J.Y. BARRY ARBITRAGE MANAGEMENT INCORPORATED

SEC LETTER

Advisers Act Sec. 202(a)(11)(E)

October 18, 1989

John Y. Barry
J.Y. Barry Arbitrage Management, Inc.
1005-2 Hughes Drive
Hamilton Square, NJ 08690

Dear Mr. Barry:

In your most recent correspondence with this Office, you have asked us to determine whether your letter of August 11, 1989, is "satisfactory." We assume that you request our advice on whether the facts contained in your letter would comply with the Investment Company Act of 1940 ("1940 Act") and the Investment Advisers Act of 1940 ("Advisers Act"). While we can give you guidance on some of the issues you present, we are unable to state anything definitive because you have not provided us with enough information. On the basis of the facts in your letter of August 11, 1989, and the information provided in your letter of August 7, 1989, it appears that you propose to offer securities in reliance upon Rule 506 under the Securities Act of 1933, to not more than one hundred investors.

We assume from these facts that you propose to rely on Section 3(c)(1) of the 1940 Act which excepts from the definition of investment company any issuer all of whose outstanding securities are beneficially owned by not more than one hundred persons and that is not making and does not presently propose to make a public offering of its securities. You may want to note that while offerings made in conformity with Rule 506 of Regulation D are deemed not to involve a public offering within the meaning of Section 3(c)(1), offerings made in compliance with, for example, Rule 505 are not necessarily non-public within the meaning of the 1940 Act. See San Jose Capital Corp. (pub. avail. Feb. 14, 1983).

Your letters also state that you believe you are not required to register as an investment adviser because (1) you intend only to provide advice regarding U.S. government securities and/or (2) you will only have one client. We assume from these facts that you believe you may rely on either Section 202(a)(11)(E) or Section 203(b)(3) of the Advisers Act.

Section 202(a)(11)(E) of the Advisers Act excepts from the definition of investment adviser

> any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 3(a)(12) of the Securities Exchange Act of 1934, as exempted securities for the purposes of that Act.

A person who falls within Section 202(a)(11)(E) is excepted from all provisions of the Advisers Act. Your letter of August 11, 1989, states that you will provide advice only on "treasury issues," but parenthetically states that "[a]lthough repos and reverse repos are used to establish the position, we do not advise on them as investments; they are tools." You should note that if you provide advice as to any security other than a government security as provided in Section 202(a)(11)(E), you may not rely on this exception. In this regard, a reverse repurchase agreement may be a security.1

Section 203(b)(3) exempts from registration any adviser who, during the previous twelve months, has had fewer than fifteen clients and who does not hold itself out generally to the public as an investment adviser. An adviser exempt from registration under this provision is, nonetheless, subject to Section 206 of the Advisers Act, that Act's antifraud provision, and the Rules thereunder. Section 206 makes it unlawful for an adviser to use interstate commerce to defraud, deceive, or manipulate any client or

prospective client. Pursuant to statutory authority in Section 206(4) the Commission has adopted several rules, including Rule 206(4)-1, that deals with advertising by investment advisers.

Rule 206(4)-1 provides, in relevant part, that

> [i]t shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act, for any investment adviser, directly, or indirectly, to publish, circulate or distribute any advertisement: [w]hich refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser.

Rule 206(4)-1(a)(1) therefore prohibits the use of a testimonial, i.e., a statement of a customer's experience or endorsement, in an advertisement by an investment adviser, because the testimonial will likely give rise to a fraudulent or deceptive implication or mistaken inference that the experience of the person giving the testimonial is typical of the experience of the adviser's clients.

As indicated in the first paragraph of this letter, the issues discussed above are by no means an exhaustive list of issues that your proposal may raise. If you have further questions, please contact this Office in writing.

Sincerely,
Carol A. Peebles
Attorney
Office of Chief Counsel

Footnote

1 For purposes of Section 18 of the 1940 Act the Commission has stated in Investment Company Act Rel. No. 10666 (April 18, 1979) that a reverse repurchase agreement itself falls within the functional meaning of the term “evidence of indebtedness.” The term “evidence of indebtedness” is included within the definition of security contained in Section 2(a)(36) of the 1940 Act and Section 202(a)(18) of the Advisers Act. You should also be aware that the staff views repurchase agreements as loans rather than the purchase and sale of the underlying government securities. See Rel. No. 10666 cited above, and Investment Company Act Rel. No. 13005 (Feb. 2, 1983). See also The Prospect Group (pub. avail. Nov. 29, 1988).

INCOMING LETTER

August 11, 1989

Carol Peebles, Esq.
Securities and Exchange Commission
Washington, DC 20549

Dear Ms. Peebles:

I hear indirectly from John Kettelle that you had some comments on either my letter to Mr. Kettelle of August 7 or of August 11 which you gave to Keith Vanderwort of Dechert, Price & Rhodes. Perhaps it is the objections to the letter of August 7 which were corrected in the letter of August 11. In any case, since we are not now represented by Dechert, Price & Rhodes, I should appreciate your directing your comments to me. If the letter of August 11 is not satisfactory to you, please tell me. I enclose copies of both letters for your convenience.

Sincerely yours,
John Y. Barry
ENCLOSURE

John D. Kettelle, Chairman
Ketron, Inc.
1700 N. Moore Street
Rosslyn, Va. 22209

Dear John:

I have had discussions with the SEC that lead me believe that:

1) We can use testimonials in any sales document (prospectus).

2) We can use both the “two pager” and the amplifying brochure so long as:

a) We deal only with accredited investors.

b) Make absolutely clear in the two pager that amplifying information is available.

c) The two pager and the amplifying brochure are the same for all prospects.

d) We accept no money until a full blown prospectus is provided to prospective investors.

Yesterday I called the SEC in New York and was referred to Mr. Robert Anthony. I asked him about testimonials and described the Eddie Fecht letter. He referred me to the SEC in Washington. I called them, left my phone number and Ms. Carol Peebles called me back. I described the situation to her. I explained that we were probably not investment advisers because we offered advice only on treasury issues. (Although repos and reverse repos are used to establish the position, we do not advise on them as investments; they are tools.) In any case since we would have a single client, we would not be required to register as investment advisers. Since we would limit the number of investors to less than 100, we would not be an investment company. She said that stipulating these facts, we were not bound by the restrictions on testimonials applying to investment advisers and investment companies.

Today I called Mr. Anthony again to ask about the two pager and the longer, amplifying, sales brochure. I thanked him for his help yesterday and went on to explain that we planed a Regulation D 506 offering to accredited investors, such as banks. He said that so long as we dealt with accredited investors no specific information was required. I explained that the sales approach we should like to use is:

1) Send the two pager to accredited investor prospects.

2) If the express interest arrange a briefing and leave the brochure for the to read.

3) If we can't arrange a briefing and they are interested send the brochure anyway.

4) When we have investors ready to put money in the arbitrage operation, provide them a full blown prospectus incorporating their wishes on organization, custody, etc.

Mr. Anthony said that so long as we dealt with accredited investors under section 506, that our sales plan sounded like, “full and fair disclosure” to him. He went on to say we did not have to provide the brochure or prospectus to everyone who received the two pager but they must be made aware that the amplifying documents are available upon request.

Sincerely,

John Y. Barry

ENCLOSURE

August 11, 1989

John D. Kettelle, Chairman
Ketron, Inc.
1700 N. Moore Street
Rosslyn, Va. 22209

Dear John:

You will recall from my letter of August 7 that I spoke with Ms. Carol Peebles at the SEC about using the Eddie Fecht letter. I had explained that we were probably not investment advisers because we offered advice only on treasury issues. (Although repos and reverse repos are used to establish the position, we do not advise on them as investments; they are tools.) I had thought that in any case since we would have a single client, we would not be required to register as investment advisers. I thought she had said that stipulating these facts, we were not bound by the restrictions on testimonials applying to investment advisers.

She called me to say that if we were investment advisers as defined in the Investment Advisers Act Of 1940 (1940 Act), even if not required to register, we were bound by the restriction on testimonials (17 CFR Ch. II pp. 639-640). I discussed this issue with her and explained that acting as investment adviser J.Y. Barry Arbitrage Management (JYBAM) would give advice solely on Treasury issues. The implementation of the advice would use whatever means of financing were available. It is rather like recommending a stock for purchase. If I do so the client can use cash or margin. The important point is that relative desirability of one arbitrage over another does not depend materially upon the means of financing.

The definition of an investment adviser in Sec. 202(a)11(E) of the 1940 Act says that so long as our advice relates, "... to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States ..." we are not investment advisers.

Ms. Peebles and I agreed that although JYBAM was treading a fine line it looked as though we could use Eddie Fecht's testimonial, providing, of course, that it was in itself true, not misleading, etc.

Sincerely,

John Y. Barry