms, Standing in line."

BD: Ouch! Your singing is awful. And I was never fond of those lyrics anyway.

PG: The truth is I am afraid that dealing with red tape will take too much time away from my job, which is to make money for the hedge fund. Having some bureaucrat looking over my shoulder with a checklist and a bunch of dumb questions and asking for documents whenever he demands it is counterproductive. The SEC came up with some cost estimates for complying with the new rule but they didn't account for opportunity costs. Time I spend on red tape is time I don't spend making money for the hedge fund. Some registered advisers have told me horror stories. They had to stop their regular work for a week just to deal with an SEC examiner's inane questions and comments. I hear the SEC now wants advisers to save all their emails in a sortable format. That seems pretty intrusive.

BD: Opportunity costs, my foot! Are you sure you have nothing to hide? Like our release says: "We cannot be at the office of every adviser at all times."

PG: You say that like it's a bad thing. Do you really think only people who have something to hide object to being subjected to constant surveillance? How would you like it if hidden video cameras were installed at the SEC?

BD: Why would they do that?

PG: You know, to deter staffers from goofing off, for example, ogling the Playboy centerfold when they should be scrutinizing that infamous interview with the Google guys to see if they said anything that would affect their IPO.

BD: I am only attracted to eggs anyway.

PG: Ok, but you get the point. And, something else is bugging me. The SEC claims it is doing all this for investors. So, why not allow the investors in each

hedge fund to vote on whether they want the adviser to register?

BD: Wow! Let investors decide for themselves!?! That's wild! I admit it does have some surface appeal. But, remember what my great great granddad's friend, Squealer said in Animal Farm: "I trust that every animal here appreciates the sacrifice that Comrade Napoleon has made in taking this extra labour upon himself. Do not imagine, comrades, that leadership is a pleasure! On the contrary, it is a deep and heavy responsibility." Of course, like Comrade Napoleon, Comrade – uh, Chairman Donaldson would be only too happy to let investors make their own decisions. But sometimes they might make the wrong decisions, and then where would we be?

PG: Yeah, I guess that could happen. People sometimes do make lousy decisions. But, why should all hedge fund managers have to register if only a few are doing bad things?

BD: Our division chief, Paul Royce, explained that. He told a story about how the children at a school party lined up for apples and a teacher watched to make sure each child took just one apple. Then, some kid posted a sign at the other end of the table where the cookies were that said: "Take as many cookies as you want, she's watching the apples." If we don't watch everyone, some hedge fund managers might be tempted to do bad things.

PG: I look at differently. If one kid does something wrong, for example, lets the air out of the principal's tires, is it fair to make the whole class stay after school?

BD: You have it all wrong. Registration is a benefit to everyone -- hedge fund advisers as well as investors. It's not a punishment.

PG: And I just don't appreciate the benefit?

BD: Right. Remember, what Orwell said? "War is peace. Freedom is slavery. Ignorance is strength. Compliance is integrity." Regulation benefits everyone. The more regulation, the better. That is our credo at the SEC. Once you accept that fundamental truth, you will change your tune.

PG: Yeah, maybe you are right. Look, I have to go back to my office and work on my investment strategy. Any last words of advice?

BD: Yes, put the strategy stuff on hold. Then, get a good lawyer. I can put you in touch with one. He doesn't work cheap but he can handle everything. He used to work with me at the SEC.

PG: Thanks. By the way, what do those tattoos on your shell say?

BD: This one says: "Word Master." That one says: "Policy Maker."

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