

PUBLIC

11 APR 1994

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 94-37-CC
Shoreline Fund, L.P.
File No. 132-3

By letter dated January 20, 1994, you request our assurance that we would not recommend any enforcement action to the Commission if neither Shoreline Fund, L.P. ("Shoreline") nor Condor Fund International, Inc. ("Condor") registers under the Investment Company Act of 1940 ("1940 Act") in reliance on Section 3(c)(1) of the 1940 Act.

Shoreline, a United States-based limited partnership that invests in securities, offers its shares exclusively to U.S. residents who are subject to federal income taxation ("taxable investors"). Shoreline has conducted and will continue to conduct its securities offering as a private placement in compliance with Rule 506 of Regulation D under the Securities Act of 1933 ("Securities Act"). Shoreline currently has 61 limited partners.

Condor is a Cayman Islands corporation that currently has no U.S. investors. Condor proposes to offer its common stock in the U.S. exclusively to institutions and retirement vehicles that typically are not subject to federal income taxation ("exempt investors"). Condor also will conduct its securities offering as a private placement in compliance with Rule 506 of Regulation D under the Securities Act.

Proceeds from sales of Condor's common stock are invested in Condor International Partnership, L.P. ("Condor L.P."). The same two individuals have primary responsibility for investment decisions made on behalf of Shoreline, Condor, and Condor L.P. The investment strategies and securities portfolios of Shoreline and Condor L.P. are substantially identical.

You ask whether Shoreline's and Condor's offerings should be integrated for the purpose of complying with the one hundred investor limitation set forth in Section 3(c)(1). ^{1/} The staff considers several factors in determining whether integration is appropriate, and generally will require integration if a

^{1/} Investors in Condor L.P. may invest either directly, by becoming limited partners of Condor L.P., or through the purchase of Condor's common shares. You state that no more than one hundred U.S. residents will be permitted to invest in Condor and Condor L.P., collectively. Similarly, no more than one hundred U.S. residents will be permitted to invest in Shoreline and Condor L.P., collectively. Accordingly, you raise no question as to whether the offerings of Condor and Condor L.P., or the offerings of Shoreline and Condor L.P., should be integrated.

reasonable purchaser would view an interest in one offering as not materially different from another. 2/ To assess whether the offerings are materially different, the staff has often focused on the distinguishing characteristics of the funds' investments and investment strategies. In addition to comparing the funds' portfolios, however, the staff also has considered whether two offerings are intended for two distinct groups of investors. 3/ In particular, 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 are similar. 4/

You state that Condor and Shoreline offer materially different investment opportunities because of the fundamental differences in the taxation of an investment in an offshore corporation such as Condor versus a domestic limited partnership such as Shoreline. Specifically, you state that U.S. tax law contains significant disincentives to investments by taxable

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- 2/ See, e.g., Pasadena Investment Trust (pub. avail. Jan. 22, 1993) ("Pasadena"); Equitable Capital Management Corp. (pub. avail. Jan. 6, 1992).
- 3/ See, e.g., Rogers, Casey & Associates, Inc. (pub. avail. June 16, 1989). The staff will not consider two offerings to be separate, however, where investor distinctions are artificial, arbitrary or immaterial. See PBT Covered Option Fund (pub. avail. Feb. 17, 1979) ("The legislative history of Section 3(c)(1) evidences a serious concern with technical avoidance of the 1940 Act's jurisdiction.") See also Section 48(a) of the 1940 Act (prohibiting a person from doing indirectly any activity that could not be done directly).
- 4/ See Pasadena (staff declined, for purposes of Section 7(d) of the 1940 Act, to require integration of the offerings of two funds with identical portfolios because differing tax laws created materially different investment opportunities for foreign and U.S. investors); Oppenheimer Arbitrage Partners, L.P. (pub. avail. Dec. 26, 1985) (staff found that two partnerships with the same general partner and investment objectives were designed for distinctly different groups of investors (taxable and tax-exempt) and therefore should not be integrated); see also L. Marvin Moorhead (pub. avail. Jul. 4, 1975) (staff permitted two similar funds, one designed for taxable investors, the other for tax-exempt investors, to rely on Section 3(c)(1) because the funds adopted somewhat different investment strategies to accommodate their needs).

investors in offshore corporations. For example, if certain elections are not made, a taxable investor that sells Condor's shares must pay federal income taxes based on the fund's realized and unrealized capital gains. 5/ These tax laws would not apply to an exempt investor that invests in an offshore corporation. Conversely, a U.S. exempt investor that invested in Shoreline would suffer significant tax consequences. The exempt investor would be required to recognize unrelated business taxable income ("UBTI") with respect to profits generated by Shoreline's margin trades. A taxable investor would not be subject to the UBTI rules. 6/

We are satisfied that the tax treatment of investments in offshore corporations as compared to domestic limited partnerships create materially different investments for taxable and exempt investors. Accordingly, based on the facts and representations in your letter, we would not recommend that the Commission take any enforcement action against Shoreline or Condor if they do not integrate their offerings for purposes of determining whether they may rely on Section 3(c)(1).

The staff, on a number of occasions, has expressed its views with respect to whether the offerings of two or more investment vehicles should be integrated for purposes of determining whether they are subject to registration and regulation under the 1940 Act. Having stated our views, we will no longer respond to letters in this area unless they present novel or unusual issues.



Jana M. Cayne
Attorney

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- 5/ Even if an appropriate election is made that would allow taxation based on only realized gains, a taxable investor may not use losses realized by the offshore fund to offset gains from other investments. This, too, creates a significant disincentive for a taxable investor to invest in Condor.
- 6/ Differences in tax treatment may also affect future portfolio investment decisions. For example, Shoreline may sell portfolio securities to realize gains or losses for tax purposes, while corresponding sales from Condor L.P.'s portfolio may not be considered necessary because tax gains and losses will not pass through to Condor's shareholders.

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January 20, 1994

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VIA FEDERAL EXPRESS

Office of the Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1004

Investment Company Act of
1940 -- Section 3(c)(1)
Section 3(c)(1)
Date 4-11-94

Attention: Thomas S. Harman, Esq.

Re: Shoreline Fund, L.P. and Condor Fund International, Inc.

Ladies and Gentlemen:

On behalf of Shoreline Fund, L.P., a California limited partnership ("Shoreline"), and Condor Fund International, Inc., a company incorporated under the laws of the Cayman Islands ("Condor"), we request confirmation that the staff of the Division of Investment Management (the "Staff") of the Securities and Exchange Commission (the "Commission") will not recommend enforcement action against Shoreline or Condor (collectively, the "Funds") if each Fund admits as investors no more one hundred (100) United States residents without registering under the Investment Company Act of 1940 (the "Act") in reliance on the exclusion from the definition of "investment company" in Section 3(c)(1) of the Act. Specifically, we seek confirmation that the Funds will not be integrated in determining the number of persons deemed to be investors in each Fund.

I. Background

Shoreline is a California limited partnership organized on April 1, 1992 for the purpose of maximizing investment returns by investing funds contributed by its partners. The general partners of Shoreline are David A. Davidson, Clark M. Lehman, SC Management, Inc., a California corporation controlled by Messrs. Davidson and Lehman, and Shoreline Capital Management, a California general partnership of which Mr. Davidson and Mr. Lehman are the general partners. The general partners of Shoreline have sole responsibility for management of Shoreline's investments.

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Shoreline invests in, holds, sells (both short and long), trades (on margin and otherwise) and otherwise deals in securities and other intangible investment instruments consisting principally, but not solely, of stocks, bonds, notes, options, warrants, rights and other securities and instruments that are actively traded in (or are investment vehicles that own securities that are actively traded in) public markets.

Shoreline's funds (other than those required for immediate operating expenses) may be invested fully in securities and other investment instruments, may be held fully in cash or cash equivalents, may be partially invested and partially held in cash, or may be fully or partly committed to short positions in securities and similar positions in other investment instruments, as its general partners believe the circumstances warrant.

The offering of Shoreline's limited partnership interests is being made as a private placement in compliance with Rule 506 of Regulation D under the Securities Act of 1933. Investment in Shoreline is limited to sophisticated persons and entities that qualify as "accredited investors" as defined in Regulation D. Investors must also have adequate means of providing for their needs and contingencies without relying on withdrawals from Shoreline, be financially able to maintain their investment and be able to afford a loss of a substantial part of their investment. As of the date of this letter, Shoreline had 61 limited partners, all of whom were residents of the United States.

Condor is a company incorporated under the laws of the Cayman Islands on July 30, 1993. Condor's principal and registered office is located at Cayside Galleries, Harbour Drive, George Town, Grand Cayman, British West Indies. Its investment manager is Condor Partners, a general partnership organized under the laws of the State of Georgia, of which J.O. PATTERSON & CO., Craig F. Magher and SC Management, Inc. are the general partners. Condor's administrator is MeesPierson (Cayman Limited). As of the date of this letter, Condor had three shareholders, none of whom were residents of the United States.

Proceeds from sales of common shares of Condor are invested in a limited partnership formed under the laws of the Cayman Islands, Condor International Partnership, L.P. ("Condor L.P."). Condor and Condor Partners serve as the general partners of Condor L.P. Messrs. Davidson and Clark, by virtue of the agreements establishing Condor Partners and Condor L.P., have primary responsibility for the investment decisions made on behalf of Condor L.P. The investment strategies of Shoreline and Condor L.P. are essentially identical. The securities portfolios and positions taken by Shoreline and Condor L.P. have also been substantially

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identical since the organization of Condor L.P. other than as regards their size.

Investors in Condor L.P. may invest either directly, by becoming limited partners of Condor L.P., or through the purchase of Condor's common shares. Condor's common shares and limited partnership interests in Condor L.P. are currently being offered only to experienced and sophisticated investors who are neither citizens nor residents of the United States nor members of the public in the Cayman Islands. As of the date of this letter, the only limited partner investors in Condor L.P. were seven affiliates of the general partners and members of their families who are citizens or residents of the United States. No additional United States residents will be permitted to become limited partners of Condor L.P.

Condor operates in a manner designed to ensure that it will not be considered a "controlled foreign corporation" under the Internal Revenue Code of 1986, as amended (the "IRC"), and to ensure that it will not be deemed to be engaged in a trade or business in the United States. Pursuant to well established precedent and IRC regulations, a fund will not be deemed to be engaged in a U.S. trade or business if all or substantially all of its corporate and financial affairs and dealings with its stockholders are carried on outside the United States. As a result, pursuant to IRC Regulations Section 1.864-2(c)(2)(iii), substantially all of the following activities of Condor will be and must be conducted outside of the United States:

1. Communicating with its shareholders (including the furnishing of financial reports);
2. Communicating with the general public;
3. Soliciting sales of its own stock;
4. Accepting subscriptions of new stockholders;
5. Maintaining its principal corporate records and books of accounts;
6. Auditing its books of accounts;
7. Disbursing payments of dividends, legal fees, accounting fees and officers' and directors' salaries;
8. Publishing or furnishing the offering and redemption price of the shares of stock issued by it;

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9. Conducting meetings of its shareholders and board of directors;
10. Making redemptions of its own stock.

Each of Shoreline and Condor is a separate legal entity and is administered separately. Each maintains its own books and records, and is separately audited. Creditors of one do not have a claim on the assets of the other, and no investor in Shoreline or Condor has a right to share in the profits or assets of the other.

II. Proposed Structure

The general partners of Shoreline propose to limit the offering of Shoreline's limited partnership interests exclusively to residents of the United States that are subject to federal income tax ("U.S. Taxable Investors") under the Code, and to prohibit investment in Shoreline by United States resident non-profit corporations, private foundations, pension and profit sharing plans and other charitable institutions and retirement vehicles that are not normally subject to federal income taxation under the Code ("U.S. Exempt Investors"). Condor proposes to offer its common shares in the United States exclusively to U.S. Exempt Investors that qualify as accredited investors. The offering would be conducted as a private placement complying with Rule 506 of Regulation D. No U.S. Taxable Investors would be permitted to purchase Condor common shares. The combined number of United States residents investing in Shoreline and Condor L.P. would be limited to 100 and the combined number of United States residents investing in Condor and Condor L.P. would be limited to 100.

The proposed structure is based on the fundamental differences in the taxation of an investment by a U.S. Taxable Investor or U.S. Exempt Investor in an offshore corporation such as Condor versus a domestic limited partnership such as Shoreline. A U.S. Exempt Investor who invested in Shoreline would be required to recognize "unrelated business taxable income" with respect to profits generated by Shoreline's margin trades. In contrast, a U.S. Exempt Investor who purchased common shares of Condor would not be required to recognize unrelated business taxable income with respect to margin trading conducted by Condor L.P. The amount of unrelated business taxable income that would be recognized by a U.S. Exempt Investor investing in Shoreline would vary depending on the gains realized by Shoreline during a particular period and the extent to which Shoreline's general partners have purchased securities on margin during that period. By way of illustration, Shoreline's accountants have calculated that 29.7% of Shoreline's realized capital gains during the first ten months of 1993 were attributable to margin positions and would be considered unrelated

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business taxable income, while approximately 17% of Shoreline's other income (relatively small amounts of interest and dividends) would be considered unrelated business taxable income.

United States tax law also contains significant disincentives to investment by U.S. Taxable Investors in offshore corporate funds such as Condor. If certain elections are not made, for example, a U.S. Taxable Investor who sells a foreign investment company's shares must pay federal income taxes plus interest charges based on their annualized proportionate share of a foreign investment company's realized and unrealized capital gains, even though the larger portion of gains are not likely to have been realized until later in the U.S. Taxable Investor's holding period. Even if an appropriate election can be made that allows current taxation only on realized gains, a U.S. Taxable Investor may not use losses realized by the offshore corporate fund to offset gains from other investments. Offshore corporate funds must also pay a 30% withholding tax on U.S. source dividends, with no corresponding credit for U.S. Taxable Investors in those funds. In contrast, a U.S. Taxable Investor would generally be required to pay federal income taxes on a current basis only with respect to realized gains generated by Shoreline and would also be permitted to use any Shoreline losses to offset other realized gains. Shoreline is also not subject to the 30% withholding tax on U.S. source dividends paid to it.

As a result of these differences in tax treatment, an investment in Shoreline versus Condor would result in significantly different tax consequences and after-tax investment returns for both U.S. Taxable and U.S. Exempt Investors, notwithstanding that Shoreline and Condor share the same investment objectives and substantially identical portfolios. Differences in tax treatment are also likely to affect future portfolio investment decisions. For instance, Shoreline's general partners may sell portfolio securities to realize gains or losses for tax purposes, while corresponding sales from Condor L.P.'s portfolio may not be considered necessary because tax gains and losses will not pass through to Condor shareholders or matter to many of Condor L.P.'s non-United States resident limited partners. As a result, we believe that any reasonable United States investor eligible to invest in both Funds would view the investments as materially different.

III. Discussion of 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

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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."

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 of 1933 will be deemed to meet the public offering test of Section 3(c)(1) of the Act. See, e.g., C&S Investment Funds (publicly available July 18, 1977). Since the offering of interests in Shoreline is presently being conducted, and the offering of the common shares of Condor would be conducted, in accordance with the requirements of Rule 506 or Section 4(2) of the Securities Act of 1933, we believe that the public offering test under Section 3(c)(1) of the Act will be met by each of Shoreline and Condor.

The issue of integration is raised, however, with respect to the beneficial ownership test. As recently stated by the Staff:

The staff considers several factors in determining whether integration is appropriate, and generally will require integration if a reasonable purchaser qualified to invest in both offerings would view an interest in one offering as not materially different from another. [Citing Equitable Capital Management Corp. (publicly available January 6, 1992); PBT Covered Option Fund (publicly available February 17, 1979) ("PBT").] In making this determination, the staff will consider whether the entities share the same investment objectives, investment portfolios, and portfolio risk/return characteristics. [Citing id.] The staff also may consider whether two funds are intended for two distinct groups of investors. [Citing Rogers, Casey & Associates, Inc. (publicly available June 16, 1989).]

Pasadena Investment Trust (publicly available January 22, 1993).

The Staff went on to note, however, that in examining whether funds are intended for two distinct groups of investors, "we will

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not consider two offerings to be separate where investor distinctions are artificial, arbitrary or immaterial." Id., citing PBT.

Applying these standards, 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. (publicly available 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 versus 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. (publicly available December 26, 1985), the Staff found that two partnerships that were designed for distinctly different groups of investors (taxable versus 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 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 Moorhead (publicly available 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 to accommodate their needs. Indeed, in at least one letter, the fact

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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 specifically distinguished the Oppenheimer letter in that regard. Frontier Capital Management Company, Inc. (publicly available 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 ("[I]ntegration should not apply if the interests in one section 3(c)(1) company are offered in the tax-qualified market and interest 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 (publicly available January 22, 1993), the Staff concluded that integration between a domestic fund and 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 a non-U.S. investors and the regulatory requirements of the foreign jurisdiction in which the feeder fund must be formed, reasonable investors would differentiate between them based upon 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 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. (publicly available July 12, 1990) and Rogers, Casey & Associates, Inc. (publicly available 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 class of

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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 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. The offering of shares in Condor, a Cayman Islands corporation, and of limited partnership interests in Shoreline, a California limited partnership, have similarly been crafted to accommodate fundamentally differing tax characteristics of two distinct groups of potential investors. As a result, the two offerings clearly do not involve the same class of securities and involve separate plans of financing.

IV. Conclusion and Request

Given the material differences between Shoreline and Condor, it is clear that a prospective investor qualified to invest in both Shoreline and Condor would view an investment in Shoreline to be materially different from an investment in Condor. Therefore, it is our opinion that Shoreline and Condor should not be integrated for purposes of Section 3(c)(1) and that each of Shoreline and Condor should be permitted to offer and sell its securities to not more than 100 United States residents as described above without registration as an investment company under the Act, all in reliance on 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 Shoreline and Condor operate in the manner described above. Should the Staff not concur with our opinion or be willing to take the 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 question regarding this request, please do not hesitate to contact the undersigned of this office at (404) 898-8197.

Sincerely,

BRANCH, PIKE & GANZ

By:

Gilbert H. Davis

Gilbert H. Davis