ESSAY

Updating the SEC's Exemptive Order Process Under the Investment Company Act of 1940 to Fit the Modern Era

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INTRODUCTION

In the late 1930s, the U.S. Securities and Exchange Commission ("SEC") was commissioned by Congress to study the then-unregulated investment company industry.[1] This series of studies "laid the foundation"[2] for the current system of investment company regulation under the Investment Company Act of 1940 ("1940 Act").[3] A critical component of investment company regulation is the definition of an investment company. Companies that fit the definition of an investment company are required to register with the SEC, unless they can rely on an exception or exemption from registration.[4] Registered investment companies are subject to the 1940 Act's disclosure require-

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1 *See* U.S. SEC. & EXCH. COMM'N, REPORT ON THE STUDY OF INVESTMENT TRUSTS AND INVESTMENT COMPANIES pt. I (1938).

2 Request for Comments on Reform of the Regulation of Investment Companies, Securities Act Release No. 6868, Exchange Act Release No. 28,124, Investment Company Act Release No. 17,534, 55 Fed. Reg. 25,322, 25,323 (June 21, 1990).

3 Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to -64 (2006).

4 *See* 15 U.S.C. §§ 80a-6 to -8; *Investment Company Registration and Regulation Package*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/divisions/investment/invcoreg121504.htm (last visited May 19, 2011).

ments and to restrictions on many aspects of their corporate structure and day-to-day operations.[5] These restrictions can drastically alter a company's capital structure, investment activities, interactions with subsidiaries, and the duties of its directors.[6] For companies not primarily engaged in investment company business, these restrictions impose a heavy burden. For example, the capital structure restrictions imposed by section 18(d) of the 1940 Act would preclude a company from issuing stock options as a form of compensation.[7]

Currently, some companies that are clearly not engaged in investment company business face the prospect of registering as investment companies if their balance sheet looks too much like the balance sheet of an investment company. In order to avoid such a predicament, these companies are forced to operate in a way that is economically inefficient and against the best interest of shareholders. In particular, technology and internet companies, which comprise an important and growing industry, face this problem more frequently than other types of companies.[8] If these companies cannot rely on any of the statutory exemptions to the definition of an investment company, they must apply to the SEC for exemptive relief.[9] This entails a process that can take years and does not exempt a company from the 1940 Act's restrictions until the process is complete.[10]

This Essay proposes two ways to improve the SEC's current handling of exemptive applications. First, the SEC should enact reforms to the mechanics of the exemptive process that would streamline it and reduce the administrative burden on the SEC's Division of Investment Management ("IM"), which handles requests for exemption under the 1940 Act.[11] These reforms include creating a form for exemptive applications, issuing new guidelines for the application pro-

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5 *See* INV. CO. INST., 2010 INVESTMENT COMPANY FACTBOOK 186 (50th ed. 2010), *available at* http://www.icifactbook.org/pdf/2010_factbook.pdf.

6 *See id.*

7 *See* 15 U.S.C. § 80a-18(d); Joseph W. Bartlett & Stephen P. Dowd, *Section 17 of the Investment Company Act—an Example of Regulation by Exemption*, 8 DEL. J. CORP. L. 449, 470 (1983).

8 *See* ROBERT H. ROSENBLUM, INVESTMENT COMPANY DETERMINATION UNDER THE 1940 ACT: EXEMPTIONS AND EXCEPTIONS, at xxv (2d ed. 2003).

9 *See id*.

10 U.S. SEC. & EXCH. COMM'N, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION 504 n.9 (1992) [hereinafter 1992 REPORT], *available at* http://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf.

11 Commission Policy and Guidelines for Filing of Applications for Exemption, Investment Company Act Release No. 14,492, 50 Fed. Reg. 19,339, 19,339–40 (May 8, 1985) [hereinafter IC-14,492].

cess, and allowing electronic filing of applications. Second, the SEC should enact a rule granting certain bona fide applicants an automatic extension of the statutory sixty-day temporary exemption period[12] if IM is unable to grant a final order within the first sixty days. Bona fide applicants are those who file their exemptive applications in good faith and have obtained an opinion of counsel stating that they are similarly situated to past applicants who have been granted exemptive orders. This proposed rule would relieve the burden placed on applicants and allow the SEC to more fully utilize its statutory authority under the 1940 Act.

Part I of this Essay provides background information on the definition of an investment company and the statutory provisions on which a company seeking to be exempted from the 1940 Act's requirements could rely in theory but not in practice. Part II gives an overview of IM's current process for exemptive orders and highlights several areas for improvement. Next, Part III discusses the application and exemptive processes of other federal agencies and identifies certain practices that could improve IM's exemptive process. Finally, Part IV makes several recommendations for reform.

I. Definition of an Investment Company and Statutory Exemptions

The 1940 Act defines an investment company as any issuer[13] which:

> (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;
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> (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or
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> (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.[14]

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12 *See* 15 U.S.C. § 80a-3(b)(2).

13 Generally, "'issuer' means every person who issues or proposes to issue any security," with certain statutory exceptions. *See id.* § 77b(a)(4).

14 *See id.* § 80a-3(a)(1).

This Essay focuses on the third definition of an investment company and its forty-percent test. The forty-percent test applies to companies that do not hold themselves out as investment companies. Despite a company's self-perception of its business, if its balance sheet shows that more than forty percent of its assets are "investment securities," then that company is deemed to be an investment company and is subject to regulation under the 1940 Act. These companies are known as "prima facie investment companies."[15]

The SEC formulated the forty-percent test by studying every corporation that was publicly traded in the late 1930s.[16] At that time, "no company, virtually no company, that [was] not popularly regarded as an investment company" would have failed the forty-percent test.[17] Although the SEC believed that this forty-percent test would provide companies with a bright-line test on which to rely when determining their investment company status, the singular focus on the character of a company's assets has created uncertainty for many companies, including companies that operate through subsidiaries that are not wholly owned by the parent corporation, and particularly technology and internet companies.

Companies that operate through subsidiaries that are not wholly owned find their investment company status uncertain because of the statutory language's focus on wholly owned subsidiaries. Technology and internet companies find their investment company status to be uncertain because their most valuable asset is usually their internally developed intellectual property.[18] The cause of this uncertainty is that the most widely recognized set of accounting standards, known as Generally Accepted Accounting Principles ("GAAP"),[19] do not treat internally developed intellectual property as an asset on a company's balance sheet.[20] For 1940 Act purposes, this is problematic because a

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15 *See, e.g.*, Certain Prima Facie Investment Companies, Investment Company Act Release No. 10,937, 44 Fed. Reg. 66,608, 66,608–12 (Nov. 13, 1979) (codified at 17 C.F.R. pt. 270).

16 *See A Bill to Provide for the Registration and Regulation of Investment Companies and Investment Advisers, and for Other Purposes: Hearings on H.R. 10,065 Before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce*, 76th Cong. 101 (1940) (statement of David Schenker, Counsel, Securities and Exchange Commission).

17 *Id.*

18 *See* ROSENBLUM, *supra* note 8, at xxv.

19 GAAP are defined by the Financial Accounting Standards Board, a private-sector organization that is recognized as authoritative not only by the SEC but also by the American Institute of Certified Public Accountants. *See Facts About FASB*, FIN. ACCOUNTABILITY STANDARDS BOARD, http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176154526495 (last visited May 19, 2011).

20 ROSENBLUM, *supra* note 8, at 173–74.

company's balance sheet must be prepared in compliance with "generally accepted" accounting principles and the SEC has designated GAAP as representative of what is "generally accepted."[21] Under GAAP, intellectual property is treated as an intangible asset, and GAAP distinguishes between intellectual property that has been purchased—which means it has a known economic value and qualifies as an asset—and internally developed intellectual property that does not have a known economic value and does not qualify as an asset.[22]

The 1940 Act anticipates the possibility that some companies might fail the forty-percent test even though they are primarily engaged in noninvestment company business. In order to avoid burdening such companies with investment company restrictions, the 1940 Act and rules promulgated by the SEC provide prima facie investment companies with several statutory exemptions. Section 3(b)(1) of the 1940 Act exempts companies that are primarily engaged in noninvestment company business if they engage in such business directly or through *wholly owned* subsidiaries.[23] A company can utilize this exemption by self-determining that it is primarily engaged in noninvestment company business.[24] This self-determination is made based on the criteria set forth by the SEC in 1947 in *Tonopah Mining Co. of Nevada.*[25] The five *Tonopah* factors include: "1) the company's historical development; 2) its public representations of policy; 3) the activities of its officers and directors; and, *most important*, 4) the nature of its present assets; and 5) the sources of its present income."[26] In many cases, however, the asset and income factors are given the most weight, which leaves companies with the same uncertainty as the forty-percent test.[27]

The SEC has also provided two notable exemptions pursuant to its rulemaking authority. The first exemption is embodied in Rule 3a-1.[28] This rule provides that a prima facie investment company will be exempted from regulation under the 1940 Act if less than forty-five percent of its assets are investment securities and less than

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21 *See* 17 C.F.R. § 210.4-01(a)(2) (2011); *see also, e.g.*, 15 U.S.C. §§ 77s(a), 77m(b)(1) (2006).

22 *See* ROSENBLUM, *supra* note 8, at 173–74.

23 *See* 15 U.S.C. § 80a-3(b)(1).

24 *See* ROSENBLUM, *supra* note 8, at 155.

25 Tonopah Mining Co. of Nev., 26 S.E.C. 426 (1947).

26 *Id.* at 427 (emphasis added).

27 *See* ROSENBLUM, *supra* note 8, at 159.

28 *See* 17 C.F.R. § 270.3a-1 (2011).

forty-five percent of its income is derived from investments.[29] This adds an extra five-percent buffer to the *Tonopah* analysis. The second exemption is embodied in Rule 3a-8.[30] This rule applies to prima facie investment companies that are research and development companies.[31] In particular, a requirement to qualify for this exemption is that a substantial portion—meaning at least twenty percent[32]—of a company's overall expenses must be for research and development.[33]

Many companies that qualify as prima facie investment companies often cannot rely on any of these statutory exemptions. Practically, the self-determination exemption under section 3(b)(1) is of little use because the balance sheets of such companies show them to be prima facie investment companies.[34] If more than forty percent of a company's assets consist of investment securities, the company "likely would be deemed to be engaged in the business of owning or holding securities."[35] The fact that Rule 3a-1 provides for a forty-five percent test provides little additional wiggle room in the *Tonopah* analysis. Additionally, this exemption is limited to companies that operate through *wholly owned* subsidiaries.[36] A company that operates through majority-owned subsidiaries cannot avail itself of the self-determination exemption.

Rule 3a-1 fails to provide prima facie investment companies with relief either, as this exemption retains the same focus on assets as the forty-percent rule.[37] Although Rule 3a-1 does provide some relief for companies operating through majority-owned or controlled subsidiaries,[38] the question of control cannot always be easily determined. Thus, some companies are still forced to apply for an exemptive order to clarify their status under the 1940 Act. Lastly, although Rule 3a-8 may provide relief for a startup technology or internet company, once that company becomes successful, its research and development expenses will eventually cease to make up a "substantial" portion of its total expenses. Thus, a company will likely lose its exemption if it becomes successful.

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29 *See id.*

30 *See id.* § 270.3a-8.

31 *See id.*

32 *See* Cooley Godward Kronish LLP, SEC No-Action Letter, 2007 SEC No-Act. LEXIS 528 (July 12, 2007).

33 *See* 17 C.F.R. § 270.3a-8.

34 *See* ROSENBLUM, *supra* note 8, at 99.

35 *Id.*

36 *See* 15 U.S.C. § 80a-3(b)(1) (2006).

37 *See* 17 C.F.R. § 270.3a-1(a).

38 *See id.*

Prima facie investment companies that believe they are primarily engaged in a business other than investment company business and find themselves unable to rely on a statutory exemption under the 1940 Act are "inadvertent investment companies."[39] When the statutory exemptions fail, the SEC retains broad power to provide these companies with the relief they need.[40] Such inadvertent investment companies can apply to the SEC for an order exempting them from regulation under section 3(b)(2) or section 6(c) of the 1940 Act.[41] The problem, however, is that this process can take over three years,[42] during which time a company's access to capital markets may be inhibited, it may be forced to restructure its business operations in an inefficient manner, and management may be forced to take actions that go against the best interests of stockholders.[43] The length of the exemptive process creates an uneven playing field for many similarly situated companies—companies that have received an exemption have a competitive advantage over companies that have not. This flies in the face of the SEC's mandate to "promote efficiency, competition, and capital formation."[44] For example, Microsoft has been benefiting since 1988 from an exemptive order[45] and has at times held more than forty percent of its assets in investment securities.[46] Apple, however, still operates under the specter of the 1940 Act's restrictions, as it has not been issued an exemptive order. Although Apple has not applied for an exemptive order,[47] that does not change the fact that Microsoft has a government-created competitive advantage over Apple, its chief rival. This problem needs to be addressed.

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39 *See* Edmund H. Kerr, *The Inadvertent Investment Company: Section 3(a)(3) of the Investment Company Act*, 12 STAN. L. REV. 29, 30–31 (1959).

40 *See* 15 U.S.C. § 80a-3(b)(2).

41 *See id.* §§ 80a-3(b)(2), 80a-6(c).

42 *See, e.g.*, Applied Materials, Inc., Investment Company Act Release No. 27,114, 86 SEC Docket 1174, 1174 (Oct. 12, 2005) (initial application filed on Aug. 14, 2002; notice posted Sept. 13, 2005; relief granted on Oct. 12, 2005).

43 *See* ROSENBLUM, *supra* note 8, at xxv–xxvi.

44 *See* 15 U.S.C. § 77b(b).

45 *See* Microsoft Corp., Investment Company Act Release No. 16,467, 41 SEC Docket 472, 472–73 (July 5, 1988).

46 *See, e.g.*, SEC v. Nat'l Presto Indus., Inc., 486 F.3d 305, 308 (7th Cir. 2007) (noting that as of 2007, Microsoft held "more than 40% of its assets in the form of investment securities but received permission to operate outside the 1940 Act").

47 The SEC publishes notice of applications for exemptive orders in the *Federal Register*. *See* 17 C.F.R. § 270.0-5(a) (2011). No such notices in the *Federal Register* pertain to Apple.

II. Overview of the SEC's Current Handling of Exemptive Orders

The SEC has delegated the task of handling exemptive applications under the 1940 Act to its Division of Investment Management ("IM").[48] IM's current procedures for handling exemptive processes were established in 1985 in Investment Company Act Release Number 14,492 ("IC-14,492").[49] IC-14,492 includes guidelines for both IM's staff and companies applying for exemption, but provides no application form.[50] Instead, this release incorporates, by reference, Rules 0-2, 0-4, and 0-5 under the 1940 Act,[51] which generally govern application procedures in the absence of an otherwise prescribed form with instructions.[52] As there is no prescribed form for applications under section 3(b)(2) of the 1940 Act, applications must comply with Rules 0-2, 0-4, and 0-5 by being in narrative letter form, including a proposed notice to be published in the *Federal Register*, and being submitted to IM by mail.[53] It is also notable that IC-14,492 is *not* available anywhere on the SEC's website—it is only available by calling the SEC's Publications Office.[54]

Upon filing an exemptive application under section 3(b)(2), an applicant is automatically exempt from the 1940 Act's requirements for sixty days.[55] IC-14,492 requires that IM provide initial comments to an exemptive application within forty-five days.[56] After comments are provided, an applicant has sixty days to respond and amend its application.[57] If an applicant does not respond within sixty days, his application is designated as "inactive."[58] This applies to successive rounds of comments as well.[59] After an application has been reviewed by IM, a notice and summary of the application is published in the *Federal Register*.[60] The public has twenty-five days to request a hearing if it wishes to challenge an exemption; otherwise, IM will automat-

48 *See* IC-14,492, *supra* note 11, at 19,339–40.

49 *See id.*

50 *See id.*

51 *See id.*

52 *See* 17 C.F.R. § 270.0-2(b).

53 *See id.* §§ 270.0-2, -5.

54 *See Investment Company Registration and Regulation Package*, *supra* note 4.

55 15 U.S.C. § 80a-3(b)(2) (2006).

56 *See* IC-14,492, *supra* note 11, at 19,339 n.1.

57 *Id.* at 19,340.

58 *Id.* An applicant who is notified that its application is inactive may, at any time, request that IM reactivate it. *See id.*

59 *See id.*

60 *See id.*

ically issue a final order granting the exemption at the expiration of the twenty-five-day comment period.[61]

If IM takes the full forty-five days to provide comments, and then the public comment period takes twenty-five days—seventy days without including time for the applicant to respond to comments—the sixty-day temporary exemption will have expired. Although IM has the authority to extend the temporary exemption period for "cause shown,"[62] it rarely grants such extensions.[63]

In general, IM does not adhere to the turnaround times announced in IC-14,492. In the SEC's 2009 annual report, the stated goal for IM was to provide initial comments to eighty percent of exemptive applications within 120 days.[64] The SEC proclaimed that IM "significantly exceeded" this goal in 2009,[65] even though this eighty-percent, 120-day goal is inconsistent with IC-14,492. The SEC does not seem to have any plan to raise this goal either, as the agency's draft 2010–2015 Strategic Plan proposes the same measuring stick for the efficiency of IM's exemptive process over the next five years.[66]

The SEC has acknowledged IM's shortcomings in the handling of exemptive requests for almost twenty years.[67] Despite these issues, neither the 2004–2009 Strategic Plan[68] nor the draft 2010-2015 Strategic Plan[69] provide any concrete proposals for ways to decrease the turnaround time for IM's process. The 1992 Report responded to public criticism regarding the processing time for exemptive applications and the fact that IM appears "relucta[nt] to exercise its dele-

61 *See, e.g.*, OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, IM EXEMPTIVE APPLICATION PROCESSING (AUDIT NO. 408) 3 (2006) [hereinafter AUDIT 408].

62 *See* 15 U.S.C. § 80a-3(b)(2) (2006).

63 *See* ROSENBLUM, *supra* note 8, at 225.

64 2009 SEC PERFORMANCE & ACCOUNTABILITY REP. 45 [hereinafter 2009 SEC ANNUAL REPORT], *available at* http://www.sec.gov/about/secpar/secpar2009.pdf.

65 *Id.*

66 *See* U.S. SEC. & EXCH. COMM'N, STRATEGIC PLAN FOR FISCAL YEARS 2010–2015: DRAFT FOR COMMENT 32 (2009) [hereinafter 2010–2015 SEC STRATEGIC PLAN], *available at* http://www.sec.gov/about/secstratplan1015.pdf. The SEC's failure to raise IM's goal for providing initial comments to exemptive applications is notable given that it raised the Division of Trading and Markets' goal in the draft 2010–2015 Strategic Plan (response within sixty days for eighty-five percent of exemptive requests) from the SEC's 2009 Annual Report (response within sixty days for seventy percent of exemptive requests). *See* 2009 SEC ANNUAL REPORT, *supra* note 64, at 44.

67 *See, e.g.*, 1992 REPORT, *supra* note 10, at 504 (recognizing criticism of "the Commission's and the Division's administration" pertaining to exemptive applications and noting complaints "that the process of obtaining an exemptive order simply takes too long").

68 *See* U.S. SEC. & EXCH. COMM'N, 2004–2009 STRATEGIC PLAN 32–41 (2004), *available at* http://www.sec.gov/about/secstratplan0409.pdf.

69 2010–2015 SEC STRATEGIC PLAN, *supra* note 66, at 32–50.

gated authority."[70] An SEC audit in 2006, Audit 408, reinforces the 1992 Report's findings. Audit 408 found that only thirteen of eighty-three (sixteen percent) of exemptive applications received initial comments within forty-five days.[71] This audit also found that IM rarely, if ever, uses the proposed notices submitted by applicants, instead drafting its own *Federal Register* notice for each application.[72] Not surprisingly, many of the recommendations from the SEC's 1992 Report and Audit 408 have yet to be implemented by the SEC.

In some circumstances, the delay is warranted. When IM receives an application for exemptive relief, the request is categorized as either routine or novel.[73] Novel applications are defined as those that implicate new issues related to the 1940 Act, current IM policy, or factual issues that IM has not addressed.[74] Routine applications, on the other hand, involve requests that have been granted in the past on the same terms and conditions.[75] IM treats all section 3(b)(2) exemptive applications as novel.[76]

This Essay suggests, however, that section 3(b)(2) applications consistent with previously granted applications and filed in good faith be deemed bona fide exemptive requests that should be treated as routine. To enhance IM's ability to identify bona fide exemptive applications that fall within the bounds of precedent, this Essay proposes that IM adopt a form to standardize exemptive applications. By using a form, IM would free itself from Rule 0-2, removing the requirement that applicants include a proposed *Federal Register* notice with their application and allowing for IM to offer electronic filing. This Essay's second proposal suggests that the SEC adopt a rule that would grant such bona fide applicants a temporary exemption for the duration of IM's review.

III. Exemptive and Application Processes of Other Federal Agencies

Many federal agencies have application or exemptive processes, some more efficient than others. This Part discusses a handful of ex-

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70 1992 Report, *supra* note 10, at 504–05.

71 Audit 408, *supra* note 61, at 3.

72 *Id.* at 9.

73 *Id.* at 2.

74 *Id.*

75 *Id.*

76 *See* Expedited Procedure for Exemptive Orders and Expanded Delegated Authority, Investment Company Act Release No. 19,362, 58 Fed. Reg. 16,799, 16,801 (Mar. 31, 1993) (codified at 17 C.F.R. pts. 200, 270).

emplars that are, by most metrics, more efficient than IM in handling their applications. Additionally, each of the highlighted agency processes has characteristics that differentiate it from IM's process. This Essay proposes that IM adopt some of these characteristics as one would adopt best practices.

A. Model Agency Processes

1. FTC Premerger Notification Process

The Federal Trade Commission ("FTC") monitors merger activity to ensure that antitrust laws are being upheld. Before certain proposed mergers can be consummated, a premerger application must be filed with the FTC.[77] This application is comprised of a fifteen-page form accompanied by an additional seven pages of detailed instructions.[78] The form may be filed by mail or electronically.[79] The form requests detailed information on the proposed transaction and the parties involved.[80] Much of the information is purely factual or requires the attachment of previous SEC filings.[81] There is, however, a section for narrative description of the acquisition, which parties can answer on the form or answer by incorporating an attachment.[82]

Filing the application starts either a fifteen-day or thirty-day waiting period, depending on the nature of the transaction, during which the FTC reviews the application.[83] The waiting period can be extended for another ten to thirty days if the FTC requests more information,[84] and if the FTC has not requested an injunction by the end of the waiting period, the parties may consummate their merger.[85] From 2000–2009, ninety-five to ninety-eight percent of premerger notifications were not delayed beyond the first thirty days, as the FTC did not

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77 *See* 15 U.S.C. § 18a(a), (d) (2006); Antitrust Improvements Act Notification and Report Form for Certain Mergers and Acquisitions, 16 C.F.R. pt. 803 app. (2011) (FTC Form C4); PREMERGER NOTIFICATION OFFICE, FED. TRADE COMM'N, INTRODUCTORY GUIDE II: TO FILE OR NOT TO FILE 1 (2008), *available at* http://www.ftc.gov/bc/hsr/introguides/guide2.pdf.

78 *See* 16 C.F.R. pt. 803 app. (instructions for FTC Form C4).

79 *See Hart-Scott-Rodino Premerger Electronic Filing System,* FED. TRADE COMMISSION, https://www.hsr.gov/ (last visited May 19, 2011). Currently, this system is disabled because the FTC Premerger Notification Office is revising the electronic form. *See id.*

80 *See id.*

81 *See id.*

82 *See* 16 C.F.R. pt. 803 app., at Item 3(a).

83 PREMERGER NOTIFICATION OFFICE, FED. TRADE COMM'N, INTRODUCTORY GUIDE I: WHAT IS THE PREMERGER NOTIFICATION PROGRAM? 9 (2009) [hereinafter FTC GUIDE I], *available at* http://www.ftc.gov/bc/hsr/introguides/guide1.pdf.

84 *See id.* at 13.

85 *See id.*

make any additional requests for information.[86] Additionally, parties can request an early termination of the statutory waiting period, and such requests are frequently granted within two weeks.[87] Overall, the FTC and members of the bar view the premerger notification process as a "success" and a "helpful tool" as it has reduced the number of postmerger-enforcement actions by the FTC.[88]

2. FCC Closed Captioning Exemption Process

All television broadcasts must be closed captioned.[89] Closed captioning provides hearing-impaired individuals with improved access to broadcasts by allowing them to read the audio component of a broadcast.[90] The Federal Communications Commission ("FCC") regulates closed captioning and the various exemptions to the closed captioning requirement.[91] Similar to the definition of an investment company under the 1940 Act, the closed captioning rules contain several self-determined exemptions.[92] When a broadcast provider cannot rely on one of those self-determined exemptions, it can apply to the FCC for an exemptive order.[93] Petitioners for the exemption must meet an "undue burden" standard, meaning that compliance with the closed captioning rules will impose a significant difficulty or expense on the broadcast provider.[94]

Akin to IM's exemptive process, there is no "form" for closed captioning exemption petitions—submissions must be in the form of letters.[95] Additionally, such applications cannot be filed electronically.[96] Petitioners must wait two weeks until confirmation of receipt,

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86 *See* 2009 FTC, BUREAU COMPETITION & DEPARTMENT JUSTICE, ANTITRUST DIVISION HART-SCOTT-RODINO ANN. REP. 4 [hereinafter 2009 FTC ANNUAL REPORT], *available at* http://www.ftc.gov/os/2010/10/101001hsrreport.pdf; Charles W. Smitherman III, *The Future of Global Competition Governance: Lessons from the Transatlantic*, 19 AM. U. INT'L L. REV. 769, 803 (2004).

87 *See* 2009 FTC ANNUAL REPORT, *supra* note 86, at 5; David A. Balto, *Antitrust Enforcement in the Clinton Administration*, 9 CORNELL J.L. & PUB. POL'Y 61, 121 (1999).

88 *See* FTC GUIDE I, *supra* note 83, at 2.

89 *Closed Captioning*, FED. COMM. COMMISSION, http://www.fcc.gov/cgb/consumerfacts/closedcaption.html (last visited May 19, 2011).

90 *See id.*

91 *Id.*

92 *Id.*

93 *Id.*

94 *Id.*

95 *See Exemptions to the Closed Captioning Requirements on the Basis of Undue Burden*, FED. COMM. COMMISSION, http://www.fcc.gov/cgb/dro/caption_exemptions.html (last updated Mar. 3, 2011).

96 *Id.* However, this may soon change. *See* Consumer and Governmental Affairs Bureau

followed by a thirty-day public comment period.[97] In contrast to the applications themselves, comments are filed electronically.[98] If any comments are received, the petitioner has twenty days to reply.[99] It is noteworthy that throughout the process, the petitioner is considered exempt from closed captioning requirements,[100] even though many of these petitions are denied upon review by the FCC.[101]

3. EPA Premanufacture Notification Process for New Chemicals

To help manage risks to environmental and human health, the Environmental Protection Agency ("EPA") has a premanufacture notification ("PMN") process for new chemicals.[102] Recently, the EPA revised this process to require electronic submission of all PMNs.[103] The motivation behind this change was to streamline the process, reduce the administrative burden, and further the purposes of the Government Paperwork Elimination Act.[104]

Chemical manufacturers and importers must file a PMN with the EPA at least ninety days before commencing manufacturing or importing activity related to a new chemical.[105] The EPA reviews each PMN to determine if there is "an unreasonable risk of injury to health or the environment."[106] After ninety days, if the EPA does not respond, the applicant can begin manufacturing or importing the new chemical.[107] If the EPA needs more information, it can obtain a consent order, whereby the applicant agrees to limit or abstain from the proposed activity until the EPA can fully evaluate the health and envi-

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Seeks to Refresh the Record on Notices of Proposed Rulemaking Regarding Closed Captioning Rules, 75 Fed. Reg. 70,168 (proposed Nov. 17, 2010) (to be codified at 47 C.F.R. pt. 79).

97 *Exemptions to the Closed Captioning Requirements on the Basis of Undue Burden*, *supra* note 95.

98 *Id.*

99 *Id.*

100 *Id.*

101 *See The "Undue Burden" Exemption*, NAT'L ASS'N DEAF, http://www.nad.org/issues/television-and-closed-captioning/-undue-burden-exemption (last visited May 19, 2011) (noting that between 1999 and 2005, the FCC granted only three temporary exemptions of sixty-seven petitions for exemption).

102 David Markell, *An Overview of TSCA, Its History and Key Underlying Assumptions, and Its Place in Environmental Regulation*, 32 WASH. U. J.L. & POL'Y 333, 360–61 (2010).

103 TSCA Section 5 Premanufacture and Significant New Use Notification Electronic Reporting; Revisions to Notification Regulations, 75 Fed. Reg. 773, 773–90 (Jan. 6, 2010) (codified at 40 C.F.R. pts. 700, 720, 721, 723, 725).

104 *Id.* at 773–74; *see* 44 U.S.C. § 3506(b)(1)(A)–(C) (2006).

105 *See Basic Information: New Chemicals Program*, U.S. ENVTL. PROTECTION AGENCY, http://www.epa.gov/oppt/newchems//pubs/basicinfo.htm (last visited May 19, 2011).

106 15 U.S.C. § 2603(a)(1)(A)(i) (2006); *see also* Markell, *supra* note 102, at 361.

107 40 C.F.R. § 720.75 (2011).

ronmental risks associated with the activity.[108] In 2009, the EPA evaluated approximately 1100 PMNs and only restricted twelve percent of them.[109]

4. SEC Division of Corporation Finance Registration Process for New Securities

Under the Securities Act of 1933, new publicly traded securities must be registered with the SEC before they can be sold to the public.[110] The Division of Corporation Finance ("CF") reviews these registration statements to ensure accurate disclosure before public sale.[111] CF has prescribed a form for registration statements,[112] freeing the registration process from the constraints of Rule 0-2.[113] Registration forms request information about the issuer's business, a description of the new security, information about the issuer's management, and the company's financial statements.[114] All registration statements are required to be filed electronically.[115]

Once a registration statement has been filed, the new securities may be offered for sale, but sales cannot be consummated until the registration statement becomes effective.[116] Registration statements become effective automatically after twenty days.[117] This twenty-day period is reset, however, if CF issues comments on the registration statement that require an amended filing.[118] In this scenario, the twenty-day period begins anew on the date that the amended registration statement is filed.[119] CF has the authority to declare a registration statement effective before the twenty-day period has elapsed and typically does so at the request of an issuer that has diligently prepared its registration statement and promptly responded to any comments or

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108 *See Basic Information: New Chemicals Program*, *supra* note 105.

109 *S*ee 2009 EPA Performance & Accountability Rep. 107, *available at* http://nepis.epa.gov/EPA/html/DLwait.htm?url=/Adobe/PDF/P1005JZH.PDF.

110 *See* 15 U.S.C. § 77e(c).

111 *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/whatwedo.shtml#corpfin (last visited May 19, 2011).

112 *See id.*

113 *See* 17 C.F.R. § 270.0-2(b) (2011).

114 *Registration Under the Securities Act of 1933*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/answers/regis33.htm (last visited May 19, 2011).

115 *See id.*

116 *See* 15 U.S.C. § 77e(a), (c) (2006).

117 *Id.* § 77h(a).

118 *Id.*

119 *See id.*

requests for additional information.[120] Quizzically, the SEC's annual report and strategic plan indicate that its goal for CF is to provide initial comments on registration statements within thirty days—ten days after a registration statement automatically becomes effective.[121] In 2009, the average turnaround time was 25.3 days.[122]

B. Efficient Practices

Based on the discussion of various federal agency application and exemption processes in Part II.A, a few common traits emerge. First, efficient processes have forms and detailed instructions. This can be seen in the FTC premerger notification process, the EPA premanufacture notification process, and the SEC CF registration statement process.[123] Additionally, agencies that require electronic filing, or at least offer electronic filing as an option, can streamline the process and reduce administrative burdens.[124]

Of particular significance is that all four of the examples above provide some form of automatic relief or approval for applicants. The FTC must affirmatively move to delay or block a proposed merger, otherwise the parties are free to consummate the merger after thirty days.[125] Additionally, the FTC frequently terminates the statutory thirty-day period early.[126] While an FCC petition for closed captioning exemption is pending, the applicant is considered exempt from the closed captioning requirements.[127] Similar to the FTC's process, the EPA has ninety days to affirmatively act, or the applicant can begin manufacturing or importing a new chemical.[128] Even another division within the SEC, CF, operates so that registration statements automatically become effective unless it affirmatively acts to delay the effective date.[129] If it fails to respond within twenty days, the investing public can begin to purchase the new securities.[130]

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120 *See* ANGELA SCHNEEMAN, LAW OF CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 441 (5th ed. 2010).

121 2009 SEC ANNUAL REPORT, *supra* note 64, at 50; 2010–2015 SEC STRATEGIC PLAN, *supra* note 66, at 32.

122 2009 SEC ANNUAL REPORT, *supra* note 64, at 50.

123 *See supra* Part II.A.

124 *See supra* Part II.A.

125 FTC GUIDE I, *supra* note 83, at 13.

126 *See supra* note 87 and accompanying text.

127 *See Exemptions to the Closed Captioning Requirements on the Basis of Undue Burden*, *supra* note 95.

128 *See Basic Information: New Chemicals Program*, *supra* note 105.

129 *See* 15 U.S.C. § 77h(a) (2006).

130 *See id.*

IV. Proposing Reforms for Exemptive Applications

If other federal agencies and another division within the SEC can quickly process applications and exemptions involving massive corporate mergers, potential environmental and health risks, and the sale of potentially risky new securities to the public, then IM should be able to process its exemptions in a similarly efficient manner. In order to facilitate this goal, this Essay proposes two types of reform. First, applications for exemption from the requirements of the 1940 Act should be submitted via an electronic form with detailed instructions. Second, the SEC should enact a new rule that provides for instant, automatic relief for companies that apply for exemption and are able to obtain an opinion of counsel stating that the facts of the application fall within the ranges established by previously granted exemptive orders.

A. Form, Electronic Filing, and Instructions

This Essay's first proposed reform focuses on the form and filing of exemptive applications, and the instructions related thereto. Since 2000, IM has published thirteen notices of application under section 3(b)(2) of the 1940 Act.[131] In theory, these published notices are the same as the proposed notices required to be submitted by an applicant under IC-14,492 and Rule 0-2.[132] In general, a proposed notice identifies the applicant, explains why the applicant qualifies for an exemption, and summarizes the critical representations of the application.[133] In the 2011 fiscal year, it costs the SEC $477 per page to publish no-

131 Dolby Laboratories, Inc., Investment Company Act Release No. 29,454, 75 Fed. Reg. 62,157 (Oct. 1, 2010); SeaCo Ltd., Investment Company Act Release No. 29,176, 75 Fed. Reg. 13,803 (Mar. 17, 2010); RealNetworks, Inc., Investment Company Act Release No. 27,877, 72 Fed. Reg. 36,740 (June 28, 2007); Hill Physicians Medical Group, Inc., Investment Company Act Release No. 27,804, 72 Fed. Reg. 24,341 (Apr. 26, 2007); Hutchinson Technology Incorporated, Investment Company Act Release No. 27,215, 71 Fed. Reg. 5388 (Jan. 25, 2006); Applied Materials, Inc., Investment Company Act Release No. 27,064, 70 Fed. Reg. 55,180 (Sept. 13, 2005); PacifiCare of Arizona, Inc., Investment Company Act Release No. 26,643, 69 Fed. Reg. 63,413 (Oct. 25, 2004); Corvis Corporation, Investment Company Act Release No. 25,774, 67 Fed. Reg. 65,615 (Oct. 21, 2002); Price Communications Corporation, Investment Company Act Release No. 25,533, 67 Fed. Reg. 21,003 (Apr. 23, 2002); Russian Telecommunications Development Corporation, Investment Company Act Release No. 25,249, 66 Fed. Reg. 56,140 (Oct. 31, 2001); Tremont Corporation, Investment Company Act Release No. 24,979, 66 Fed. Reg. 28,765 (May 17, 2001); Bill Gross' idealab!, Investment Company Act Release No. 24,642, 65 Fed. Reg. 57,211 (Sept. 15, 2000); Yahoo! Inc., Investment Company Act Release No. 24,459, 65 Fed. Reg. 33,591 (May 18, 2000).

132 *See* 17 C.F.R. § 270.0-2(b), (e), (f) (2011); IC-14,492, *supra* note 11, at 19,340.

133 *See* IC-14,492, *supra* note 11, at 19,340.

tices in the *Federal Register*,[134] and IM claims to devote "substantial staff time to condense applications into notices" that are adequate.[135] It is likely that some practitioners find that IM frequently makes comments to proposed notices. Audit 408, however, indicated that IM does not use proposed notices due to the extensive revision that is required.[136] Regardless of whether IM uses proposed notices, too much time is being spent on this part of the application. By standardizing as much of the application as possible, the time spent summarizing an exemptive application in the *Federal Register* notice would be reduced.

A form would also be useful because each application contains some information that does not need to be stated in narrative form. The nature of these applications lends itself to a form akin to the FTC premerger notification form—a form that includes a narrative component.[137] Among the thirteen notices issued in the last decade, the reasons for applying have varied.[138] Six applicants were technology companies that either failed or were concerned about failing the forty-percent test in section 3(a)(1)(c) of the 1940 Act due to their wealth of internally developed intellectual property.[139] Two applicants were health maintenance organizations that failed the forty-percent test because their business models required them to invest in securities to manage the risk inherent in their businesses.[140] The remaining five companies applied for exemption because they failed the forty-percent test and could not rely on the exemption in section 3(b)(1) as their assets included investments in majority-owned or -controlled subsidiaries instead of wholly owned subsidiaries.[141]

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134 Circular Letter No. 777, U.S. GOV'T PRINTING OFF. (July 2, 2010), http://www.gpo.gov/customers/letters/777.htm.

135 *See* IC-14,492, *supra* note 11, at 19,340.

136 *See* AUDIT 408, *supra* note 61, at 9.

137 *See supra* note 77 and accompanying text.

138 *See supra* note 131.

139 *See* Dolby Laboratories, Inc., Investment Company Act Release No. 29,454, 75 Fed. Reg. 62,157, 62,157 (Oct. 1, 2010); RealNetworks, Inc., Investment Company Act Release No. 27,877, 72 Fed. Reg. 36,740, 36,741 (June 28, 2007); Hutchinson Technology Incorporated, Investment Company Act Release No. 27,215, 71 Fed. Reg. 5388, 5388–89 (Jan. 25, 2006); Applied Materials, Inc., Investment Company Act Release No. 27,064, 70 Fed. Reg. 55,180, 55,182 (Sept. 13, 2005); Corvis Corporation, Investment Company Act Release No. 25,774, 67 Fed. Reg. 65,615, 65,615 (Oct. 21, 2002); Bill Gross' idealab!, Investment Company Act Release No. 24,642, 65 Fed. Reg. 57,211, 57,212 (Sept. 15, 2000).

140 *See* Hill Physicians Medical Group, Inc., Investment Company Act Release No. 27,804, 72 Fed. Reg. 24,341, 24,341–42 (Apr. 26, 2007); PacifiCare of Arizona, Inc., Investment Company Act Release No. 26,643, 69 Fed. Reg. 63,413, 63,414 (Oct. 25, 2004).

141 *See* SeaCo Ltd., Investment Company Act Release No. 29,176, 75 Fed. Reg. 13,803,

Despite the variety of reasons these companies had for seeking exemption from the 1940 Act, there are some types of information common to all of them.[142] If IM were to craft a form for exemptive applications, such information should be included. In the thirteen exemption notices published since 2000, the following information frequently appeared: (1) company name; (2) date of application; (3) company's primary noninvestment company business; (4) whether that business is capital intensive, cyclical, or involves ongoing research and development activity; (5) whether the business requires substantial amounts of cash and short term investments for operations or research and development activity; (6) whether the company has adopted a policy that its primary investments are capital preservation investments; (7) whether the company's investment policy avoids speculative investments; (8) the proportion that research and development expenses make up of total expenses; (9) whether the company has substantial amounts of internally developed intellectual property; (10) the history of the company's primary business; the company's public representations of policy; the activities of the company's officers and directors; (11) the percentage of the company's total assets that consists of investment securities; and (12) the percentage of the company's total income derived from investment securities.[143]

Some of this information could be conveyed by checking a box or simply filling in a text field. For example, there could be one box asking what percentage of the company's total assets is made up of investment securities. Other types of information would still be best conveyed in narrative form. For example, the description of a company's history cannot be conveyed in a single word or number but could be summarized in a short paragraph. Overall, however, the use of a form for as much information as possible would streamline the process. If the narrative portion of the application is shorter, there is less material on which IM may comment. This would save time and

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13,803–04 (Mar. 17, 2010); Price Communications Corp., Investment Company Act Release No. 25,533, 67 Fed. Reg. 21,003, 21,003–04 (Apr. 23, 2002); Russian Telecommunications Development Corporation, Investment Company Act Release No. 25,249, 66 Fed. Reg. 56,140, 56,141 (Oct. 31, 2001); Tremont Corp., Investment Company Act Release No. 24,979, 66 Fed. Reg. 28,765, 28,766 (May 17, 2001). Although clearly an internet company, Yahoo! couched its application in terms of how it controlled a nonmajority-owned subsidiary, and not that its assets were primarily internally developed intellectual property. Yahoo! Inc., Investment Company Act Release No. 24,459, 65 Fed. Reg. 33,591, 33,592 (May 18, 2000).

142 *See supra* note 131.

143 These informational categories are derived from IM's prior exemptive orders, *see supra* note 131, and past rules and decisions that granted exemptive relief to companies, *see, e.g.*, Tonopah Mining Co. of Nev., 26 S.E.C. 426, 432 (1947); 17 C.F.R. §§ 270.3a-1, -8 (2011).

allow IM to focus on any novel substantive issues that a new application might raise, thereby streamlining the process and reducing the burden on IM.

By requiring electronic filing, IM could provide a short-form notice of the public comment period and make the electronic form publicly available on its website. IM could also allow for the electronic filing of comments. The FCC takes this approach with regard to closed captioning exemptions, often grouping multiple exemptive requests into a single public notice.[144] The FCC notices do not include many details of the applications themselves, instead referring commenters directly to the application, which is publicly available through its online commenting system.[145] This approach minimizes time spent revising each notice, as the FCC essentially has a form that can be quickly customized for each exemptive application or for groups of applications. By adopting an approach similar to the FCC, the SEC could streamline the exemptive process and reduce the administrative burden on IM, thereby furthering the goal of the Government Paperwork Elimination Act.[146] Moreover, such an approach would facilitate the posting of more information on the SEC's website in a time where people rely on the internet as their primary source for information.

Additionally, IM should issue a new release that updates IC-14,492, which contains the guidelines for filing an exemptive application with IM.[147] As noted previously, IC-14,492 was published over twenty-five years ago and does not currently reflect how IM currently handles its exemptive process.[148] Along the same lines, the SEC should revise its goals for IM's handling of exemptive applications for the sake of consistency. Currently, IC-14,492 gives IM forty-five days to provide initial comments,[149] while the SEC's annual reports set the goal at 120 days.[150] By providing clearer instructions and giving companies a better idea of what IM considers in evaluating exemptive applications, both applicants and IM would benefit because IM would receive fewer deficient and time-wasting applications.

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144 *See Exemptions to the Closed Captioning Requirements on the Basis of Undue Burden*, *supra* note 95.

145 *See id.*

146 *See supra* note 104 and accompanying text.

147 *See supra* notes 48–60 and accompanying text.

148 *See supra* text accompanying note 49 and text preceding note 64.

149 *See* IC-14,492, *supra* note 11, at 19,339 n.1.

150 *See* 2009 SEC ANNUAL REPORT, *supra* note 64, at 45.

B. Automatic Temporary Relief for Certain Bona Fide Exemptive Applications

This Essay's second proposal is that the SEC should enact a new rule that would grant relief to certain bona fide exemptive requests on a temporary basis for the duration of IM's consideration of the application. The SEC has delegated broad discretionary power to IM with regard to exemptions, particularly under section 3(b)(2). When an application is initially filed, the applicant company is exempt from regulation under the 1940 Act for a period of sixty days.[151] This is similar to the four agency examples discussed in Part III. Unfortunately, although IM has the power to extend the period of temporary exemption, it rarely does so.[152] Once an exemptive order has been issued, even a temporary exemptive order, IM has the power to unilaterally revoke that exemption if it finds that the facts justifying the exemption have changed.[153] It does not appear that IM has ever invoked its revocation power.

IM's current timeframe for exemptive orders does not follow the statutory sixty-day temporary exemption, effectively preventing applicants from relying on it. IC-14,492 only provides for initial comments within forty-five days of application, without specifying a timeframe within which the SEC must complete its review.[154] Inexplicably, IM does not even adhere to IC-14,492's forty-five day timeframe but rather a 120-day period as evidenced by the SEC's annual reports and strategic plans.[155] In the past decade, only two exemptive orders have been processed within the sixty-day temporary exemption window.[156]

For bona fide exemptive requests, IM should fully utilize its power to extend the temporary exemption period until an exemptive order is issued. This Essay proposes that the SEC promulgate a rule that would require IM to extend the temporary exemption period for certain bona fide applications for the duration of IM's review of an application. To qualify for the automatic extension of the temporary exemptive period, an applicant company would be required to include an opinion of outside counsel with its application. The opinion of

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151 *See* 15 U.S.C. § 80a-3(b)(2) (2006).

152 *See* ROSENBLUM, *supra* note 8, at 225.

153 *See id.*

154 *See* IC-14,492, *supra* note 11, at 19,339 n.1.

155 *See* 2009 SEC ANNUAL REPORT, *supra* note 64, at 45.

156 *See* SeaCo Ltd., Investment Company Act Release No. 29,176, 75 Fed. Reg. 13,803, 13803 (Mar. 17, 2010); RealNetworks, Inc., Investment Company Act Release No. 27,877, 72 Fed. Reg. 36,740, 36,740 (June 28, 2007); *see also supra* note 129 (listing exemptive order applications filed since 2000).

counsel would provide evidence of the good-faith intentions of the applicant and state that the company is similarly situated to other companies that have received exemptive orders, such that the exemption being requested would be consistent with precedent.

Promising expedited relief for exemptive applicants, through the corresponding requirement of an opinion of outside counsel that the application is consistent with precedent, is not a novel concept. In fact, IM recommended such treatment in 1992,[157] and the SEC proposed just such a rule in 1993.[158] These proposals would have authorized expedited review for "certain routine applications," which at that time explicitly excluded section 3(b)(2) applications.[159] Under the proposed rule, to qualify for expedited review an application would have required a signed statement of counsel, representing that the applicant's situation was consistent with precedent.[160] The 1993 proposed rule, however, was never finalized and the SEC dropped it from its agenda in 1996 because "the Commission [did] not expect to consider the item within the next 12 months, but the Commission may consider the item further at some point."[161] It is time to revisit the rationale underlying the 1992 and 1993 proposals and to expand that rationale to include section 3(b)(2) applications because IM's approach to exemption from regulation under the 1940 Act has changed dramatically over the past two decades. Examples of how IM has modernized its understanding of exemptive relief regarding investment company status include a no-action letter issued in 2000 allowing all companies to treat investments in money market mutual funds as noninvestment assets under the forty-percent test,[162] and a 2003 rule exempting certain research and development companies from the forty-percent test.[163]

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157 1992 REPORT, *supra* note 10, at 510–11.

158 Expedited Procedure for Exemptive Orders and Expanded Delegated Authority, Investment Company Act Release No. 19,362, 58 Fed. Reg. 16,799 (proposed Mar. 31, 1993).

159 *Id.* at 16.799 n.2.

160 *Id.* at 16,803. The proposed rule defined precedent as an order granting the same relief within two years of an application. *Id.* at 16,802. Given that the SEC issues so few section 3(b)(2) orders every year, five years might be a more appropriate time period.

161 Regulatory Flexibility Agenda, Securities Act Release No. 7,270, Exchange Act Release No. 36,915, Investment Company Act Release No. 21,795, 61 Fed. Reg. 24,066, 24,084 (May 13, 1996).

162 *See* Willkie Farr & Gallagher, SEC No-Action Letter, 2000 SEC No-Act. LEXIS 916, at *8–17 (Oct. 23, 2000) (allowing companies to treat investments in money market mutual funds as "cash items" thus allowing such investments to count as noninvestment assets for purposes of the forty-percent test).

163 *See* 17 C.F.R. § 270.3a-8 (2011).

One concern raised by this proposal is that IM could become inundated with new or frivolous exemptive applications. This fear is unfounded for three reasons. First, IM does not currently receive many exemptive applications. In the past decade, only thirteen have reached the public notice stage.[164] Second, lawyers for applicants would be subject to professional discipline for providing false or frivolous opinions in violation of section 34(b) of the 1940 Act, which makes it unlawful to make any untrue statement of material fact or omit facts so as to make a statement materially misleading.[165] Third, if IM is suddenly flooded with bona fide exemptive applications, then that indicates a real need to reevaluate the substance of the forty-percent test, and is not a true reflection on the form of the exemptive process.

The proposed extension of the temporary exemption period is not unprecedented. The Bill Gross' idealab! application received *three* temporary extensions, totaling almost ten months.[166] All that was required was a request by the applicant and a showing of cause justifying the extension.[167] By analogy, a bona fide applicant's opinion of counsel stating that its application is in good faith and consistent with precedent should qualify as a showing of cause and justify an extension of the temporary exemption period until IM is able to fully evaluate its application. IM considered such a reform in 1992 and decided not to implement it because "applicants would not find temporary relief helpful."[168] With IM taking years to fully process section 3(b)(2) applications, however, it is highly likely that applicant companies would find tremendous value in a temporary exemption. This would allow them to manage their cash and investments in the most economically efficient manner that still complies with their fiduciary duties to their shareholders and without having to operate under the specter of regulation under the 1940 Act.

CONCLUSION

By enacting the reforms proposed by this Essay, IM and the SEC could streamline the exemptive application process for applicants, and provide bona fide applicants that are not investment companies with

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164 *See supra* note 131.

165 15 U.S.C. § 80a-34(b) (2006); *see* 1992 REPORT, *supra* note 10, at 513.

166 *See* Bill Gross' idealab!, Investment Company Act Release No. 24,642, 65 Fed. Reg. 57,211, 57,211 (Sept. 15, 2000).

167 *See id.*

168 *See* 1992 REPORT, supra note 67, at 513 n.45.

immediate relief from unnecessary regulation under the 1940 Act. In addition to ensuring consistency between the 1940 Act, IM's stated policies, and IM's actual practices, these proposals would minimize any government-created competitive advantage that an exempt company would have over a similarly situated nonexempt company. Additionally, these reforms could reduce the administrative burden on IM, reduce the number of deficient exemptive applications, and allow IM to focus on regulating investment companies, instead of worrying about other industries.