



December 21, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Definition of Eligible Portfolio Company under the Investment Company Act of 1940; File Number S7-34-04

Dear Ms. Morris:

We are writing to commend the Commission for adopting a Final Rule that clarifies the definition of "eligible portfolio company" under the Investment Company Act of 1940 (the "1940 Act"), and to respond to the Commission's request for comment regarding an additional definition of eligible portfolio companies. As a business development company ("BDC") that provides long-term debt and equity capital to small and middle market companies, we appreciate the Commission's continued efforts to revise the definition of eligible portfolio company and encourage the Commission to adopt a final rule that provides an additional definition of eligible portfolio company that includes exchange-listed companies with market capitalizations of \$250 million or less.

In response to the Commission's request for comment regarding whether the final rule should utilize a public float or a market capitalization standard, it is our belief that a market capitalization standard represents the more workable approach. Market capitalization is generally considered to be a leading indicator of how a public company is perceived in the financial markets, as the size of a company's equity capital base tends to correlate to the number of research analysts following a company, which, in turn, reflects its ability to attract new capital for growth.¹ Information regarding a company's market capitalization is already available to the public. Data regarding market capitalization is relatively straightforward and provides a

¹ As we previously reported in our prior letter dated January 7, 2005, according to the Banc of America Securities LLC data, companies with a market capitalization below \$250 million had an average of one analyst covering their stock, an average trading volume of 129,500 shares, and an average of 16.4% institutional ownership. In addition, such companies raised an average of \$26.8 million from the sale of their common stock and an average of \$50 million from debt issuances in the aggregate from 1997 to 2003.¹ These statistics stand in stark contrast to companies with a market capitalization between \$500 million and \$700 million. Companies in that category had an average of five analysts covering their stock, an average trading volume of 279,900 shares, and an average of 63.6% institutional ownership. In addition, companies in this category raised an average of \$95.3 million from the sale of their common stock and an average of \$206.9 million from debt issuances in the aggregate from 1997 to 2003.

benchmark that is both easily understood and enforceable. These points stand in contrast to the proposed public float standard, the calculation of which can be more difficult, and the understanding of which is less intuitive.

In view of the foregoing, we recommend that the Commission adopt the \$250 million market capitalization standard set forth in "Alternative Two" of its reproposal. Public companies with a market capitalization of up to \$250 million, and in some cases even more, often have trouble accessing the traditional capital markets despite the fact that their shares are listed on an exchange. Plainly stated, these companies would not be seeking financing from BDCs if they could obtain financing from the traditional lower priced sources.

In response to the Commission's concern that a high size-based standard might lead BDCs to investment in companies Congress did not intend to help, we note that a \$250 market capitalization standard is consistent with Congressional intent provide small public companies with access to capital.² Although no uniform definition of small issuer exists, it seems that a \$250 million market capitalization standard would be acceptable by any definition. For example, the S&P SmallCap 600 Index, which measures a segment of the market "typically renowned for poor trading liquidity and financial instability," includes companies with a market capitalization in the range of \$300 million to \$1.5 billion.³ In addition, the Russell Microcap, which measures the microcap segment of the market, includes companies with market capitalizations in the range of \$20 million to \$1.5 billion.⁴

Perhaps the best example of the SEC's use of market capitalization as an indicator of how a public company is perceived in the financial markets is the final rule regarding securities offering reform (the "Securities Offering Reform Proposal"). In the proposing release of the Securities Offering Reform Proposal, the SEC provides a thoughtful analysis of how closely an issuer is followed by the market, identifying useful indicators such as trading volume, the level of analyst coverage and the amount of institutional ownership.⁵ Such information provides a framework by which one could determine whether an issuer is "well-followed" by the market. In the Securities Offering Reform Proposal, the SEC declared that issuers with market capitalization above \$700 million would be considered "well-followed." Based on the data set forth in the Proposal, one could conclude generally that companies with market capitalizations below \$700 million include those companies that do not have ready access to the capital markets and, therefore, should be eligible to receive financial assistance from BDCs.

Given that the SEC already utilizes a market capitalization standard with respect to eligibility determinations in other areas of the law specifically geared towards access to the market, it is our belief that the SEC should utilize the same market capitalization standard when

² The legislative history of the Small Business Investment Incentive Act of 1980, which amended the 1940 Act, indicates that it was the intent of Congress for a broad number of companies, both public and private, to be eligible for BDC investment.

³ See The S&P SmallCap 600 Index Fact Sheet, available at <http://www2.standardandpoors.com/spf/pdf/index/600factsheet.pdf>

⁴ See The Russell Microcap Index Fact Sheet, available at http://www.russell.com/Indexes/PDF/Fact_Sheet/microcap.pdf

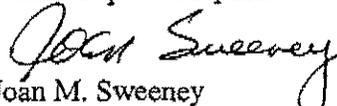
⁵ See SEC Release No. 34-50624 (November 3, 2004).

assessing the eligibility of portfolio companies for BDC investment in order to ensure a consistent analysis of companies and application of the federal securities laws. In addition, we believe that the use of a market capitalization standard in assessing the eligibility of BDC investments without reference to a third-party regulatory construct, such as the quantitative listing standards of the exchanges and NASDAQ, provides the SEC with the control over the definition of "eligible portfolio company" necessary to ensure that those small and developing companies in need of capital can obtain BDC financing.

We commend the Commission for its continued rulemaking to address the definition of eligible portfolio company under the 1940 Act and appreciate the opportunity to provide comments on the reproposal. We believe an additional definition of eligible portfolio company that includes any public companies with market capitalizations of \$250 million or less represents the right approach.

Respectfully submitted,

Allied Capital Corporation


Joan M. Sweeney
Chief Operating Officer