No. 23-60471

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NATIONAL ASSOCIATION OF PRIVATE FUND MANAGERS; ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION, LIMITED; AMERICAN INVESTMENT COUNCIL; LOAN SYNDICATIONS AND TRADING ASSOCIATION; MANAGED FUNDS ASSOCIATION; and NATIONAL CAPITAL VENTURE ASSOCIATION,
Petitioners,

vs.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Petition for Review from the Securities & Exchange Commission

BRIEF OF *AMICUS CURIAE* THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF PETITIONERS AND VACATUR

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November 8, 2023

CERTIFICATE OF INTERESTED PERSONS

No. 23-60471

NATIONAL ASSOCIATION OF PRIVATE FUND MANAGERS; ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION, LIMITED; AMERICAN INVESTMENT COUNCIL; LOAN SYNDICATIONS AND TRADING ASSOCIATION; MANAGED FUNDS ASSOCIATION; and NATIONAL CAPITAL VENTURE ASSOCIATION,
Petitioners,

vs.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the Judges of this Court may evaluate possible disqualification or recusal.

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The Chamber of Commerce of the United States of America ("Chamber") is a nonprofit, tax-exempt organization incorporated in the District of Columbia. The Chamber has no parent corporation, and no publicly held company has 10% or greater ownership in the Chamber.

Dated: November 8, 2023

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INTEREST OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation. It represents approximately 300,000 direct members and indirectly represents the interests of more than 3 million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases, like this one, that raise issues of concern to the nation's business community.

Private funds play an integral role in developing companies and creating jobs throughout the United States and the world. The industry has thrived in the existing regulatory environment, which is characterized by a high degree of transparency and sophistication among market participants. Private funds permit greater flexibility and efficiency in capital structure, strategy, and operation than funds available to retail investors due to their differing statutory and regulatory regimes. But the Rule adopted by the Securities and Exchange Commission ("SEC" or "Commission") threatens to upend that critical distinction. The Commission replaces the successful

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[1] No counsel for any party authored this brief in whole or in part, and no entity or person, aside from *amicus curiae*, its members, or its counsel, made any monetary contribution intended to fund the preparation or submission of this brief. Counsel for all parties have consented to the filing of this brief.

regime that has persisted since the passage of the Investment Advisers Act of 1940 ("Advisers Act") and the Investment Company Act of 1940 ("Investment Company Act") with a prescriptive regime that would needlessly change the market and harm the ability of highly sophisticated investors and advisers to negotiate mutually agreeable terms. The Commission lacks the statutory authority to adopt such restrictions, which would in all events impose unjustifiable costs on stakeholders across the business community.

INTRODUCTION AND SUMMARY OF ARGUMENT

Congress has not authorized the Commission to wreak fundamental changes on the private funds marketplace. In 1940, Congress built the federal architecture that has governed the relationships surrounding various investment vehicles and their advisers for over 80 years. In adopting a pair of laws—the Advisers Act and the Investment Company Act—Congress recognized that thriving capital markets required rules that appropriately protected retail investors, but at the same time, preserved the flexibility of asset managers to offer specialized investment products to sophisticated investors.

To that end, Congress drew a sharp distinction between public and private funds. Public funds are widely available to retail investors, many of whom Congress believed might lack the means and knowledge to protect themselves from potentially manipulative and deceptive practices. Congress thus subjected public funds to the prescriptive regulatory framework of the Investment Company Act, which establishes detailed corporate governance standards and pervasively regulates the relationship between investment companies, their advisers, and investors. Although that framework inevitably constrains investor choice and imposes costs, Congress deemed such tradeoffs appropriate to create a fair market for retail investors.

Congress made a different choice when it came to privately offered funds. Private funds are, by their nature, available only to sophisticated and well-resourced investors. And "[i]nvestment vehicles that remain private and available only to highly sophisticated investors have historically been understood not to present the same dangers to public markets as more widely available investment companies." *Goldstein v. SEC*, 451 F.3d 873, 875 (D.C. Cir. 2006) (citation omitted). Those investors typically access private funds via professionals who can closely monitor their investments, negotiate appropriate terms, and ensure that the products meet their needs. Congress thus exempted private funds from the prescriptive framework of the Investment Company Act.

As to the Advisers Act, "Congress recognized the diversity of advisory relationships and through a principles-based statute provided them great flexibility." Andrew J. Donohue, SEC Director of Division of Investment Management, *Keynote Address at the 9th Annual International Conference on Private Investment Funds* (Mar. 10, 2008), https://bit.ly/3FOsIhI. That is, the legislature "chose not to subject registered advisers to a 'fit and proper' test." *Id.* Congress instead took "especial care . . . in the drafting of the bill to respect th[e] relationship" between advisers and their clients, *Lowe v. SEC*, 472 U.S. 181, 201 (1985) (emphasis omitted) (quoting H. R. Rep. No. 76–2639, at 28 (1940)), which in the private funds context are the funds themselves, and to avoid imposing a prescriptive regime that would undermine the benefits of those arrangements, *see* Barry P. Barbash & Jai Massari, *The Investment Advisers Act of 1940: Regulation by Accretion*, 39 Rutgers L.J. 627, 627–28 (2008).

Over the years, the SEC has addressed certain gaps in that statutory regime by regulation, but the Commission has never before claimed the authority to erase the fundamental distinction between public and private funds. That changed with the Private Fund Advisers Rule (the "Rule"). *See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, 88 Fed. Reg. 63206 (Sept. 14, 2023). Here, the Commission "stubborn[ly] refus[ed] to accept" Congress's judgment and the reality that "private fund investors have the ability to negotiate the terms that are important to them." Commissioner Hester M. Peirce, *Uprooted: Private Funds Advisers; Documentation of Registered Investment Adviser Compliance Reviews* (Aug. 23, 2023), https://bit.ly/3s8E1Ou (quotation marks omitted). It instead has claimed the authority to "us[e] the coercive power of government regulation to favor one side of a private negotiation." Commissioner

Mark T. Uyeda, *Statement on Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews* (Aug. 23, 2023), https://bit.ly/3SdBcGA.

The Commission's effort undercuts Congress's deliberate policy choice concerning the treatment of private funds and does so without identifying a legitimate statutory source for its rulemaking. Recognizing that its action is unprecedented, the Commission relies primarily on Section 913(g) of the Dodd-Frank Act. *See* 15 U.S.C. § 80b-11(h). But that provision cannot reasonably be interpreted to provide the Commission with the sweeping authority to regulate prescriptively the private funds industry.

As the Supreme Court has recognized, Congress "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes." *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001) (citation omitted). Yet that is precisely what the Commission would have this Court assume here. Congress included an ancillary provision, entitled "Other Matters," in a section of the Dodd-Frank Act that addresses "*retail* customers"—*i.e.*, natural persons who use personalized investment advice "primarily for personal, family, or household purposes." Dodd-Frank Wall Street Reform and Consumer Protection Act, § 913, Pub. L. No. 111–203, 124 Stat. 1376, 1824–30 (2010) (emphasis added). That provision does not concern the sophisticated entities that invest in private funds, and it can hardly be a source of authority for regulating private fund advisers. Simply put, Congress did not intend for Section 913(g) to alter fundamentally its longstanding, principles-based approach to the private funds industry.

And even if the Commission could discover some authority to regulate private fund advisers in Section 913(g), that section would at most permit the Commission to "prohibit[] or restrict[] certain sales practices, conflicts of interest, and compensation schemes" that are "contrary to the public interest and the protection of investors." 15 U.S.C. § 80b-11(h)(2). The regulations at issue have little if anything to do with sales practices, conflicts of interest, or compensation schemes.

Besides the lack of statutory authorization, the Commission's Rule is arbitrary and capricious several times over. To start, the SEC has "failed once again" to "adequately . . . assess the economic effects" of its Rule. *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011). It has saddled the private funds industry with billions of dollars in compliance costs, without identifying any appreciable defect in the existing marketplace. And it has failed to articulate any meaningful, non-speculative benefit that its Rule might produce. Hence, the Commission has violated its statutory duty to promulgate regulations that "will promote efficiency, competition, and capital formation." 15 U.S.C. § 80b-2(c). On the contrary, the Rule will impede those statutorily prescribed ends.

The Commission also has violated the Administrative Procedure Act's requirement that it "examine the relevant data and articulate a satisfactory explanation for its action." *All. for Hippocratic Med. v. U.S. Food & Drug Admin.*, 78 F.4th 210, 245 (5th Cir. 2023) (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)). Faced with decades of lived experience to the contrary, the Rule needlessly and baselessly finds private funds investors to be incapable of negotiating satisfactory agreements. That explanation "runs counter to the evidence," and it thus cannot justify the Commission's fundamental shift in the federal government's regulatory approach to the private funds industry. *Id.* (citation omitted).

Because the SEC lacks the statutory authority to promulgate the Rule and the SEC flouted numerous requirements of the APA, the Court should "hold unlawful and set aside" the Commission's ill-considered action. 5 U.S.C. § 706(2).

ARGUMENT

I. Congress Enacted A Statutory Regime That Permits Private Funds To Operate Within A Contract-Based Market Without The Regulatory Burdens Imposed On Public Investment Companies.

The Rule runs roughshod over the hands-off approach that Congress has statutorily mandated for private funds. And the Commission's overreach threatens to derail the success that the private funds industry has enjoyed in the contract-based marketplace that Congress intentionally left to flourish on its own.

A. Congress Has Consistently Exempted Private Funds From Direct Regulation Under The Investment Company Act.

Far from granting the Commission the sweeping regulatory authority that it has asserted, Congress chose the opposite approach. It adopted the Investment Company Act and the Advisers Act only after receiving the Commission's "exhaustive study" of "'the functions and activities of investment trusts and investment companies,'" *SEC v. Capital Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 187 (1963) (citation omitted), and conducting "lengthy hearings" before both the Senate and the House, *Lowe*, 472 U.S. at 194–201. That intensive groundwork led Congress to carefully craft its regulatory regime.

On the one hand, the Investment Company Act "places significant restrictions on the types of transactions registered investment companies may undertake," and it imposes a litany of additional measures designed to protect investors. *Goldstein*, 451 F.3d at 875. That prescriptive framework governs almost every aspect of an investment company's operations. *See* 15 U.S.C. § 80a-3 (defining "investment company"). For instance, the Investment Company Act imposes detailed requirements for independent directors. *Id.* §§ 80a-10, 80a-16. It restricts how investment companies may engage in securities transactions. *Id.* §§ 80a-12, 80a-22. It limits the ability of funds to shift investment policies. *Id.* § 80a-13. It dictates the capital structure of investment companies. *Id.* § 80a-18. It constrains their ability to declare dividends and issue loans. *Id.* §§ 80a-19, 80a-21. And it imposes significant reporting requirements. *Id.* § 80a-29.

However, Congress chose *not* to impose the same prescriptive framework on private funds. Because not all investment vehicles pose the same hazards for investors, Congress exempted from the definition of "investment company" several types of entities, including privately held companies that do not make or propose to make a public offering of securities and do not have more than 100 beneficial owners. *See* Investment Company Act, Pub. L. No. 76–768, 45 Stat. 789, 798 (1940) (codified at 15 U.S.C. § 80a-3(c)(1)).

As private funds grew, Congress expanded that exemption even further. In 1996, Congress eliminated the 100-investor threshold for funds whose securities are owned exclusively by "qualified purchasers," which it defined to include only the most sophisticated and well-resourced investors. *See* 15 U.S.C. §§ 80a-2(a)(51), 80a-3(c)(7); National Securities Markets Improvement Act of 1996, Pub. L. No. 104–290, 110 Stat. 3417, 3433–35 (1996).

That long-running exemption reflects Congress's conviction that private funds flourish without the yoke of prescriptive regulations, and that additional regulations were unnecessary. As the 1996 Senate Report explained, qualified purchasers can "evaluate on their own behalf matters such as the level of a fund's management fees, governance provisions, transactions with affiliates, investment risk, leverage, and redemption rights." *Prohibition of Fraud By Advisers of Certain Pooled Investment Vehicles, Securities Act Release No. 8766*, 2006 WL 3814994, at *8 n.45 (Dec. 27, 2006) (quoting S. Rep. No. 104–293, at 10 (1996)). The Staff of the Commission's Division of Investment Management expressed a similar view: "[N]o sufficiently useful governmental purpose is served by continuing to regulate funds owned exclusively by sophisticated investors." Division of Investment Management, U.S. Securities and Exchange Commission, *Protecting Investors: A Half Century of Investment Company Regulation* 114–15 (May 1992). Congress agreed, making the policy judgment that it should expand the market-based approach permitting sophisticated investors in private funds to make their own decisions concerning the appropriate terms that they should seek in connection with private funds' investments.

Congress in no way disturbed that judgment in the Dodd-Frank Act. Although Congress expanded the *registration* requirements for private fund advisers under the Advisers Act, *see* Pub. L. No. 111-203, § 403, 124 Stat. 1376, 1571 (2010), it did not eliminate other distinctions between private and public funds, *see Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Release No. IA-3222, at 3 (June 22, 2011), https://bit.ly/40snWzT ("The primary purpose of [the Dodd-Frank Act in this context] was to require advisers to 'private funds' to register under the Advisers Act.”). Specifically, Congress did *not* compel private funds to comply with the strictures of the Investment Company Act.

In so doing, Congress also preserved the market-driven relationships between a private fund adviser, the fund, and outside investors. As the D.C. Circuit had held, a private fund adviser owes a fiduciary duty not to investors, but to the fund itself, which is the client of the adviser under the Advisers Act. *See Goldstein*, 451 F.3d at 880–81. The Dodd-Frank Act endorsed that conclusion by reaffirming that the Commission could not redefine investors as the “client[s]” of the private fund adviser. *See* 15 U.S.C. § 80b-11(a). In this way, Congress took an incremental step in regulating the relationship between advisers and the private funds they advise, but it did not disturb the market-based contractual relationships between advisers and the sophisticated investors who provide capital to the private fund.

B. Private Funds Have Thrived Under A Market-Based Regime.

Congress’s decision to preserve the structure of the private funds industry was not an oversight; instead, it reflected that sophisticated investors benefit from a market-based approach to investing in private funds. Private fund investors frequently “engage in active due diligence before investing, routinely retain advisory firms to evaluate options for them, and negotiate for more disclosure” from private funds as they find necessary to meet their particularized needs. Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC’s Regulatory Philosophy, Style,* *and Mission*, 2006 U. Ill. L. Rev. 975, 992 (2006). Indeed, studies suggest that the "vast majority" of investors have decided to walk away from investments in such funds when they find those funds' terms unattractive. *See Preqin Private Capital Fund Terms Advisor – Sample Pages* 1 (2019), https://bit.ly/3QQkuMx; *see also* AR.159.13 (citing a similar study as "evidence of an active (and proactive) investor base").

That is no surprise. Private funds have blossomed under Congress's market-based approach, producing a successful and competitive market for advisers and investors alike.[2] According to the Commission, the number of private funds has more than tripled over the last decade—from 32,000 in 2012 to over 100,000 in 2022—and their value has ballooned from $9.8 trillion to $26.6 trillion over that same span. *See* 88 Fed. Reg. at 63208. This remarkable growth is a testament to the benefits of a market-based approach and the ability of sophisticated market participants to negotiate around potential pitfalls on their own accord. *See Amends. to Form Pf to Require Event Reporting for Large Hedge Fund Advisers & Priv. Equity Fund Advisers & to Amend Reporting Requirements for Large Priv. Equity Fund Advisers*, Release No. 6297, 2023 WL 3317921, at *44 (May 3, 2023) (noting the growth of the industry).

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[2] *See generally* Committee on Capital Markets Regulation, *A Competitive Analysis of the U.S. Private Equity Fund Market* (Apr. 2023), https://bit.ly/3MmIc07; AR.360.

The SEC itself recognized this reality as recently as 2019. *See Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Release No. IA-5248, 2019 WL 3779889, at *9 (June 5, 2019). The Commission acknowledged the value of allowing sophisticated investors to address their interests through negotiation and disclosure, so as to arrive at the investment terms that are appropriate for their individual facts and circumstances. *Id.* at *4 n.31. In that release, the SEC noted that "[f]ull and fair disclosure for an institutional client (including the specificity, level of detail, and explanation of terminology) can differ, in some cases significantly, from full and fair disclosure for a retail client because institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications." *Id.* at *9.

At bottom, the evidence confirms Congress's judgment that "[p]rivate ordering works for private funds." Statement of Commissioner Peirce, *supra*. The private funds industry has grown rapidly, creating jobs, fueling capital formation, benefitting the economy, and yielding outsized returns for investors. And those trends will continue so long as the government gives the market space to prosper. The Commission may believe it knows better than the market, but it has no authority to ignore Congress's deliberate legislative judgment. The Court should reject such agency overreach.

II. The Rule Exceeds The Commission's Statutory Authority.

An agency "literally has no power to act . . . unless and until Congress authorizes it do so by statute." *FEC v. Ted Cruz for Senate*, 596 U.S. 289, 301 (2022) (citation omitted). Here, though, the Commission has promulgated several prescriptive regulations in defiance of the market-based regime that Congress created for private funds. The Commission discovered this novel power to inject itself into arms-length negotiations between advisers and sophisticated private fund investors in an ancillary provision of the Dodd-Frank Act. But Congress enacted that provision in the wake of the global financial crisis to address concerns surrounding *retail* investment advisers. Section 913 did not disturb Congress's historical approach to private funds. Nor did it otherwise enable the Commission to adopt many of the specific regulations at issue. The same goes for the other provisions of the Advisers Act that the Commission has invoked.

A. Section 913 Of The Dodd-Frank Act Does Not Permit The Commission To Regulate Negotiations Between Private Fund Advisers and Investors.

Statutory interpretation is a "holistic endeavor." *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). This Court thus must construe "the words of a statute . . . in their context and with a view to their place in the overall statutory scheme." *Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 320 (2014) (citation omitted). "And beyond context and structure, the Court often looks to 'history and purpose' to divine the meaning of language." *Gundy v. United States*, 139 S. Ct. 2116, 2126 (2019) (plurality op.) (alteration adopted) (quoting *Maracich v. Spears*, 570 U.S. 48, 76 (2013)). Those indicators of statutory meaning confirm that Section 913 does not empower the Commission to dictate the results of negotiations between private fund investors and advisers.

Instead, that Section, which was enacted as part of the Dodd-Frank Act, plainly addresses retail customers, not private fund investors. Section 913(a) begins by defining "retail customer" as a natural person or representative of such person who "receives personalized investment advice" and "uses such advice primarily for personal, family or household purposes." Next, subsections (b) through (e) direct the Commission to evaluate the "effectiveness of existing legal or regulatory standards of care" for brokers, dealers, and investment advisers who "provid[e] personalized investment advice and recommendations about securities to retail customers," and to analyze whether any "gaps" or "shortcomings" in the existing standards "should be addressed by rule or statute." In fact, those provisions alone mention "retail customers" no less than 29 times.

Then, in Section 913(f), Congress authorized the Commission to commence a rulemaking, "for the protection of retail customers," to address the "legal or regulatory standards of care" for those who provide investment advice to "such retail customers." And, in Section 913(g), Congress enabled the Commission to promulgate rules related to the standard of care "when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide)."

At the same time, Congress made clear that these changes did not affect private fund investors. Section 913(g) specifically forbids the Commission from "ascrib[ing] a meaning to the term 'customer' that would include an investor in a private fund managed by an investment adviser, where such private fund has entered into an advisory contract with such adviser." Only then—after carving out private funds from Section 913's reach—did Congress set forth the language that would be codified as Section 211(h) of the Advisers Act:

> (h) OTHER MATTERS
>
> The Commission shall—
>
> (1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and
>
> (2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.

15 U.S.C. § 80b-11(h).

The Commission's expansive reading of this subsection ignores this context. Properly understood, Section 211(h) authorizes the Commission to engage in rulemaking to address conduct incompatible with the standards set forth in Section

211(g) for *retail customers*. And Section 211(h)'s heading, "Other Matters," dispels any doubt that Congress buried a sweeping grant of regulatory authority over private funds in an ancillary provision comprising the eighth subsection in a section devoted entirely to retail investors. *See Almendarez-Torres v. United States*, 523 U.S. 224, 234 (1998). "The word 'other' usually indicates that the term that follows it is 'of the same kind as the item or person already mentioned.'" *United States v. Hendrickson*, 949 F.3d 95, 99 n.5 (3d Cir. 2020) (quoting *Other*, Cambridge English Dictionary (2019) (online ed.)); *see Thibodeaux v. Grasso Prod. Mgmt.*, 370 F.3d 486, 492 n.5 (5th Cir. 2004). And the surrounding provisions in the Dodd-Frank Act focus entirely on the protection of *retail customers*, not the institutional and other sophisticated investors that invest in private funds. Section 211(h) cannot be reasonably read to sweep well beyond the unambiguous focus on retail investors.

Other contextual clues confirm the point. Most notably, Congress devoted an entire, separate title of the Dodd-Frank Act to the regulation of private funds. *See* Dodd-Frank Act, Title IV, 124 Stat. 1570–80. Had Congress intended to confer upon the Commission the authority to reorder the market for private funds, that is the title in which it would have conferred such authority. Yet nothing in Title IV includes language like that of Section 211(h)—not even in the Section entitled "Clarification of Rulemaking Authority." *See id.* § 406, 124 Stat. 1574. The Commission cannot credibly argue that Congress would have omitted any grant of authority to fashion prescriptive regulations for private funds in a section expressly devoted to clarifying private-fund-related rulemaking but would then smuggle such authority in through another section five titles away, in an ancillary provision addressing the protections for retail investors.

The Commission's interpretation becomes even less plausible in view of the statutory history. As described above, Congress has chosen for decades to distinguish the treatment of public funds from that of private funds. *See supra* Part I. In light of that history, "it would be odd indeed if Congress had tucked an important expansion" to the SEC's traditionally limited power to regulate private funds into "a relatively obscure provision" concerning retail customers. *Sackett v. EPA*, 598 U.S. 651, 677 (2023). That is not how Congress "alter[s] the fundamental details of a regulatory scheme." *Whitman*, 531 U.S. at 468 (citation omitted).

In short, Section 211(h) provides no authority for the Commission to dictate the terms of arms-length negotiations between private fund investors and advisers. It cannot support the Rule promulgated here.

B. Even If The SEC Could Rely On The Dodd-Frank Act To Regulate Private Fund Terms, It Does Not Support Many Of The Particular Regulations Here.

Even accepting the Commission's dubious contention that Section 211(h) extends beyond the retail context, it faces additional textual hurdles. As an initial matter, only Section 211(h)(2) gives the Commission the authority to "promulgate rules." Section 211(h)(1) confers no similar power. It merely directs the Commission to "facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers." 15 U.S.C. § 80b-11(h)(1). That lack of express rulemaking authority is telling. "[W]hen Congress has made an explicit delegation of authority to an agency" to promulgate rules in one provision—as it did in Section 211(h)(2)—the Court must presume that it "did not intend to delegate additional" rulemaking authority absent a similarly clear expression. *Texas v. United States*, 497 F.3d 491, 503 (5th Cir. 2007). Nothing rebuts that presumption here. The Commission's reliance on Section 211(h)(1) is therefore untenable.

The Commission would get little further by relying upon Section 211(h)(2). Again, that provision allows for rules "prohibiting or restricting certain *sales practices*, *conflicts of interest*, and *compensation schemes* for . . . investment advisers." 15 U.S.C. § 80b-11(h)(2) (emphases added). The Commission dramatically inflates the plausible meanings of those terms.

Take the term "sales practice": The word "sales" ordinarily refers to "operations and activities involved in promoting and selling goods or services." *Sales*, Merriam-Webster Online Dictionary, https://bit.ly/3s7DyMG (last visited Nov. 8, 2023). And a "practice" is a "way of doing something." *Practice*, Merriam-Webster Online Dictionary, https://bit.ly/3Qi0Ffj (last visited Nov. 8, 2023). Thus, a "sales practice" concerns a "way" or method used to promote a good or service. Yet the Commission seeks to rely upon that provision to dictate the *substance* of the service offered—that is, the actual terms of the investment adviser agreements. Such a reading conflicts with the statutory text.

The Commission also stretches the meaning of "conflicts of interest" to include differences in treatment between investors. *See* 88 Fed. Reg. at 63278. But that does not implicate a "conflict[] of interest . . . for . . . [an] investment adviser[]." 15 U.S.C. § 80b-11(h)(2). After all, while investment advisers owe fiduciary duties to their clients, a private fund adviser's "client[]" is the private fund itself. *See Goldstein*, 451 F.3d at 880–81. "The adviser is concerned with the fund's performance, not with each investor's financial condition." *Id.* at 880. By blurring that distinction—which Congress reaffirmed in the very statute the Commission attempts to rely on, the Dodd-Frank Act, *see* 15 U.S.C. § 80b-11(a)—the Commission has attempted to regulate conflicts of interest that are not the subject matter of this law.

The Commission's "broad[] interpret[ation]" of the term "compensation scheme" misses the mark too. 88 Fed. Reg. at 63216. The plain meaning of "compensation" is "[r]emuneration and other benefits received in return for services rendered." *Compensation*, Black's Law Dictionary 342 (10th ed. 2014). And the word typically "denotes a proportionality or connection between benefits received and services rendered." *Lejeune v. JFK Cap. Holdings, L.L.C. (In re JFK Capital Holdings, L.L.C.)*, 880 F.3d 747, 754 (5th Cir. 2018). Along those lines, the classic example of a "compensation scheme" in the private fund space is the "2 and 20," in which the adviser receives an annual fee equal to two percent of the fund's assets under management, plus a carried interest in twenty percent of the capital gains. *See* 88 Fed. Reg. at 63227; William A. Birdthistle & M. Todd Henderson, *One Hat Too Many - Investment Desegregation in Private Equity*, 76 U. Chi. L. Rev. 45, 46 n.3 (2009). Such fees are paid "in return for services rendered."

Yet the Commission here seeks to rely upon this provision to restrict the ability of advisers to receive *reimbursement* for legal expenses. *See* 88 Fed. Reg. at 63389. Such reimbursement is not a form of compensation in ordinary parlance. *See, e.g.*, *Self-Regul. Organizations; Fin. Indus. Regul. Auth., Inc.; Notice of Filing of A Proposed Rule Change to Amend Finra Rule 5110 (Corp. Fin. Rule - Underwriting Terms & Arrangements) to Make Substantive, Organizational & Terminology Changes*, 84 Fed. Reg. 18592, 18595 (May 1, 2019) ("[T]he proposed rule change would clarify that the payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer would not be considered underwriting compensation."); 12 U.S.C. § 1761(c) ("[R]eimbursement of reasonable expenses . . . shall not be considered compensation."); *cf.* 18 U.S.C. § 666(c) (distinguishing between "compensation paid" and "expenses paid or reimbursed"). Nor is the *borrowing* of assets a form of compensation. *See* 88 Fed. Reg. at 63389. The Commisssion thus has exceeded its statutory authority by seeking to classify these measures as "compensation schemes."

C. The Commission Gets No Further By Relying Upon Other Provisions As Authority For Its Rulemaking.

Unable to find refuge in Section 211(h), the Commission turns to a trio of alternative statutory provisions. *See* 88 Fed. Reg. at 63386. But those efforts fare no better. Section 203(d) does not afford the Commission any rulemaking authority. *See* 15 U.S.C. § 80b-3(d). Nor does the Commission explain how Section 211(a)—which authorizes rulemaking to facilitate "the functions and powers conferred upon the Commission *elsewhere in this title*"—might empower it to adopt this novel, prescriptive regime. *Id.* § 80b-11(a) (emphasis added).

As for Section 206(4), it enables the Commission to "define . . . acts, practices, and courses of business as are fraudulent, deceptive, or manipulative," and then "prescribe means reasonably designed to prevent" them. *Id.* § 80b-6(4). But the Commission largely fails to "define" the fraudulent acts or practices that its purportedly prophylactic measures are designed to prevent. For instance, in promulgating the Preferential Treatment Rule (Rule 275.211(h)(2)-3), the Commission expressed its desire for a standard that would "remain evergreen so that it can be applied to various types of arrangements between advisers and investors and fund structures." 88 Fed. Reg. at 63281. That is, rather than define prohibited practices, the Commission has left the issue open to a nebulous "facts and circumstances analysis." *Id.* at 63283–84, 63288; *see also id.* at 63258 (similar for Adviser-Led Secondaries provision (Rule 275.211(h)(2)-2)).

Where the Commission does attempt to define targeted acts or practices, it repeatedly distorts the meaning of "fraudulent, deceptive, or manipulative." In the securities context, those terms "clearly connote[] intentional misconduct." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201 (1976). Consequently, Section 206(4) provides "an uncomfortable home for [the] routine compliance obligations" embodied in the Commission's regulations, turning "violations of those rules, even foot-faults, into enforcement actions." Statement of Commissioner Peirce, *supra*. The Commission also appears to believe that failing to disclose information to investors is "deceptive." *See, e.g.*, 88 Fed. Reg. at 63264, 63271, 63279, 63308. But an act of concealment "cannot be deceptive" within the meaning of the securities laws "where the actor has no duty to disclose." *Regents of the Univ. of Cal. v. Credit Suisse First Bos.*, 482 F.3d 372, 386 (5th Cir. 2007). And while investment advisers certainly have a "duty to disclose material information to clients," *SEC v. Wash. Inv. Network*, 475 F.3d 392, 404 (5th Cir. 2007), the individual investors in a private fund, as explained above, are not the client of the fund's adviser, *see Goldstein*, 451 F.3d at 880–81; 15 U.S.C. § 80b-11(a). The "client" is the fund itself.

III. The Commission's Regulations Are Arbitrary And Capricious.

In addition to lacking statutory authority, the Final Rule is also "arbitrary" and "capricious." 5 U.S.C. § 706(2)(A). The Commission offers an insufficient assessment of the economic consequences of its Rule, imposing paternalistic and intrusive restrictions on private funds and their advisers without adequately explaining how those regulations affect efficiency, competition, and capital formation. The Commission also bases its Rule on the speculative and unsupported conclusion that these regulatory costs are needed because sophisticated investors cannot fend for themselves. These defects likewise require the Court to set aside the Commission's Rule.

A. The Commission Has Not Adequately Analyzed The Economic Consequences Of Its Far-Reaching Regulation.

In exercising its rulemaking authority, the Commission has a statutory obligation to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. § 80b-2(c). The Commission must "apprise itself—and hence the public and the Congress—of the economic consequences" of its regulations. *Chamber of Com. of U.S. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005). Here, however, the Commission has "failed" to "adequately . . . assess the economic effects" of its Rule. *Bus. Roundtable*, 647 F.3d at 1148.

Instead, in violation of this duty, the Commission throws up its hands, stating that it is "unable to quantify certain economic effects because it lacks the information necessary to provide estimates or ranges of costs." 88 Fed. Reg. at 63293. The Commission instead resorts to a discussion that is almost entirely "qualitative in nature," while declining to choose among various assumptions and potential estimates it found "difficult to quantify." *Id.* at 63293. But the statute does not permit the Commission to punt on these hard questions. Difficulty in quantifying costs "does not excuse the Commission from its statutory obligation to determine as best it can the economic implications of [its] rule." *Chamber of Com.*, 412 F.3d at 143. Thus, the Commission's refusal to "make tough choices about which of the competing estimates is most plausible, or to hazard a guess as to which is correct," violates the Commission's "statutory obligation." *Bus. Roundtable*, 647 F.3d at 1150 (alteration adopted; quotation marks omitted).

The Commission's consideration of costs only gets worse when viewed next to the paltry benefits it articulates. When conducting a cost-benefit analysis, an agency "must identify benefits that 'bear a rational relationship to the costs imposed.'" *Chamber of Com. of U.S. v. SEC*, ___ F.4th ___, 2023 WL 7147273, at 10 (5th Cir. Oct. 31, 2023) (alteration adopted; citation omitted). Here, the Commission contends that its Rule will protect investors from one-sided arrangements. *See, e.g.*, 88 Fed. Reg. at 63210. But it ignores that "under the existing regime, sufficient protections" already exist. *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 179 (D.C. Cir. 2010). Again, the institutional and high-net-worth investors that participate in this market are more than capable of making their own decisions.

The Commission simply provides no good reason backed by evidence to disturb, for example, the ability of these entities to freely negotiate to meet their individualized needs. *See Chamber of Com.*, ___ F.4th ___, 2023 WL 7147273, at *11. If anything, the costs of the Commission's prescriptive regulations will ultimately be borne by investors—the very entities whom the Commission purports to benefit. The Commission eliminates opportunities for investors and advisers to agree to efficient and beneficial arrangements and also undermines investors' bargaining power. At the same time, the burdensome costs created by the Rule will erect significant barriers to entry for new market participants, thereby undermining market efficiency and investor choice.

In sum, the Commission's deficient economic analysis independently requires this Court to invalidate the Rule in its entirety as "arbitrary and capricious and not in accordance with law." *Bus. Roundtable*, 647 F.3d at 1148 (citation omitted).

B. The Commission Has Failed To Provide A Satisfactory Explanation For Its Rule.

At bottom, the Commission's Rule is a solution in search of a problem. But the APA does not permit agencies to regulate in that way. It requires that the

Commission "examine the relevant data and articulate a satisfactory explanation for its action." *State Farm*, 463 U.S. at 43. Courts therefore "must set aside any action premised on reasoning that fails to account for 'relevant factors' or evinces 'a clear error of judgment.'" *Univ. of Tex. M.D. Anderson Cancer Ctr. v. U.S. Dep't of Health & Hum. Servs.*, 985 F.3d 472, 475 (5th Cir. 2021) (quoting *Marsh v. Or. Nat. Res. Council*, 490 U.S. 360, 378 (1989)). This review is "not toothless" and can have "serious bite." *Wages & White Lion Invs., L.L.C. v. FDA*, 16 F.4th 1130, 1136 (5th Cir. 2021) (quotation marks omitted). Moreover, in conducting this "searching and careful" analysis, *Marsh*, 490 U.S. at 378 (citation omitted), the Court may consider only the reasoning "articulated by the agency itself," *State Farm*, 463 U.S. at 50.

Here, the Commission has failed to articulate a satisfactory explanation for its action. Its Rule is replete with conclusory and unsubstantiated assertions that the private funds industry is riddled with "problematic practices." 88 Fed. Reg. at 63209. And the anecdotal smattering of enforcement actions cited by the Commission cannot back up that tenuous claim to justify its sweeping and fundamental regulatory change. On the contrary, "these enforcement actions, most of which were settlements, illustrate that [the Commission] already can bring cases where necessary." Statement of Commissioner Peirce, *supra*.

The fact that the Commission can cite just a handful of enforcement actions—scattered across a multi-trillion-dollar industry that involves thousands of advisers—only highlights that there is no "genuine problem" in need of a costly regulatory solution. *See Chamber of Comm.*, ___ F.4th ___, 2023 WL 7147273, at *11 ("A reasoned response to uncertainty about matters of low probability or low magnitude should be markedly different from those of high probability and magnitude."). The Commission has simply failed to provide the requisite "level of analysis" needed to justify its expansive and burdensome regulations. *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016).

* * *

In the end, the Commission's Rule will harm private funds at their core. The Rule unlawfully and unjustifiably departs from Congress's and the Commission's longstanding approach to private fund regulation. Its provisions will result in a costly attempt to homogenize investor reporting, where homogeneity fails to serve investors' interests. The Rule will increase compliance costs, which will harm all parties across the industry by increasing expenses or reducing investment opportunities. The Rule will also all but eliminate the negotiation of certain valuable terms between seed investors and advisers, which are critical to allow for fundraising and capital formation. And, more broadly, the Rule will impair the ability of sophisticated investors to construct contracts on their own preferred terms. There is no need for this unauthorized restrictive regime. This Court should thus invalidate the Rule and restore the regulatory landscape that Congress and the Commission have maintained for more than eight decades.

CONCLUSION

For the foregoing reasons, the Chamber respectfully requests that this Court hold unlawful and set aside the SEC's Private Fund Advisers Rule.

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CERTIFICATE OF SERVICE

I hereby certify that on November 8, 2023, I caused the foregoing *amicus curiae* brief to be filed with the Clerk of the Court for the United States Court of Appeals for the Fifth Circuit. The Court's CM/ECF system was used to file the brief, and service will therefore be accomplished by the CM/ECF system on all CM/ECF-registered counsel.

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 29(a)(5) because it contains 6,486 words, excluding those portions of the brief exempted by Fed. R. App. P. 32(f). This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and 5th Cir. R. 32.1 and the typestyle requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Times New Roman 14-pt font.

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