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**TOPICS:**

**CONNECTICUT  
REGULATORS REACT  
TO CALLS FOR HEDGE  
FUND REGULATION**

**FEDERAL COURT VACATES SEC  
HEDGE FUND RULE**

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## Connecticut Regulators React To Calls For Hedge Fund Regulation

By Richard Slavin

Connecticut Attorney General Richard Blumenthal responded quickly to the *Goldstein* decision of the Court of Appeals for the District of Columbia, which vacated the SEC Hedge Fund Rule (see next article for background on *Goldstein*). He testified at a Congressional hearing in which he implored Congress and the Securities and Exchange Commission to act to regulate hedge funds and implied that if the federal regulators did not, that Connecticut would take action.

Interestingly, unlike Elliot Spitzer in New York, Attorney General Blumenthal is not the Connecticut Securities Commissioner. While he can implore, it is up to the Connecticut

Banking Commissioner to enforce the Connecticut Uniform Securities Act. Under the current law, the Banking Commissioner would have to refer a case to the Attorney General for civil action before the Attorney General could act.

At the Banking Commissioner's Securities Forum 2006, Ralph Lambiase, the Director of the Banking Commissioner's Securities and Business Investments Division, confirmed that he had formed a task force to deal with hedge funds. The task force includes six examiners, so one can assume that the task force was created to perform fraud investiga-

tions. Typically the Banking Department initiates fraud investigations based on investor complaints or collateral examinations of registered broker-dealers or investment advisers.

***There are no new Connecticut hedge fund regulations or laws***

Despite Mr. Blumenthal's warnings and the formation of the task force, Connecticut has no regulations or new laws which impose any additional regulation on hedge funds. Last

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spring, two bills reached the Connecticut legislature with the goal of registering hedge funds. Those bills died in committee. The Banking Commissioner has the ability to adopt

regulations governing hedge funds but neither the Commissioner nor his staff seems eager to do anything now but study the industry.

Most hedge funds are sold as private offerings of securities and comport with Regulation D of the Securities Act of 1933. They are "covered" securities within the meaning of the National Securities Markets Improvement Act of 1996 ("NSMIA") and cannot be regulated by the states. The only power Congress left for the states is the ability to perform investigations of fraud.

### ***The Connecticut action was designed to head off new legislation and to respond to cases like the Bayou Fund.***

Connecticut, and particularly Fairfield County, is home to a proliferation of hedge funds. With so many funds and so much money housed in those funds that there is some likelihood that wrongdoing exists, even if it is a small percentage. Connecticut regulators had not investigated the Bayou Fund before its failure, even though it had its own in-house registered broker-dealer. It seems likely that there is a desire on the part of the Banking Department to, at least, examine registered persons associated with hedge funds.

### ***What about firms with their own broker-dealers and state-registered investment adviser-managers?***

The best advice for funds in Connecticut is to insure they maintain their private offering documents, adhere to the representations and disclosures made in their offering memoranda, avoid even the hint of prohibited insider trading, and allow clients to redeem based on the terms of the offering memoranda.

For firms with their own in-house broker-dealers or state registered investment adviser-managers it is important to follow the written supervisory policies and procedures manual and to cooperate with Banking Department examiners when they appear. Compliance officers should insure that e-mails are retained and that any communication with investors is documented.

These admonitions suggest nothing different from the normal operation of these entities, but managers should be

aware that a registered person working for the fund gives the examiner almost carte-blanche to examine any transactions initiated or processed by the registered person.

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### ***What about federally registered investment advisers who are fund managers?***

NSMIA prohibits the states from regulating federally registered investment advisers. It does not prohibit fraud investigation. Connecticut has recently taken the position, at least informally, that it has the right to determine whether an investment adviser should be state registered. In other words, the Banking Department believes that it can perform an investigation on an investment adviser to determine whether it has less than \$25,000,000 under management, a finding that would require state registration.

### ***Will hedge funds have to change the way they operate?***

For the honest hedge fund manager there should be no change in how the fund operates as a result of the Banking Department's actions. If the new task force actually discovers fraud based on

a complaint or based upon its own internally generated investigation, it would help the honest hedge fund. Rooting out bad actors always makes sense. If the number of hedge fund related cases brought by the Banking Department does not increase, then the task force may turn out to be simply a nuisance to the hedge fund community but, at a minimum, it could still serve as a deterrent to new Connecticut laws that might cause hedge funds to change the way they do business. Ralph Lambiase maintained that by studying the hedge fund industry his agency will be able to cooperate with hedge funds to make the industry better.

It remains to be seen whether the task force's examiners will really examine or, as Mr. Lambiase insists, just study. Ultimately the Banking Department's task force may prove to be helpful to the industry by preventing unnecessary legislation and it may just catch a few bad actors.



## *Federal Court Vacates SEC Hedge Fund Rule*

By Karen Wackerman Myers

The controversial rule of the United States Securities and Exchange Commission requiring many investment advisers to hedge funds to register with the SEC (the "Hedge Fund Rule") was vacated by the United States Court of Appeals for the District of Columbia Circuit this summer. The unanimous decision, *Phillip Goldstein v. Securities and Exchange Commission*, leaves the future of federal regulation of hedge funds in some doubt.



Investment advisers are generally exempt from registering with the SEC if they have fewer than fifteen clients. The SEC had previously counted a fund as one client in this calculation, but the Hedge Fund Rule required advisers to count every investor in a hedge fund to determine whether the adviser had more than fifteen clients, resulting in a requirement that many hedge fund advisers register by this past February. The *Goldstein* court concluded that this interpretation of the word "client" was arbitrary, and it vacated the Hedge Fund Rule and remanded it to the SEC, which

decided not to appeal the court's decision.

### ***Hedge Fund Advisers who are Registered with the SEC***

In response to the void left by the *Goldstein* decision, the SEC issued a "no action" letter on August 10 in which it continued several exemptions it had created as part of the Hedge Fund Rule. Most importantly, the letter stated that the SEC staff would not recommend enforcement against a registered investment adviser that withdraws from registration by February 1, 2007 if the adviser does not hold itself out to the public as an investment adviser and has fewer than fifteen clients (with a fund counting as one client.) This gives registered advisers to hedge funds some time to consider whether to withdraw their registration with the SEC.

In addition, the letter confirmed that offshore advisers are not subject to the Investment Advisers Act with respect to offshore private funds and other offshore clients. It also continued its limited "transition" exemption for advisers to hedge funds who were required to register due to the Hedge Fund Rule, requiring such advisers to maintain records supporting performance-based fees only

from February 10, 2005 on and permitting such advisers to charge performance-based fees from clients who are not "qualified clients" if they were clients before February 10, 2005. The letter also clarified and confirmed several other exemptions and requirements.

### ***Should a Registered Hedge Fund Adviser De-register?***

So what should a registered investment adviser to a hedge fund do in light of the uncertainty regarding SEC regulation at this time? This decision depends on a number of factors. A registered adviser to a hedge fund is vulnerable to examination by the SEC, which would include examination of the records on its hedge fund. For this reason, an adviser that is not currently registered and that may rely on the private adviser exemption may choose not to register. On the other hand, some hedge fund advisers prefer to be registered to assure their investors that they are open to scrutiny and therefore a good investment choice. Regardless of an adviser's decision on registration, the SEC continues to have jurisdiction over hedge funds, whether they are registered or not, for enforcement of anti-fraud, insider trading and similar statutes.

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### MOST ACTIVE, GAINERS AND LOSERS

Stock (TICKER)	Close	Change	% Change	Volume (100)	Stock (TICKER)	Close	Change	% Change	Volume (100)	Stock (TICKER)	Close	Change	% Change	Volume (100)
<b>25 MOST ACTIVE</b>					<b>25 TOP GAINERS</b>					<b>25 TOP LOSERS</b>				
SunMicro (SUNW)	5.38	+ 0.11	+ 2.1	962025	Future (FUTU)	29.49	+ 5.60	+ 23.2	20280	Telefonos (TELE)	4.14	- 1.26	- 30.4	4492
Case (CASE)	26.64	- 0.05	- 0.2	492018	Clorox (CLX)	18.80	+ 3.15	+ 16.8	21190	CaseID (CASE)	7.77	- 2.22	- 28.5	1639
Inet (INET)	21.99	+ 2.42	+ 11.0	455229	Solara (SOLA)	12.56	+ 2.80	+ 22.3	36520	Bohemian (BOHE)	8.57	- 2.23	- 26.0	18854
Microsoft (MSFT)	25.25	+ 0.11	+ 0.4	442024	Chineton (CHIN)	8.82	+ 1.75	+ 19.8	13950	Zenada (ZEN)	4.88	- 0.89	- 18.2	292
Pfizer (PFE)	23.89	+ 0.18	+ 0.7	360215	ChLush (CHLU)	8.25	+ 1.62	+ 19.6	11038	Karim (KAR)	10.28	- 1.41	- 13.7	7069
Motorola (MOT)	21.17	- 0.21	- 1.0	366233	InterDC (IDC)	24.42	+ 4.51	+ 18.5	80988	Rupha (RUPH)	36.81	- 3.74	- 10.1	52300
Case (CASE)	19.18	+ 0.40	+ 2.1	342317	Cherex (CHCX)	18.83	+ 3.29	+ 17.5	4980	FiberLow (FIBL)	6.95	- 0.74	- 10.6	22000
Lucent (LUC)	2.52	+ 0.02	+ 0.8	339805	Cherex (CHCX)	17.80	+ 1.59	+ 8.9	4879	Empire (EMPR)	12.40	- 1.34	- 10.8	8880
United (UNIT)	4.11	- 0.02	- 0.5	334481	Cherex (CHCX)	12.43	+ 2.05	+ 16.5	22625	Adaptive (ADPT)	4.82	- 0.51	- 10.6	116
Norfolk (NOR)	2.06	+ 0.02	+ 1.0	272900	Cherex (CHCX)	11.80	+ 1.59	+ 13.5	11801	Amgen (AMGN)	52.72	- 0.50	- 0.9	10914
Synthesia (SYN)	20.58	+ 0.13	+ 0.6	262290	Cherex (CHCX)	11.80	+ 1.59	+ 13.5	11801	Prime (PRIME)	19.91	- 1.92	- 9.6	22152
Dell (DELL)	35.48	+ 0.60	+ 1.7	242330	Cherex (CHCX)	10.72	+ 1.36	+ 12.6	4915	RushCo (RUSH)	6.26	- 0.45	- 7.2	1866
Wal-Mart (WMT)	45.32	+ 0.15	+ 0.3	241199	Cherex (CHCX)	9.88	+ 0.63	+ 6.4	813	Berenson (BER)	35.96	- 3.40	- 9.5	440
Apollon (APOL)	18.19	+ 0.45	+ 2.5	236152	Cherex (CHCX)	9.27	+ 0.68	+ 7.4	1938	Intellix (INTE)	5.11	- 0.50	- 9.8	604
TimeWar (TIME)	19.89	+ 0.26	+ 1.3	235201										
BNC (BNC)	12.81	- 0.09	- 0.7	232000										
Qualcomm (QCOM)	35.29	+ 0.36	+ 1.0	229200										
Gen (GEN)	13.43	+ 0.25	+ 1.9	228200										
Gen (GEN)	35.29	+ 0.19	+ 0.5	228200										
Home (HOME)	35.48	- 0.24	- 0.7	228200										
Conrad (CONR)	2.29	+ 0.01	+ 0.4	228200										
Novus (NOV)	14.21	+ 0.35	+ 2.5	228200										
Fort (FORT)	9.87	+ 0.29	+ 2.9	228200										
Oceanic (OCE)	3.29	- 0.03	- 0.9	228200										
Evonik (EVON)	74.43	+ 0.01	+ 0.0	228200										

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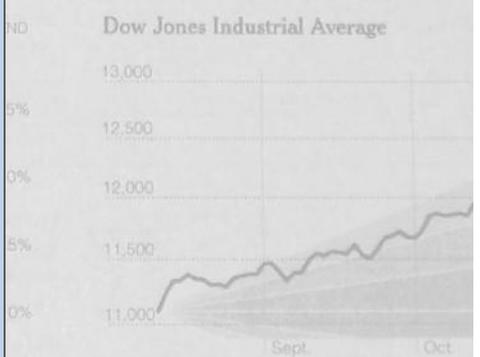
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Close	1-Day Chg	1-Yr %Chg	YTD %Chg	52-Week Price	Stock (TICKER)	Low	High
22.70	+ 0.25	+ 44.2	+ 43.4	16.87	Cisco Syst (CSCO)	16.87	22.70
33.04	+ 0.01	+ 43.3	+ 36.0	44.81	OilDrill (OIL)	44.81	33.04
45.68	- 0.32	+ 10.1	+ 15.8	27.17	Clear Channel (CC)	27.17	45.68
35.49	- 0.02	+ 10.8	+ 3.7	39.36	CoorTech (CT)	39.36	35.49
77.78	+ 1.39	+ 164.5	+ 115.5	53.04	CoorTech (CT)	53.04	77.78
63.82	- 0.04	+ 10.0	+ 16.6	75.35	Comcast Co (CMCSA)	75.35	63.82
89.84	+ 0.08	+ 13.0	+ 3.2	65.23	Computer Sci (CS)	65.23	89.84
41.43	- 0.05	+ 17.7	+ 11.7	16.95	Del Inc (DELL)	16.95	41.43
38.97	+ 0.11	+ 18.1	+ 14.5	23.70	Dynegy (DYG)	23.70	38.97
70.85	+ 1.02	+ 4.5	+ 3.5	23.00	Dow Chem (DOW)	23.00	70.85
73.79	- 0.76	+ 10.2	+ 7.8	38.52	OutPeak (OP)	38.52	73.79
46.97	- 0.32	+ 12.4	+ 9.3	9.44	EMC Corp (EMC)	9.44	46.97
33.24	+ 0.10	+ 22.2	+ 18.4	19.83	East Kodak (EK)	19.83	33.24
88.29	- 0.30	+ 31.7	+ 13.3	10.78	El Paso Corp (EP)	10.78	88.29
54.80	- 0.31	+ 25.5	+ 10.0	66.78	Energy (ENR)	66.78	54.80
48.89	- 0.13	+ 15.6	+ 15.6	49.78	Eastern Corp (ECC)	49.78	48.89
34.40	+ 0.72	- 0.3	+ 2.9	35.80	Evonik (EVON)	35.80	34.40
85.59	+ 0.37	+ 31.3	+ 20.0	92.70	FeedCo (FCO)	92.70	85.59
24.41	- 0.01	+ 17.4	+ 8.2	9.86	Ford Motor (F)	9.86	24.41
78.97	+ 0.22	+ 19.8	+ 8.1	53.99	Gen Dynamics (GD)	53.99	78.97
30.21	+ 0.14	+ 17.7	+ 17.7	31.81	Gen Electric (GE)	31.81	30.21
120.20	+ 0.85	+ 7.8	+ 7.4	18.23	Gen Motors (GM)	18.23	120.20
37.47	+ 0.28	+ 29.3	+ 25.9	198.20	Goldman Sachs (GS)	198.20	37.47
88.52	+ 0.98	+ 11.3	+ 3.6	41.82	HCA Inc (HCA)	41.82	88.52
78.25	+ 0.81	+ 27.1	+ 23.9	26.33	Helix (HLX)	26.33	78.25

of Returns	Annually	% YTD	% 1 yr	% 3 yr	% 5 yr	Expense Ratio	Assets (bil.)
1	+ 12.5	+ 16.9	+ 15.0	+ 18.4	0.88	37,397	
2	+ 12.9	+ 17.8	+ 18.1	+ 14.9	0.72	17,140	
3	+ 6.0	+ 9.1	+ 15.5	+ 18.7	0.80	6,648	
4	+ 3.4	+ 5.0	+ 8.9	+ 10.1	1.20	2,556	
5	+ 13.1	+ 19.0	+ 13.4	+ 7.7	0.72	12,475	
6	+ 12.2	+ 15.1	+ 16.7	+ 18.0	0.74	1,583	
7	+ 12.4	+ 12.9	+ 18.4	+ 14.5	1.10	9,299	
8	+ 8.0	+ 11.1	+ 11.9	+ 9.9	0.81	8,317	
9	+ 18.0	+ 15.9	+ 19.5	+ 20.7	0.55	3,374	
10	+ 10.9	+ 15.2	+ 16.3	+ 13.1	0.22	7,399	
11	+ 11.1	+ 13.3	+ 14.2	+ 12.2	0.82	7,000	
12	+ 11.1	+ 14.6	+ 15.0	+ 14.2	0.40	7,914	
13	+ 5.1	+ 7.5	+ 12.5	+ 11.5	0.84	3,308	
14	+ 9.2	+ 13.0	+ 16.8	+ 11.7	1.07	6,842	
15	+ 13.1	+ 15.2	+ 14.8	+ 19.1	0.23	8,737	
16	+ 15.9	+ 19.7	+ 17.3	+ 16.0	0.82	8,134	
17	+ 11.5	+ 14.2	+ 14.7	+ 13.1	0.25	8,071	
18	+ 6.2	+ 9.0	+ 10.9	+ 8.4	0.90	3,953	
19	+ 4.9	+ 7.1	+ 14.3	+ 14.8	1.09	6,036	
20	+ 13.0	+ 14.0	+ 14.4	+ 17.5	0.94	3,352	
21	+ 11.6	+ 12.1	+ 12.8	+ 14.0	1.31	3,814	
22	+ 15.4	+ 18.0	+ 18.4	+ 13.2	0.51	3,219	
23	+ 12.6	+ 15.4	+ 16.1	+ 11.1	0.92	3,184	
24	+ 11.0	+ 14.4	+ 13.7	+ 13.3	0.66	4,729	
25	+ 12.6	+ 14.6	+ 13.6	+ 16.8	0.52	6,722	

