BURR, EGAN, DELEAGE & CO., INC.

Investment Advisers Act of 1940 -- Section 203(b)(3) -- Rule 203(b)(3)-1

Apr 27, 1987

Burr, Egan, Deleage & Co., Inc.

TOTAL NUMBER OF LETTERS: 2
SEC-REPLY-1:
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
MAR 26 1987

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT
Our Ref. No. 87-60-CC
Burr, Egan, Deleage & Co.
File No. 13203

Your letter of February 6, 1987, requests our assurance that we would not recommend any enforcement action to the Commission under Section 203(b)(3) of, or Rule 203(b)(3)-1 under, the Investment Advisers Act of 1940 ("1940 Act") if Burr, Egan, Deleage & Co. Partners, Burr, Egan, Deleage & Co., Inc., or their respective partners or stockholders (collectively referred to as "Bedco") proceed as outlined in your letter. For the reasons discussed below, we cannot assure you that the limited partnership arrangement proposed by Bedco falls within the safe harbor of Rule 203(b)(3)-1.

Rule 203(b)(3)-1 provides, in part, that a limited partnership, rather than each limited partner, shall be counted as one client if (1) the limited partnership interests are securities and (2) the general partner or other person provides investment advice to the partnership based on the investment objectives of the partnership. n1 As more fully discussed in Release 956, paragraph (b)(2)(ii) limits the availability of the rule to a situation where the general partner advises the partnership based on the investment objectives of the limited partners as a group, rather than one that is merely a device for providing individualized investment advice to the limited partners. In addition, paragraph (b)(3) of the rule provides, in part, that any limited partner who is, separate and apart from its status as a limited partner, an investment advisory client of a general partner or other person acting as an investment adviser to the limited partnership must be counted as a separate client for purposes of Section 203(b)(3). n2 However, the fact that the safe harbor is not available with respect to a particular limited partner shall not affect its availability with respect to any other limited partner complying with paragraph (b)(2) of the rule.

You represent that Bedco currently is acting as an investment adviser for a number of venture capital limited partnerships ("Investing Partnerships"), and is relying on Rule 203(b)(3)-1 as the basis for not registering as an investment adviser. For tax reasons, you state that some of the limited partners would prefer that the underlying investments of the Investing Partnerships in which they have limited partnership interests be primarily in the form of corporate stock rather than limited partnership interests. To accommodate the limited partners, Bedco proposes to restructure each Investing Partnership to create two separate pools of assets within a partnership, one primarily holding investments in the form of corporate stock and the other holding limited partnership interests. You argue in effect that this arrangement is ancillary to Bedco's primary obligation of making common investment decisions for the Investing Partnerships. Finally, because you view this arrangement as merely incidental to the Investing Partnerships' investment objectives, you assert the continued availability of the rule's safe harbor.

We question whether Bedco's proposed restructuring of the Investing Partnerships would continue to fall within the safe harbor of rule 203(b)(3)-1. It appears to us that by restructuring the Investing Partnerships to accommodate the individual tax situations of the limited partners, Bedco would not meet the requirements contained in paragraph (b)(2)(ii) of the rule because Bedco may not be providing

investment advice that is solely incidental to the stated investment objectives of the Investing Partnerships. In addition, it appears that Bedco would be providing investment advisory services, as that term is defined in paragraph (a)(2)(i) of the rule, to the limited partners that may not be solely incidental to the stated investment objectives of the Investing Partnerships. Whether investment advice or investment advisory services are solely incidental to the stated investment objectives of the limited partnership depends on whether the services are reasonably related to those objectives, i.e., services that are not tailored to meet the individual investment objectives of a limited partner. We do not believe that Bedco can claim that the services it would provide to the limited partners in connection with the proposed restructuring are reasonably related to the stated investment objectives of the Investing Partnerships. While we recognize that there may be situations where the investment objectives of a limited partnership could be altered subsequent to its formation that would not affect the availability of the safe harbor, we believe those situations are limited to changes that would continue to reflect the collective investment objectives of the limited partners rather than their individual investment objectives.

We also believe that the limited partners of the Investing Partnerships could be deemed to be investment advisory clients of Bedco, as that term is defined in paragraph (a)(2)(ii) of the rule, due to the creation of two separate pools and the transfer of the limited partners' assets from an existing Investing Partnership into one of those pools. n3 It appears that Bedco would be providing investment advisory services under paragraph (a)(2)(ii) because the substance of Bedco's proposal is to provide a means by which the limited partners can switch from one limited partnership arrangement to another thereby accommodating the individual investment objectives of the limited partners.

Accordingly, we cannot assure you that we would not recommend any enforcement action to the Commission under Section 203(b)(3) or Rule 203(b)(3)-1 if Bedco proceeds as set forth in your letter. Although the arrangement proposed by Bedco does not appear, in our view, to satisfy the requirements of the safe harbor, the rule is not intended to specify the exclusive method for a limited partnership, rather than each limited partner, to be counted as a client for purposes of Section 203(b)(3). However, the staff, as a matter of policy, does not express any opinion on the status under Section 203(b)(3) of limited partnership arrangements that fall outside the safe harbor.

Thomas Smith III
Attorney

Footnotes

n1 The phrase "investment objectives of the limited partnership" as it currently exists in paragraph (b)(2)(ii) of Rule 203(b)(3)-1 was originally proposed, in Investment Advisers Act Rel. No. 956 (Feb. 22, 1986) ("Release 956"), to read "investment objectives of the limited partners as a group." This change, as stated in the adopting release, Investment Advisers Act Rel. No. 983 (July 12, 1985) ("Release 983"), produces the same intended result and, therefore, constitutes a change of form rather than substance.

n2 Paragraph (a)(2) of the rule provides, in part, that a limited partner is an investment advisory client of a general partner or other person if the limited partner receives from any such person (1) investment advisory services of a nature that the person provides the services would be an investment adviser or (2) investment advice to transfer its assets from one limited partnership to another one.

n3 This condition, as discussed more fully in Release 983, was intended to prevent a general partner, in reliance of this safe harbor, to be able to establish a series of limited partnerships and switch limited partners from one partnership to another to meet their individual investment objectives, thereby, in effect, providing the limited partners with individualized investment advice.

INQUIRY-1:
CHOATE, HALL & STEWART
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TELEPHONE (617) 227-5020
February 6, 1987

Securities & Exchange Commission
500 North Capital Street, NW
Washington, DC 20549

ATTENTION: Linda A. Schneider
Office of Chief Counsel
Division of Investment Management

Gentlemen:

This is to request your confirmation that the staff of the Securities and Exchange Commission (the "commission") will not recommend enforcement action against Burr, Egan, Deleage & Co. Partners, Burr, Egan, Deleage & Co., Inc., or their respective partners or stockholders (together "Bedco"), if Bedco does not register under Section 203(c) of the Investment Advisor Act of 1940, as amended (the "Act"), even though Bedco renders investment advice and acts as a venture capital investment advisor under the following circumstances. Bedco is presently not required to register as an investment advisor by virtue of Section 203(b)(3) of the Act.

FACTS

Bedco acts as an investment advisor to several venture capital limited partnerships (the "Funds"). As a consequence of the Internal Revenue Code of 1986, the limited partners of several of the Funds are in different situations with respect to taxes such that some would be better served if the investments of such Funds were in partnership interests, while others would find investments in corporate stock to be acceptable. Accordingly, it is proposed to divide the investments of these Funds into two pools, one including partnership interests and the other consisting principally of shares of stock, with the gains and losses of the two pools to be allocated specially to the separate groups of limited partners. The amount of the existing capital of these Funds to be allocated to each pool would be fixed at the outset and thereafter each investment would be divided between the two pools in the ratio of the respective fund capital allocated to each. Neither Bedco nor any partner of these Funds would have any discretion with respect to such division after the initial size of each pool has been determined.

It is anticipated that the mechanics of the foregoing process would be effected by causing each portfolio company to be organized in partnership form, with one pool of such Funds holding stock of an intermediary corporation which would in turn hold partnership interests in the portfolio companies. It should be noted that not all portfolio companies will be appropriate candidates for partnership form; in those instances where partnership form is not appropriate, both pools will own shares of stock of the portfolio company in proportion to the capital allocated to each pool.

The question presented by the foregoing proposal is whether, by virtue of the allocation of the capital of such Funds into two pools as described above, each such Fund remains a single client of Bedco for the purposes of Section 203(b)(3) of the Act or must be counted as two separate clients. We submit that, because the decision to make each investment in a portfolio company of each Fund remains a single decision despite the (non-discretionary) allocation of the investment between the two pools, each Fund should continue to be construed as a single client.

DISCUSSION

Rule 203(b)(3)-1 under the Act was adopted in Release No. 1A-983 (the "Adopting Release") and specifies certain circumstances in which a general partner or other person acting as investment advisor to a limited partnership (a "general partner") may count the partnership, rather than each of the individual limited partners, as a "client" for purposes of the Act's registration exemption for any advisor with fewer than 15 clients who does not hold himself out to the public as an investment advisor (the "private advisor exemption"). The rule is available to any general partner, subject to two conditions. First, the limited partnership interests must be securities. (This is not an issue here.) Second, the general partner must provide investment advice to the partnership based on the investment objectives of the limited partnershiop. The Rule also defines certain situations under which the safe harbor is unavailable with respect to certain limited partners.

The Adopting Release states that the purpose of Rule 203(b)(3)-1 was to provide limited partnerships the same treatment accorded passive investment vehicles organized as corporations. Release No. IA-956 (the "Proposed Release"), states that the availability of the Rule is limited to situations where the general partner acts as an investment advisor to a limited partnership that, in fact, is a collective investment vehicle, rather than one which is merely a device for providing individualized investment advice. Advice must be provided to the partnership as a common investment vehicle. This ensures that, like the investment company organized as a corporation, the limited partnership is in reality the client. In the instant case, the present practice of making one business decision on behalf of all of the limited partners of ALTA III will continue. Although the allocation of partnership and corporate interests will have the effect of minimizing the tax consequences of investments to individual limited partners, this effect is a mere passive result, subordinate to the larger purpose of achieving the investment objectives of the entire partnership. Once established, there will be no discretion to change the allocation.

We believe that the purposes underlying the Act, and Section 203(b)(3) thereof, will best be served by construing ALTA III to be a single "client" of Bedco despite the existence of two separate pools.

We respectfully request that the Division of Investment Management concur in our view that each Fund is one "client" of Bedco for purposes of Section 203 (b)(3) of the Act, irrespective of the structure of the investments where the investment decision retains a unitary character based on the overall investment objectives of the Fund.

If you have any questions or need further information in connection with our request please call Andrew L. Nichols or Reginald J. Ghiden.

Very truly yours,

CHOATE, HALL & STEWART