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1940 Act/3(c)(1)

June 11, 1996

ACT ICA-40
SECTION 2(a)(42)
RULE
PUBLIC AVAILABILITY 6/21/96

Jack W. Murphy, Esq.
Associate Director
Division of Investment Management
Securities and Exchange Commission
Stop 10-6
450 Fifth Street, N.W.
Washington, DC 20549

Dear Mr. Murphy:

We represent several clients who have asked for advice concerning the availability of the exception from the definition of an investment company provided by section 3(c)(1) of the Investment Company Act of 1940, as amended (the "1940 Act"), as it applies to private investment companies that invest in other private investment companies. Accordingly, we are writing to seek your concurrence with our views concerning section 3(c)(1) of the 1940 Act.

As you know, section 3(a) of the 1940 Act defines the term "investment company" to include any issuer engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(c)(1), in turn, excepts from this definition, "[a]ny issuer whose outstanding securities . . . 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." Subparagraph (A) of that section provides further as follows:

> Beneficial ownership by a company shall be deemed to be beneficial ownership by one person, except that, if the company owns 10 per centum or more of the outstanding voting securities of the issuer, the beneficial ownership shall be deemed to be that of the holders of such company's outstanding securities (other than short-term paper) unless, as of the date of the most recent acquisition by such company of securities of that issuer, the value of all securities owned by such company of all issuers which are or

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> would, but for the exception set forth in this subparagraph, be excluded from the definition of investment company solely by this paragraph, does not exceed 10 per centum of the value of the company's total assets. Such issuer nonetheless is deemed to be an investment company for purposes of section 12(d)(1).

Section 2(a)(42) of the 1940 Act defines "voting security" to mean any security presently entitling the owner thereof to vote for the election of directors of a company. The staff (the "Staff") of the Division of Investment Management has construed the right to vote for the election of directors broadly to include, with respect to companies organized as partnerships, the right to (i) remove or replace the general partner, (ii) vote on the election or removal of the general partner in the event of the general partner's death, insanity or retirement, (iii) terminate the partnership if one of the initial managing general partners ceases to serve in that role and (iv) take part in the conduct or control of the limited partnership's business. See SEC No-Action Letter, Standish Equity Investments, Inc. (December 15, 1993). The Staff has also stated that the definition of "voting security" includes not only the de jure right to vote for the election of directors but also the de facto power to determine the directors of the issuer. Id. The Staff also has stated that the statutory definition of "voting security" was not intended to be rigidly applied and that a limited partnership interest is a voting security if the limited partner has an economic interest that gives it the power to exercise a controlling influence over the partnership. Id.

The Staff has issued several no-action letters to the effect that the securities of a private investment company, if certain conditions are met, are not "voting securities" under section 3(c)(1). See Standish Equity Investments, Inc. (December 15, 1993); Robert N. Gordon and Thomas J. Herzfeld (November 30, 1987); Kohlberg, Kravis, Roberts & Co. (August 9, 1985); CIGNA & Co. (October 1, 1984) (the "CIGNA Letter"). It appears from these no-action letters, particularly the CIGNA Letter, that a necessary condition to the granting of the no-action position has been that no investors in the securities of the private investment company rely on section 3(c)(1) to except themselves from the definition of an investment company. This requirement may have been instituted in response to concerns that the exception provided by section 3(c)(1) might otherwise be manipulated to permit sham, multi-tiered transactions under which a new company seeking

to be excepted from the definition of an investment company by section 3(c)(1) would be formed to invest in a company that is also excepted from the definition of an investment company by section 3(c)(1), with a view to skirting the section's 100-investor limit.

Assuming that a collective entity is not structured or operated for the purpose of circumventing the 1940 Act, we believe the question whether an investor is relying on section 3(c)(1) should not affect the analysis of whether the securities issued by a private investment company should be regarded as "voting securities" under section 3(c)(1), and thus should not have any bearing on whether 1940 Act registration is required. The reference to "voting securities" in section 3(c)(1) presumably relates to rights that attach to the securities themselves, rather than to external considerations such as whether the securities have been purchased by an entity that is itself relying on section 3(c)(1). Obviously, the law must be interpreted and applied flexibly to prevent evasion, but to provide that securities will be deemed to be voting securities per se on the basis of the identity of their purchaser rather than on the basis of the purchaser's ability to exercise de jure or de facto voting rights would effectively read the word "voting" out of the statute.

We request that you concur in our view that a collective investment vehicle (a "Fund") that beneficially owns only non-voting securities of a company relying on section 3(c)(1) may be treated as one beneficial owner of the company's securities regardless of whether the Fund itself relies on section 3(c)(1).

If for any reason you do not concur in our conclusion, we respectfully request a conference with the Staff before any adverse written response to this letter. Should you or any member of the Staff have any questions concerning the foregoing or need additional information or clarification, please call either me at (212) 821-8206 or my partner, Jon S. Rand, at (212) 821-8256.

Very truly yours,

Roger D. Blanc

Roger D. Blanc

cc: Jon S. Rand, Esq.

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Wilkie Farr & Gallagher
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter of June 11, 1996 requests that the staff confirm that a collective investment vehicle ("Fund") that beneficially owns only non-voting securities of a company relying on Section 3(c)(1) of the Investment Company Act of 1940 (the "1940 Act") may be treated as a single beneficial owner of the company's securities regardless of whether the Fund itself relies on Section 3(c)(1).

The staff previously has issued a number of no-action letters with regard to whether securities issued by a private investment company were "voting securities"[1] for purposes of the attribution provisions of Section 3(c)(1)(A).[2] In some of these letters, either the requesting party represented, or relief was expressly conditioned upon the representation, that no Fund investing in the private investment company itself would rely on 3(c)(1).[3] You maintain that whether an investor in a private investment company relies on Section 3(c)(1) is not relevant to the determination of whether the private investment company issues voting securities. You suggest instead that the representation underscores the staff's concern that multi-tier structures may be shams or conduits formed or structured for the purpose of evading the 100-securityholder limit of Section 3(c)(1). You seek confirmation from the staff that the determination of whether a private investment company issues voting securities, and thus whether the attribution provisions of Section 3(c)(1)(A) apply, does not depend on whether any investor in the private investment company relies on Section 3(c)(1).

We confirm that whether an investor in a private investment company relies on Section 3(c)(1) is not a factor in determining

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1/ Section 2(a)(42) of the 1940 Act defines "voting security" as a security entitling the holder to vote for the election of the directors of a company.

2/ See, e.g., Standish Equity Investments, Inc. ("Standish Equity") (pub. avail. Dec. 15, 1993); Laifer, Inc. (pub. avail. Jan. 5, 1993); Weiss, Peck & Greer Venture Associates II (pub. avail. Apr. 10, 1990); Meuse, Rinker, Chapman, Endres & Brooks ("Meuse, Rinker") (pub. avail. May 1, 1989); Indiana Hospital Ass'n Investment Funds, L.P. (pub. avail. Oct. 15, 1985); Kohlberg Kravis Roberts & Co., Inc. (pub. avail. Sept. 9, 1985).

3/ See Rogers, Casey & Associates, Inc. (pub. avail. Jun. 16, 1989); Cigna Corporation (pub. avail. Oct. 1, 1984); see also Standish Equity, supra; Meuse, Rinker, supra; The MMC Fund, L.P. (pub. avail. Mar. 31, 1989); Robert N. Gordon and Thomas J. Herzfeld (pub. avail. Nov. 30, 1987); Kohlberg Kravis, supra.

whether the private investment company issues voting securities. Accordingly, if you conclude, based on the definition of voting security in Section 2(a)(42), as applied by the Commission and the staff in prior precedent,[4] that an entity issues non-voting securities, then each investor in that entity may be counted as a single securityholder. Such an entity may rely on Section 3(c)(1) if it meets the enumerated conditions of that section.[5]

Eileen M. Smiley
Senior Counsel

4/ For example, a holder of non-voting securities may be considered to hold the equivalent of a voting security if the holder possesses an economic interest in the issuer such that it, in effect, has the power to exercise control over how the issuer is managed. See Brief for the Securities and Exchange Commission amicus curiae at 18, 21, Clemente Global Growth Fund, Inc. v. T. Boone Pickens, III, et al., 705 F. Supp. 958 (S.D.N.Y. 1989), appeal docketed, No. 89-7117 (2d Cir. 1989), appeal withdrawn on consent (discussing circumstances under which limited partnership interests may be considered voting securities); see also Devonshire Capital Corp. (pub. avail. Feb. 15, 1976).

5/ As we have previously stated, however, Section 48(a) of the 1940 Act gives the Commission the authority to "look through" a transaction or a multi-tiered structure if, despite compliance with the express conditions of Section 3(c)(1), the structure is a sham or conduit formed or operated for no purpose other than circumventing the requirements of Section 3(c)(1) or any other provision of the 1940 Act. See Cornish & Carey Commercial, Inc. (pub. avail. June 21, 1996).