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1940 Act/3(c)(1)
1940 Act/12(d)(1)

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September 15, 1987

PUBLIC AVAILABILITY DATE: 11-30-87

ACT	SECTION	RULE
1940C	3(c)(1)	---
1940C	12(d)(1)	---

FEDERAL EXPRESS

Mary C. Podesta, Esq.
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
Stop 5-2
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Ms. Podesta:

On behalf of our clients, Messrs. Robert N. Gordon and Thomas J. Herzfeld, we respectfully request that the staff of the Commission concur with our interpretation of Section 3(c)(1)(A) of the Investment Company Act of 1940, as amended (the "1940 Act"), as it applies to our clients' proposed activities as described below.

Our clients propose to establish a limited partnership under the laws of the State of Delaware (the "Partnership") for the purpose of investing primarily in publicly traded closed-end investment companies that are registered under the 1940 Act and that are trading at a discount to net asset value. The Partnership's objective will be to achieve capital appreciation in its investment portfolio.

The Partnership expects to have fewer than fifteen security owners and will certainly have fewer than 100, and it does not propose to make a public offering of limited partnership interests or other securities issued by it. The limited partnership interests in the Partnership will be offered either in compliance with Rule 506 under the Securities Act of 1933, as amended (the "1933 Act"), or in such other manner as will not involve a "public offering" within the meaning of Section 3(c)(1) of the 1940 Act and Section 4(2) of the 1933 Act. The minimum investment required of limited partners is expected to be approximately $5,000,000. The Partnership's general partners will be corporations of which Messrs. Gordon and Herzfeld will be the only security owners, and an individual who is associated with Mr. Gordon.

The Partnership's limited partnership agreement will permit a limited partner to sell or otherwise dispose of its limited partnership interest under certain designated circumstances, but each limited partner will acknowledge in the limited partnership agreement that its limited partnership interest has not been registered under the 1933 Act and cannot be sold or otherwise disposed of unless it is registered thereunder or an exemption from registration is available, as evidenced by an opinion of counsel for the transferor. The general partners may, upon reasonable grounds, withhold their consent to any limited partner's sale or other disposition of its limited partnership interest. The general partners would withhold such consent unless satisfied that the transfer would comply with the 1933 Act and that admission of the transferee as a limited partner would not cause the Partnership to be treated as an investment company subject to registration and regulation under the 1940 Act.

Under the limited partnership agreement of the Partnership, the general partners will manage and control the Partnership and its business and will make all policy and investment decisions relating to the conduct of the Partnership's business. The limited partners will not participate in the conduct or control of the Partnership or its business and will not have any ability to remove or replace the general partners. Indeed, a dissatisfied limited partner's sole remedy under the limited partnership agreement would be to withdraw from the Partnership. A limited partner would be permitted to withdraw without restriction or penalty after the limited partner had remained in the Partnership for one year. Such withdrawal would then be permitted at the end of any calendar quarter; provided, however, that any such withdrawal could be delayed in circumstances where, in the general partners' judgment, it would require the sale of portfolio

securities at a time that would disadvantage the remaining limited partners.

Some prospective limited partners in the Partnership are individuals, but others are publicly held companies, or subsidiaries thereof (each a "Company Limited Partner"), and some of the Company Limited Partners have expressed a desire to purchase 10 percent or more of the limited partnership interests in the Partnership. Each Company Limited Partner has substantial business activities outside of its investment in the Partnership and none was formed for the purpose of investing in the Partnership. None of the Company Limited Partners is an investment company registered under the 1940 Act and none will rely on Section 3(c)(1) of the 1940 Act to except itself from the definition of the term "investment company".

We believe that each such Company Limited Partner, regardless of whether it purchases 10 percent or more of the Partnership's limited partnership interests, should be deemed to be a single person for purposes of Section 3(c)(1) of the 1940 Act and that, accordingly, the Partnership should not be deemed to be an "investment company" for purposes of the 1940 Act, including Section 12(d)(1) thereof. Section 3(c)(1) of the 1940 Act provides a statutory exception to the definition in Section 3(a)(1) of the term "investment company" and exempts from all provisions of the 1940 Act "[a]ny 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." For purposes of Section 3(c)(1), Section 3(c)(1)(A) 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 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).

Under Section 3(c)(1)(A), each of the Company Limited Partners would generally be treated as "one person" for purposes of their investment in the Partnership, but if any such Company Limited Partner owned 10 percent or more of the Partnership's limited partnership interests, that Company Limited Partner's beneficial ownership would be deemed to be that of its public shareholders, which total more than 100. As set forth above, however, Section 3(c)(1)(A) provides further that this attribution rule does not apply to a 10 percent holder "unless, as of the date of the most recent acquisition by such [Company Limited Partner] of securities of that issuer, the value of all securities owned by such [Company Limited Partner] of all issuers which are or 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 Limited Partner's] total assets."

No Company Limited Partner will have over 10 percent of its assets invested in issuers that are, or, but for Section 3(c)(1)(A) would be, exempt under Section 3(c)(1) from the definition of "investment company". If the Partnership needs to rely on this "exception to the exception" of Section 3(c)(1)(A), however, it will nevertheless be subject to Section 12(d)(1) of the 1940 Act since the immediately following sentence of Section 3(c)(1)(A) provides that "[s]uch issuer [that is, the Partnership, if it must rely on the 10 percent asset exclusion from the attribution rule] nonetheless is deemed to be an investment company for purposes of Section 12(d)(1)."

Section 12(d)(1) of the 1940 Act, and in particular subparagraph (A) thereof, would preclude the Partnership from acquiring more than three percent of the total outstanding voting stock of any other investment company; securities issued by another investment company "having an aggregate value in excess of 5 per centum of the value of the total assets" of the Partnership; or securities issued by investment companies "having an aggregate value in excess of 10 per centum of the value of the total assets" of the Partnership. Such limitations, if deemed applicable to the Partnership, would limit the Partnership's investment activities unduly and would not promote the public interest or the protection of investors.

Under the facts and circumstances presented here, that result is not required by the 1940 Act's purposes. Indeed, we also believe it would not be consistent with the 1940 Act's literal language. The 10 percent securities ownership test in Section 3(c)(1)(A) applies only to the ownership of "voting securities". Section 2(a)(42) of the 1940 Act defines the term "voting security" as "any security presently entitling the owner or holder thereof to vote for the election of directors of a

company." Section 2(a)(12), in turn, defines "director" as "any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated . . . ." The Partnership does not have directors and the only persons "performing similar functions" are the general partners. As noted above, the limited partners of the Partnership will not be permitted to elect or remove the general partners and a dissatisfied limited partner's sole remedy under the Partnership's limited partnership agreement would be to withdraw from the Partnership, which would generally be permitted without restriction or penalty at the end of any calendar quarter (after the limited partner had been in the Partnership for a year). Accordingly, the limited partnership interests should not be deemed to be "voting securities", and a Company Limited Partner holding 10 percent of the Partnership's limited partnership interests should not be deemed to have 10 percent of the "voting securities" of the Partnership, for purposes of Section 3(c)(1)(A). We believe this view is consistent with a number of recent staff interpretive positions see SEC No-Action Letters in Morgan Grenfell Investment Services International Trust (March 11, 1985); Sirach, Inc. (September 17, 1984); Global Investment Trust (June 14, 1984); Asset Allocation Incorporated (July 27, 1983); National Bank of North Carolina (July 20, 1983); Sarofim Trust Co. (September 27, 1982); Krehbiel & Hubbard, Inc. (October 19, 1981); Wall, Patterson, McGrew & Richards, Inc. (October 11, 1980); and YMCA of Metropolitan Chicago (September 15, 1979).

In Kohlberg Kravis Roberts & Co. (August 9, 1985), ['85-'86 Transfer Binder], SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 78,143 (the "KKR Letter"), the Division of Investment Management (the "Division") stated that it would not recommend enforcement action under Section 3(c)(1) in regard to institutional investors' purchases of limited partnership interests in partnerships formed by Kohlberg Kravis Roberts & Co. ("KKR") to participate in management buyouts of public and private companies (or subsidiaries or divisions thereof). Those partnerships participated in buyouts by contributing capital in exchange for the substantial majority of the voting common stock in corporations formed for purposes of acquiring the subject companies. According to the KKR Letter one or more institutional investors may each have owned 10 percent or more of any of the partnerships.

The Division's no-action position was expressed in reliance on KKR's representations, which included: that the limited partners would not take any part in the conduct or control of partnership business and could not remove or replace the general partner; that there would not be any public offering of limited partnership interests or interest in the omnibus

"fund" organized to establish and capitalize the limited partnerships; and that the total number of participants in any limited partnership and in the overall fund would be less than 100 persons. The Division also relied on KKR's representations that no limited partner would be formed for the purpose of investing in the omnibus fund or the partnerships and that no limited partner that owned 10 percent or more of any limited partnership or of the omnibus fund itself would rely upon Section 3(c)(1) of the 1940 Act to except itself from the definition of the term "investment company".

The policy underlying the 1940 Act does not command or suggest any different conclusion in our case. Implicit in Section 3(c)(1) is the congressional intent not to regulate as investment companies entities that have up to 100 security owners. 1 T. Frankel, The Regulation of Money Managers 403 (1978). Any entity formed with the purpose and objective of the Partnership with 100 individuals investing therein would be exempt from the 1940 Act pursuant to Section 3(c)(1), and would be permitted to engage in its purpose and pursue its objective free of the constraints of Section 12(d)(1). Under the facts presented here, it should make little difference from a policy point of view if some of the limited partners are Company Limited Partners and if some of the Company Limited Partners hold more than 10 percent of the limited partnership interests.

Of course, where companies are involved as investors, a concern could arise under the 1940 Act, as discussed in the KKR Letter, that "sham, multi-tiered transactions" could be perpetrated, wherein investors could create a series of companies outside the purported investment vehicle and then form the vehicle which would, inappropriately, take advantage of the Section 3(c)(1) exception. Indeed, as the Congress has noted, Sections 3(a)(1)(A) and 12(d)(1) of the 1940 Act are designed to prevent such pyramiding. H.R. Rep. No. 1341, 96th Cong., 2d Sess. 35 (1980). See also Cigna Corporation, SEC No-Action Letter (October 1, 1984).

Such a concern should not arise in this case, however. As discussed above, the Partnership will have fewer than 100 security owners, there will not be any public offering of limited partnership interests or other Partnership securities, and the limited partners will not take any part in the conduct or control of the Partnership and will not have any ability to remove or replace the general partners. In addition, no Company Limited Partner will be formed for the purpose of investing in the Partnership and each will have substantial business activities outside of its investment in the Partnership. None of the Company Limited Partners is an investment company

registered under the 1940 Act and none will rely on Section 3(c)(1) to except itself from the definition of the term "investment company".

* * *

In view of the foregoing, we respectfully request that the staff concur with our interpretation that each Company Limited Partner, regardless of whether it purchases 10 percent or more of the Partnership's limited partnership interests, should be deemed to be a single person for purposes of Section 3(c)(1) of the 1940 Act and that the Partnership, accordingly, should not be deemed to be an "investment company" for purposes of the 1940 Act, including Section 12(d)(1) thereof.

In compliance with the procedures set forth in Securities Act Release Nos. 6269 (December 5, 1980) and 5127 (January 25, 1971), seven copies of this letter are submitted herewith, and the specific subsection of the particular statute to which this letter pertains is indicated in the upper right hand corner of the first page of this letter and each copy. If for any reason you do not concur with our conclusions, we respectfully request a conference with the staff before any adverse written response to this letter. Should you or any member of your staff have any questions concerning the foregoing or need additional information or clarification, please call either me or Mark J. Ghouralal of this office at (212) 935-8000.

Very truly yours,

Roger D. Blanc

Roger D. Blanc

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OCT 30 1987

Our Ref. No. 87-525-CC
Robert N. Gordon
Thomas J. Herzfeld
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

In your letter of September 15, 1987, you state that your clients, Robert N. Gordon and Thomas J. Herzfeld, propose to establish a limited partnership under the laws of Delaware ("Partnership") for the purpose of investing in publicly traded closed-end investment companies that are registered under the Investment Company Act of 1940 ("1940 Act") and that are trading at a discount to net asset value. You further state that some limited partners will be individuals, but others will be publicly-held companies, or their subsidiaries (each a "Company Limited Partner"), that are neither registered investment companies nor companies relying on Section 3(c)(1) of the 1940 Act. Finally, you state that some of the Company Limited Partners have expressed a desire to purchase 10 percent or more of the limited partnership interests in the Partnership.

You request our assurance that (1) for purposes of determining whether the Partnership may rely on the exception from the definition of an investment company provided by Section 3(c)(1) of the 1940 Act, each Company Limited Partner will be counted as one person, and (2) the Partnership will not be deemed an investment company for purposes of Section 12(d)(1) of the 1940 Act.

For purposes of Section 3(c)(1), we would count each Company Limited Partner as one beneficial owner and would not count the shareholders of each Company Limited Partner as separate beneficial owners of the Partnership, if the Partnership proceeds as described in your letter. Since a Section 3(c)(1) issuer would be subject to Section 12(d)(1) only if it relies on the exception to the 10% voting securities ownership test set forth in Section 3(c)(1)(A), */ and since the Company Limited Partners would not be acquiring any "voting

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*/ Congress, in the Small Business Investment Incentive Act of 1980, amended Section 3(c)(1) to provide all private investment companies (not just business development companies) with relief from that section's attribution of ownership rule. P.L. 96-477, Sec. 102, 94 Stat. 2276 (1980). Subparagraph (A) of Section 3(c)(1), added to the 1940 Act as part of this legislation, provides that an entity may own more than ten percent of the voting securities of an issuer relying on the 3(c)(1) exception without having its own shareholders or partners treated as owners of the issuer's securities, so long as the entity does not devote more than ten percent of its assets to investment in issuers that are, or, but for Section 3(c)(1)(A) would be, exempt under Section 3(c)(1). The legislative history of subparagraph (A) shows that Congress liberalized the beneficial ownership test in Section 3(c)(1) to eliminate a problem some privately-held investment companies were having attracting substantial amounts of capital from, for example,

(Footnote Continued)

securities" of the Partnership, we would not deem the Partnership to be an investment company for purposes of Section 12(d)(1). See Kohlberg Kravis-Roberts & Co. (pub. avail. Sept. 9, 1985) and Cigna Corporation (pub. avail. Oct. 1, 1984), where the staff granted no-action relief to a limited partnership relying on Section 3(c)(1) under similar circumstances. Our position here is is based on the facts and representations in your letter, especially the representations that no Company Limited Partner will (1) have over ten percent of its assets invested in issuers that are, or, but for Section 3(c)(1)(A) would be, exempt under Section 3(c)(1) from the definition of "investment company," (2) be formed for the purpose of making investments in the Partnership, (3) have any ability to elect, remove or replace the general partners of the Partnership, and (4) participate in the conduct or control of the Partnership or its business.

Joseph R. Fleming

Joseph R. Fleming
Attorney

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*/ (Continued Footnote)

institutional investors without exceeding the 100-investor ceiling. In doing so, however, Congress imposed the Section 12(d)(1) constraints on any issuer relying on the exception to the 10% voting securities ownership test in subparagraph (A) of Section 3(c)(1). See H.R. Rep. No. 96-1341, 96th Cong., 2d Sess. 26-27, 34-36 (1980); Investment Company Act Release No. 11818 (June 17, 1981), withdrawing proposed amendments to Rule 3c-2 which would have provided an exception to the attribution provision in Section 3(c)(1), as constituted prior to the 1980 amendments.