Your letter of March 8, 1993, requests our assurance that we
not recommend enforcement action to the Commission if Welsh,
Carson, Anderson & Stowe ("WCAS") organizes and manages three new
investment limited partnerships (the "Funds") without registering
the Funds under the Investment Company Act of 1940 (the "1940
Act") in reliance on Section 3(c)(1) of the 1940 Act, if the
aggregate number of limited partners of all Funds exceeds one
hundred. 1/

WCAS is a private investment firm that currently manages
seven limited partnerships. 2/ The limited partnerships invest
substantially in management buy-outs, venture capital
investments, and other private equity and debt investments in the
data processing, financial services, healthcare, and computer
software industries. 2/ The general partners of the existing
limited partnerships are general partnerships comprised of nine
individual general partners of WCAS.

WCAS proposes to organize a new private investment fund (the
"Institutional Fund") to invest in equity securities of companies
in the information services and healthcare industries. The
Institutional Fund will offer limited partnership interests to a
limited number of institutional investors, most of whom
previously have invested in WCAS-managed venture capital or buy-

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1/ Section 3(c)(1) excepts from the definition of investment
company any issuer whose outstanding securities (other than
short-term paper) are beneficially owned by not more than
one hundred persons and which is not making and does not
presently propose to make a public offering of its
securities.

2/ You state that WCAS has not registered as an investment
adviser in reliance on Section 203(b)(3) of the Investment
Advisers Act of 1940 (the "Advisers Act") and Rule
203(b)(3)-1 thereunder. You have not requested, nor do we
express, any opinion with respect to the status of WCAS
under the Advisers Act.

3/ You have not requested, nor do we express, any opinion with
respect to whether one or more of the Funds could be
integrated with one or more of the existing limited
partnerships.
The minimum investment will be $5 million. It is anticipated that the number of investors in the Institutional Fund will be greater than 30 but fewer than 50. The general partner of the Institutional Fund will be a limited partnership whose general partners will be the general partners of WCAS.

Shortly after the closing of the Institutional Fund, WCAS proposes to organize two new private investment limited partnerships, WCAS Healthcare Partners, L.P. (the "Healthcare Fund") and WCAS Information Partners, L.P. (the "Information Fund") (collectively, the "Individual Funds"). The Individual Funds will invest side by side with the Institutional Fund and other WCAS funds in all healthcare industry investments (in the case of the Healthcare Fund) and in all information services investments (in the case of the Information Fund), and will purchase securities at the same price as is negotiated for the Institutional Fund or other WCAS funds.

Only individuals with prior experience in the healthcare industry will be permitted to invest in the Healthcare Fund, and only individuals with prior experience in the information services industry will be permitted to invest in the Information Fund. The minimum investment per person for each of the Individual Funds will be $25,000, and the maximum will be

4/ The offerees of the Institutional Fund will include pension and profit sharing plans having total assets of not less than $100 million, major corporations, insurance companies, banks, private foundations, and charitable institutions.

5/ You represent that any investor that is a "company" for purposes of Section 3(c)(1)(A) of the 1940 Act and will hold more than 10% of the partnership interests will be required to represent that not more than 10% of its assets are invested in companies that are excluded from the definition of investment company under Section 3(c)(1).

6/ Each of the three Funds will be a separate limited partnership and will be administered separately. Each Fund will maintain its own books and records, which will be separately audited. Creditors of any one Fund will not have a claim on the assets of any other Fund, and no limited partner of one Fund will have a right to share in the profits or assets of any other Fund.

7/ You expect that the Individual Funds will purchase positions that are approximately three to five percent of the value of the positions purchased by the Institutional Fund and other WCAS funds in each healthcare and information services investment.
$500,000. The number of investors in each of the Individual Funds will be fewer than 100. 8/

You state that the Institutional Fund and the two Individual Funds are designed for distinct types of investors, and the differing needs of those investors are reflected in the structure and operation of the Funds. The tax status of the targeted investors, for example, will materially influence the operations of both the Institutional Fund and Individual Funds. Nearly all of the investors in the Institutional Fund will be institutions exempt from federal income tax under Section 501 of the Internal Revenue Code of 1986. Because of tax constraints on these targeted tax-exempt investors, the Institutional Fund will not be able to employ leverage or certain option and short-sale investment strategies. By contrast, each Individual Fund will be permitted to leverage up to 50% of its committed capital and to purchase and sell options and make short sales. 9/ In addition, to satisfy requirements under the Employee Retirement Income Security Act of 1974 ("ERISA"), the Institutional Fund will be required to negotiate for "management rights" in at least a majority of its investments. 10/ In contrast, because of the relatively small size of their investments, the Individual Funds

8/ All investors in each of the Individual Funds will be "accredited investors" within the meaning of Rule 502 under the Securities Act of 1933.

9/ Further, because the limited partners of the Individual Funds will be subject to federal income tax on distributed and undistributed profits attributable to Fund transactions, the Individual Funds will be required to make cash distributions to limited partners whenever the Individual Funds' activities generate taxable income to the limited partners. No similar provision is required for the Institutional Fund.

10/ You state that because a large proportion of the investors in the Institutional Fund will be pension plans subject to ERISA, the Institutional Fund will conduct its business in such a manner as to qualify as a "venture capital operating company," thus avoiding the characterization of the Fund's assets as "plan assets" subject to ERISA. To qualify, the Institutional Fund will be required to structure its investments so that, on predetermined annual valuation dates, at least 50% of its assets are invested in operating companies in which the Fund has obtained management rights. The Institutional Fund, therefore, will follow a strategy of investing in a small number of buy-out situations in which it will generally exercise a significant influence over the management and policies of the portfolio companies.
will not negotiate for, and will not generally be in a position to obtain, such rights.

In addition, you state that because investors in the Individual Funds will be more active in consulting with the general partners of their respective Funds than the passive role played by the investors in the Institutional Fund, the Funds will differ in the manner in which gains and losses are allocated to their respective general and limited partners. The general partner of the Institutional Fund will receive a special allocation of 20% of the net capital gains attributable to securities sold or distributed over the life of the Institutional Fund. By contrast, the general partners of each of the Healthcare Fund and the Information Fund will be allocated gains and losses only in proportion to their respective capital contributions to these funds.

You also state that in addition to differences in the structure and operation of the Funds, the expected differences in portfolio composition and the potential risks and return on investment in the three Funds would cause a reasonable investor to regard them as materially different investments. Investments of the Healthcare Fund and the Information Fund will be highly concentrated in their respective core industries, and there is likely to be very little overlap in investments between the Healthcare Fund and the Information Fund. In contrast, you state that the Institutional Fund will be less focused and more diversified, due to the much larger amount of capital it has to invest and the broader spectrum of potential investments it can make. Thus, although there will be substantial overlap between the investments of the Healthcare Fund and the Information Fund with the investments of the Institutional Fund, the portfolio compositions of each of the Funds taken as a whole will differ markedly. Further, you state that the risks and rewards associated with investments in the Funds should also differ due to the riskier, more aggressive investment techniques that the Individual Funds will employ. Specifically, each of the Individual Funds will be permitted to leverage its investments up to 50% of its committed capital, but the Institutional Fund will not be able to employ leverage. In addition, the Individual Funds will be permitted to employ investment strategies designed to hedge or lock in investment returns, such as purchasing put options and selling securities short. The Institutional Fund, in contrast, may not utilize these techniques.

In determining whether integration is appropriate under the 1940 Act, the staff has previously considered whether a reasonable investor in two or more entities relying on Section 3(c)(1) would consider the interests to be materially different. Relevant to this determination, among other things, is whether
the entities share the same investment objectives, portfolio securities, and portfolio risk/return characteristics. 11/

On the basis of the facts and representations in your letter, and without necessarily agreeing with your legal analysis, we would not recommend enforcement action to the Commission under Section 3(c)(1) if WCAS organizes and manages the Funds as described in your letter. Because our position is based on the facts and representations in your letter, you should note that different facts or representations may require a different conclusion. Further, this response expresses the Division's position on enforcement action only and does not purport to express any legal conclusions on the issues presented.

John K. Carter
Attorney

11/ See Equitable Capital Management Corporation (pub. avail. Jan. 6, 1992); Monument Capital Management, Inc. (pub. avail. July 12, 1990); PBT Covered Option Fund (pub. avail. Feb. 17, 1979). The fact that an investor is prohibited from purchasing interests in more than one entity does not determine whether integration is appropriate.
Securities and Exchange Commission
Judiciary Plaza
450 Fifth Street, N.W.
Washington, D.C. 20549
Attention: Office of the Chief Counsel
Division of Investment Management

Welsh, Carson, Anderson & Stowe

Ladies and Gentlemen:

We are writing on behalf of Welsh, Carson, Anderson & Stowe, a New York private investment firm ("WCAS"), to request confirmation that the staff (the "Staff") of the Securities and Exchange Commission will not recommend enforcement action against WCAS if it proceeds to organize and manage three new investment limited partnerships (the "Funds") in the manner described below. Specifically, we seek confirmation that the Funds will not be integrated for the purpose of applying the exclusion from the definition of "investment company" in Section 3(c)(1) of the Investment Company Act of 1940 (the "Act"), if the aggregate number of limited partners of all Funds exceeds one hundred. This letter details and expands on matters we have discussed informally with Mr. John Carter of the Division of Investment Management.

WCAS is a private investment firm that currently manages seven institutionally funded limited partnerships with aggregate committed capital of $1.3 billion. The existing

1 WCAS has not registered as an investment adviser in reliance on the exemption provided by Section 203(b)(3) of the Investment Advisers Act, as amended, and Rule 203(b)(3)-1 thereunder. We are not requesting a no-action position on this issue.
limited partnerships were organized at various times between 1979 and 1990 and their committed capital has been substantially invested in management buy-outs, venture capital investments and other private equity and debt investments in the data processing, financial services, healthcare and computer software industries. All of these existing funds are closed-end and do not accept new partners, or new capital contributions by existing partners, after their original formation. None of the existing funds has accepted any new partners or any new capital commitments since January 1991.

The general partners of the existing funds are general partnerships comprised of individual general partners of WCAS. The individual general partners of WCAS are Patrick J. Welsh, Russell L. Carson, Bruce K. Anderson, Richard H. Stowe, Charles G. Moore, III, Thomas E. McInerney, Andrew M. Paul, James E. Hoover and Laura VanBuren.

The investors in WCAS' existing funds include approximately seventy-five institutional investors, principally pension and profit-sharing plans of major U.S. corporations, state retirement systems, insurance companies, private foundations and university endowment funds, as well as a small number of wealthy individuals. The minimum investment in any of the existing funds is $1 million.

Institutional Fund

WCAS proposes to organize a new private investment fund (hereinafter referred to as the "Institutional Fund"), along the lines of the existing funds, to invest in equity securities of companies in the information services and healthcare industries. The Institutional Fund will be organized as a Delaware limited partnership, and will offer limited partnership interests to a limited number of very substantial institutional investors, most of whom have invested in previous venture capital or "buy-out" funds organized by WCAS.

The offerees of the Institutional Fund will include pension and profit sharing plans having total assets of not less than $100 million, major corporations, insurance companies, banks, private foundations and charitable institutions.
The minimum investment in the Institutional Fund will be $5 million, and it is anticipated that the number of investors in the Institutional Fund will be greater than 30 but fewer than 50. Any investor that is a "company" for purposes of Section 3(c)(1)(A) of the Act and would hold more than 10% of the partnership interests will be required to represent that not more than 10% of its total assets are invested in companies that are exempt from the definition of "investment company" under Section 3(c)(1). The offering and sale of interests in the Institutional Fund will not be registered under the Securities Act of 1933 (the "Securities Act"), in reliance on Section 4(2) thereof. The total committed capital of the Institutional Fund is expected to exceed $500 million.

The general partner of the Institutional Fund will be a limited partnership whose general partners will be the general partners of WCAS. It will be solely responsible for selecting investments of and making all decisions with respect to the activities of the Institutional Fund.

Because nearly all of the investors in the Institutional Fund will be institutions exempt from federal income tax under Section 501 of the Internal Revenue Code of 1986, the investment policies of the Institutional Fund will be subject to certain constraints imposed by such investors. First, the Institutional Fund will be required to adopt investment strategies that will avoid generating "unrelated business taxable income" for its tax-exempt limited partners. This restriction will prevent the Institutional Fund from employing any form of leverage in structuring its investments; from structuring investments in a manner that could generate income that might not be considered capital gains, interest, dividend or other forms of exempt income under the applicable Internal Revenue Code provisions; and from selling owned securities short, effecting "uncovered" short sales or purchasing put options as a means of "locking in" gains on restricted securities that are not yet eligible for sale or distribution to the partners.

Second, due to the fact that a large proportion of the investors in the Institutional Fund will be pension plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), the Institutional Fund will also be required to conduct its business in such a manner as to qualify as a "venture capital operating company", thus avoiding the characterization of the
Fund's assets as "plan assets" subject to ERISA. In order to so qualify, the Institutional Fund will be required to structure its investments so that, on predetermined annual valuation dates, at least 50% of its assets are invested in operating companies in which the Institutional Fund has obtained "management rights." Therefore, the Institutional Fund will follow a strategy of investing in a small number of buy-out situations in which the Institutional Fund will generally exercise a significant influence over the management and policies of the portfolio companies.

The Institutional Fund, like the other Funds, will generally purchase securities of private issuers with the intention of disposing of such securities in the public securities markets, or distributing them to its partners, after the class of securities is registered under the Securities Exchange Act of 1934. Since the securities acquired by the Institutional Fund will be "restricted securities" within the meaning of Rule 144 under the Securities Act, resales of such securities in the public securities markets will have to satisfy the requirements of Rule 144. Due to the preference of institutional investors not to hold restricted securities, the agreement of limited partnership of the Institutional Fund will prohibit distributions of securities that are not freely salable under paragraph (k) of Rule 144. Therefore, the Institutional Fund will have to hold portfolio securities for a minimum of three years before they can be distributed to the partners.

The agreement of limited partnership of the Institutional Fund will provide a standard profit allocation formula for an institutional venture capital fund, in which the general partner will be allocated 20% of the excess of net profits over net losses realized over the entire twelve-year life of the Fund, as well as its pro rata share of profits and losses (based on its 1% capital contribution).

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3 See 29 CFR 2510.3-101.

4 "Management rights" are contractual rights running directly between the Institutional Fund and a portfolio company, which give the Institutional Fund rights to substantially participate in or substantially influence the management of the portfolio company. See 29 CFR 2510.3-101(d)(3)(ii).
Individual Funds

Shortly after the closing of the Institutional Fund, WCAS proposes to organize two new investment limited partnerships, WCAS Healthcare Partners, L.P. (hereinafter called the "Healthcare Fund") and WCAS Information Partners, L.P. (hereinafter called the "Information Fund" and, together with the Healthcare Fund, the "Individual Funds"). The Individual Funds will invest side by side with the Institutional Fund and other WCAS funds in all healthcare industry investments (in the case of the Healthcare Fund) and in all information services investments (in the case of the Information Fund), and will purchase securities at the same price as is negotiated for the Institutional Fund or other WCAS fund. It is expected that the Individual Funds will purchase approximately three to five percent of the total positions taken by the Institutional Fund and other WCAS funds in all healthcare and information services investments, and that the total committed capital of each of the Healthcare and Information Funds will be approximately $5 million to $10 million.

Interests in the Individual Funds will be offered only to individuals who are known to WCAS through its previous investments in the healthcare and information services industries. Only individuals with prior experience in the healthcare industry will be permitted to invest in the Healthcare Fund, and only individuals with prior experience in the information services industry will be permitted to invest in the Information Fund. These individuals will invest a minimum of $25,000, but in no event more than $500,000 per person. The investors in the Individual Funds will also consult with the general partners of these Funds regarding finding investments and developing relationships between the portfolio companies that will permit all three Funds to maximize the values of their investments. The opportunity to invest in the Individual Funds will be offered only to individuals who the general partners believe have the ability to benefit the Funds in this manner, and such consulting represents, in effect, a portion of the consideration that the individual limited partners are required to furnish in exchange for their partnership interests.

5 Under Section 17-303 of the Delaware Uniform Limited Partnership Act, limited partners of the Information and Healthcare Funds may consult with or advise the general partner with respect to any matter, including the business of the Fund, without jeopardizing their status as limited partners and the limitation on liability associated therewith.
The number of investors in each of the Individual Funds will be fewer than 100, all of whom will be "accredited investors" within the meaning of Rule 502. The offering and sale of interests in the Individual Funds will be not be registered under the Securities Act, in reliance on Rule 506 of Regulation D.

The management structures of each of the Individual Funds will reflect the narrower investment objectives and investment focuses of the two Funds as compared with the Institutional Fund. The Information Fund will be managed primarily by Messrs. Anderson and McInerney, two partners of WCAS with extensive experience in the data processing and computer industries, who will be the general partners of the general partner of the Information Fund. The Healthcare Fund will be managed primarily by Messrs. Welsh and Carson, each of whom has extensive experience in the healthcare industry, who will be the general partners of the general partner of the Healthcare Fund. By contrast, the Institutional Fund will be managed by all the partners of WCAS (all of whom will be general partners of the general partner of the Institutional Fund), reflecting the more varied and diversified investment focus of the Institutional Fund.

Unlike the Institutional Fund, which will not be able to employ leverage, each of the Individual Funds will be permitted to leverage its investments to the extent of up to 50% of its committed capital. Because the Individual Funds will be relatively small, the ability to use leverage may be important in affording the Funds a broader range of investment opportunities than would otherwise be available to them. Leverage will also generally make investment in the Individual Funds more risky, while creating the possibility of greater returns on investment. The general partners of the Individual Funds will also be permitted to employ investment strategies designed to hedge or lock in investment returns, such as purchasing put options and selling securities short. None of these strategies may be employed by the Institutional Fund.

Further, because partners of the Individual Funds will be taxpayers, rather than tax-exempt institutions, the Individual Funds will be required to make cash distributions to their partners to cover tax liabilities of the limited partners arising out of Fund transactions.

Unlike the Institutional Fund, the Individual Funds will be free to distribute restricted securities to their partners. The general partners of the Individual Funds will be in a
position to distribute securities held for only two years, which
could then be held or resold by the distributees. This feature
of the Individual Fund will enable the limited partners of the
Individual Funds to realize on their investment more quickly than
the investors in the Institutional Fund, for which distributions
may not generally be made for a minimum of three years after the
original investment.

Although each of the three Funds will invest primarily
in securities of private companies for long-term appreciation,
the Individual Funds will each have terms of eight years (as
compared to the twelve-year term of the Institutional Fund), re­
flecting the fact that the smaller amounts invested by the
Healthcare Fund and the Information Fund can be more easily
liquidated, and that the individuals who will be their limited
partners prefer a medium-term investment vehicle.

The Individual Funds will also compensate their general
partners differently than the Institutional Fund compensates its
general partner. Unlike the general partner of the Institutional
Fund, the general partners of the Healthcare and Information
Funds will be allocated only their pro rata share of profits and
losses (based on the general partners' 1% capital contribution),
and will not receive any special allocation of profits over the
life of the Funds.

Each of the three Funds will be a separate limited
partnership and will be administered separately. Each Fund will
maintain its own books and records, which will be separately
audited. Creditors of any one Fund will not have a claim on the
assets of any other Fund, and no limited partner of one Fund will
have a right to share in the profits or assets of any other Fund.

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6 For a period of two years following the distribution, or
until sales may be made under Rule 144(k), distributees would be
required to aggregate sales among themselves and with the Part­
ership for purposes of the Rule 144 volume limitation.

7 A management company affiliated with WCAS will receive a
management fee for services rendered to the Funds based on com­
mitted capital, in the case of the Institutional Fund, or assets
under management, in the case of the Healthcare and Information
Funds. These fees are in addition to the allocations of profits
and losses to the general partners of the respective Funds.
Section 3(c)(1) and Integration

Section 3(c)(1) of the Act provides in pertinent part:

[N]one of the following persons is an investment company within the meaning of this title:

(1) Any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities.

Accordingly, an issuer must meet a two-part test to qualify for an exemption under Section 3(c)(1): (1) the outstanding securities of the issuer must be beneficially owned by not more than 100 persons (the "beneficial ownership test"); and (2) the issuer must not be making, and must not propose to make, a public offering of its securities. The Staff has on many occasions indicated that an offering conducted in accordance with Rule 146 (formerly), Regulation D (at present) or Section 4(2) of the Securities Act will be deemed to meet the public offering test of Section 3(c)(1) of the Act. See, e.g., C&S Investment Funds (July 18, 1977). Since the offerings of interests in the Funds are proposed to be conducted in accordance with the requirements of Rule 506 or Section 4(2) of the Securities Act, we believe that the public offering test under Section 3(c)(1) of the Act will be met by each of the Funds.

The issue of integration is raised, however, with respect to the beneficial ownership test. The Staff has applied the concept of integration in determining whether each of two or more investment partnerships with the same or a related general partner can satisfy the test set forth in Section 3(c)(1). In PBT Covered Option Fund (February 17, 1979), the Staff indicated that it will integrate offerings of limited partnership interests for the purposes of determining the number of beneficial owners of the securities involved if, in economic reality, the ostensibly separate issuers are really one issuer. The standard applied by the Staff was "whether the interest in one [partnership], as compared to an interest in a second partnership, would be considered materially different by a reasonable investor qualified to purchase both."

Applying this standard, the Staff has looked to a variety of factors to determine whether investments in different
investment funds are, in reality, materially different from the standpoint of a reasonable investor. While the Staff has often focused on distinguishing characteristics of the funds' investments and investment strategies -- similarity of investment objectives, portfolio securities and portfolio risk/return characteristics -- the Staff has also considered the characteristics of the funds themselves insofar as these materially affect a reasonable investor's view of the investment. Particularly in the more recent letters, the Staff has recognized that investment funds can differ in structure and operation for legitimate business reasons, such as the tax status of targeted investors, and that investments in such funds can therefore be materially different even where the investment objectives, portfolio securities and portfolio risk/return characteristics of the funds are similar.

Where two or more funds are intended for the same class of investors and have similar structural and operational characteristics, the Staff has generally concentrated on differences in investment objectives, portfolio composition and expected levels of risk and return on investment in evaluating differences between the funds. In Meadow Lane Associates, L.P. (May 24, 1989), for example, integration was not required where two funds were targeted at the same types of investors and had similar structural and operational characteristics, but had different investment objectives (long-term growth vs. special situations), portfolio securities and risk/reward characteristics. However, in cases where funds were structured to accommodate particular tax and other requirements of different classes of investors, those differences figured prominently in the integration analysis. In Oppenheimer Arbitrage Partners, L.P. (December 26, 1985), the Staff found that two partnerships that were designed for distinctly different groups of investors (taxable vs. tax-exempt) should not be integrated, even though both funds shared a common investment objective of investing in risk arbitrage transactions. In that situation, the fact that one fund was precluded from using leverage, uncovered options and other strategies that could result in unrelated business taxable income to its tax-exempt limited partners was a critical distinction between the funds. Similarly, in L. Marvin Moorehead (July 4, 1975), the Staff found that integration of two funds was inappropriate where the fund designed for tax-exempt investors adopted somewhat different investment strategies, including restrictions on the use of leverage, to accommodate their needs. Indeed, in at least one letter, the fact that the funds in issue were designed "for one group of investors with similar investment profiles" was one of the principal reasons that integration was required, and the Staff spe-
specifically distinguished the Oppenheimer letter in that regard. Frontier Capital Management Company, Inc. (July 13, 1988). See also Lemke and Lins, "Private Investment Companies under Section 3(c)(1) of the Investment Company Act of 1940," 44 Bus. Law. 401, 427 ("Integration should not apply if the interests in one section 3(c)(1) company are offered in the tax-qualified market and interests in the other are offered in the non-tax-qualified market.").

Most recently, the Staff concluded that two funds should not be integrated even though they were to have identical investment portfolios, where the differences between them resulted from differences in the targeted investors. In Pasadena Investment Trust (January 22, 1993), the Staff concluded that integration between a domestic fund and a foreign "feeder" fund was inappropriate even though the two funds were to have identical portfolios, investment strategies and risk/return characteristics (since the feeder fund could only invest in the domestic fund). Because the foreign fund would be operated in a manner that reflected the particular tax requirements of non-U.S. investors and the regulatory requirements of the foreign jurisdiction in which the feeder fund was to be formed, reasonable investors would differentiate between them based on their own tax status. Thus, the offshore fund could not possibly be considered the equivalent of a concurrently offered domestic investment fund, even though the two funds invested in identical securities.

In these and other instances, the Staff has examined investment funds both from the standpoint of their structure and operational characteristics designed to accommodate the needs of the particular investors targeted, and from the standpoint of the funds' investments. Where the differences in either of these two general areas were considered material to a reasonable investor and reflected legitimate business concerns, the Staff concluded that integration was not warranted. Where the differences were either insubstantial or artificially imposed by the sponsor in order to avoid registration, the Staff concluded that ostensibly separate funds should be integrated. See, e.g., Monument Capital Management, Inc. (July 12, 1990), Rogers, Casey & Associates, Inc. (June 16, 1989).

Recently, in Equitable Capital Management Corporation (January 6, 1992), the Staff also reaffirmed the relevance of the general principles of integration set forth in Securities Act Release No. 4552, including whether the offerings (i) are part of the same plan of financing, (ii) involve the issuance of the same
We believe that because of differences in the structure and operation of the three Funds, which stem from the different tax and regulatory requirements of the targeted groups of investors, as well as differences between the Funds in investment objectives, portfolio securities and portfolio risk/return characteristics, none of the three Funds should be integrated for purposes of Section 3(c)(1).

Structure and Operation

The Institutional Fund and the two Individual Funds are designed for distinct types of investors, and the differing needs of those investors are reflected in the structure and operation of the Funds.

First, the tax status of the targeted investors will materially influence the operations of both the Institutional Fund and the Individual Funds. In response to tax constraints on its targeted tax-exempt investors, the Institutional Fund will not be able to employ leverage or certain option and short-sale investment strategies. By contrast, the Individual Fund will be permitted to leverage up to 50% of its committed capital and to purchase and sell options and make short sales. Because the limited partners of the Individual Funds will be subject to Federal income tax on distributed and undistributed profits attributable to Fund transactions, the Individual Funds will be required to make cash distributions to limited partners whenever the Individual Funds' activities generate taxable income to the limited partners. No similar provision is required for the Institutional Fund.

Similarly, to satisfy ERISA requirements, the Institutional Fund will be required to negotiate for "management rights" in at least a majority of its investments. The Individual Funds class of security, (iii) take place at the same time, (iv) require the same type of consideration and (v) are made for the same general purpose. There, the Staff concluded that integration was not warranted, presumably because the "custom crafted" nature of the capital and management fee structures of the several funds demonstrated that the offerings were not really part of the same plan of financing, even though the funds were sold at roughly the same time and had similar investment objectives, portfolio securities and, to some degree, risk/reward characteristics.
will not negotiate for, and (due to the relatively small size of their investments) will not generally be in a position to obtain, such rights.

The structures of the Funds also take into account the perceived preferences of the classes of investors. The Institutional Fund, for example, is not permitted to distribute portfolio securities until they may be freely resold under Rule 144(k), because institutional investors do not want the burden of complying with the volume limitations, manner of sale restrictions and other provisions of Rule 144. The Individual Funds are permitted to distribute securities earlier, reflecting individual investors' greater willingness to assume the burden of compliance in exchange for liquidity of their investment. The terms of the Funds, twelve years in the case of the Institutional Fund and eight years in the case of the Individual Funds, also respond to the investment horizons of institutional as opposed to individual investors.

Due to the more active role the investors in the Individual Funds will play in consulting with the general partners of these Funds, and the passive role played by the investors in the Institutional Fund, the Funds will also differ in the manner in which gains and losses are allocated to their general and limited partners. As is typical in investment funds for institutional investors, the general partner of the Institutional Fund will receive a special allocation of 20% of the net capital gains attributable to securities sold or distributed over the life of the Fund. By contrast, the general partners of the Healthcare Fund and the Information Fund will be allocated gains and losses only in proportion to their respective capital contributions to these Funds. This feature strongly differentiates the Individual Funds from the Institutional Fund and most other venture capital funds, and reflects the contribution of knowledge and expertise that limited partners of the Individual Funds are expected to make in realizing the Institutional Fund's objectives. Institutional investors are generally unable or unwilling to make such a contribution.

9 The burden of compliance is also lighter when the number of shares involved is small. Even though distributee partners will have to aggregate with one another and the Fund for purposes of the Rule 144 volume limitation on resales, where an Individual Fund's holdings are less than 1% of the class there will be no practical need to monitor or coordinate resales.
Portfolio and Risk/Reward Characteristics

In addition to differences in the structure and operation of the Funds, the expected differences in portfolio composition and the potential risks and return on investment in the three Funds would also cause a reasonable investor to regard them as materially different investments.

The portfolio composition of the three Funds will vary significantly. Investments of the Healthcare Fund and the Information Fund will be highly concentrated in their respective core industries, and there is likely to be very little overlap in investments between the Healthcare Fund and the Information Fund.\(^\text{10}\) The performance of these two Funds will therefore depend largely on the growth and competitive factors in these industries, and can be expected to diverge over time depending on the pace of technological advance, changes in the regulatory environment and other factors. In contrast, the Institutional Fund will be less focused and more diversified, due to the much larger amount of capital it has to invest and the broader spectrum of potential investments it can make. Thus, although there will be substantial overlap between the investments of each of the Healthcare Fund and the Information Fund and the investments of the Institutional Fund, the portfolio compositions of each of the Funds taken as a whole will differ markedly, and these differences should be reflected in varying risks and returns on investment over the life of the three Funds.

The risks and rewards associated with investments in the Funds should also differ due to the riskier, more aggressive investment techniques to be employed for the Individual Funds. As noted above, the Individual Funds may employ leverage and use investment strategies involving options and short selling, while the Institutional Fund may not employ any of these techniques.

Perhaps the most significant difference affecting the risk and rewards to be expected by a reasonable investor is the 20% special allocation to the general partner of net capital gains, which is present in the Institutional Fund but not in the Individual Funds. This factor should make an investment in the Healthcare Fund or the Information Fund substantially more at-

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\(^{10}\) Overlap in the investments of the Healthcare Fund and the Information Fund will occur only if investments are made in companies that provide information services to the healthcare industry.
tractive than an investment of an equivalent amount of cash (if such were possible) in the Institutional Fund, and provides a substantial incentive for the investors in the Individual Funds to work with the general partner in maximizing the Funds' opportunities.

Conclusion

Given the material differences between the Institutional Fund, the Healthcare Fund and the Information Fund described above, it is highly unlikely that a prospective investor qualified to invest in any of the Funds would view an investment in any one Fund as the same as an investment in any other Fund. Indeed, the Staff has taken no-action positions with respect to funds in which the anticipated dissimilarities in targeted investors, investments and risk/reward characteristics were less significant than the differences that are expected to emerge among the Institutional Fund, the Healthcare Fund and the Information Fund. See Oppenheimer Arbitrage Partners, L.P. and Pasadena Investment Trust, supra.

Therefore, it is our opinion that the Funds should not be integrated for purposes of Section 3(c)(1) and that each of the Funds should be permitted to offer and sell limited partnership interests to not more than 100 persons in reliance upon Section 3(c)(1). We respectfully request that the Staff concur in this opinion and assure us that it will not recommend that the Commission take any action if the Funds are organized and operated in the manner described above. Should the Staff not concur with our opinion or be willing to take the no-action position requested, we respectfully ask that you contact the undersigned so that we may have the opportunity to discuss this matter further.

Should you have any questions regarding this request, please do not hesitate to contact the undersigned or Karen C. Wiedemann of this office at (212) 841-5700.

Very truly yours,

Mark J. Tannenbaum