

**PUBLIC**

28 DEC 1994

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 94-743-CC  
Latham & Watkins  
File No. 132-3

Your letters of November 10, 1994 and December 13, 1994 request that, notwithstanding the position taken by the Division in PanAgora Group Trust (pub. avail. Apr. 29, 1994), a private investment company be permitted to treat as one beneficial owner, for purposes of section 3(c)(1) of the Investment Company Act of 1940 ("1940 Act"), each participant-directed defined contribution plan that has made a capital commitment to the company prior to April 29, 1994.

Section 3(c)(1) of the 1940 Act excepts from the definition of investment company any issuer that is not making and does not propose to make a public offering and whose outstanding voting securities are beneficially owned by not more than 100 persons (a "3(c)(1) entity"). In PanAgora, the staff concluded that, for purposes of determining compliance with the 100-person limit of section 3(c)(1), each participant in a participant-directed defined contribution plan who allocates a portion of his or her account balance to a 3(c)(1) entity must be counted as an individual beneficial owner of that entity. In a letter to Edward H. Fleischman (pub. avail. June 30, 1994), the staff announced that the effective date of the PanAgora letter would be delayed until January 1, 1995.

You state that participant-directed defined contribution plans and other investors may enter into binding contractual obligations to commit capital over an extended period of time to 3(c)(1) entities such as leveraged buyout and venture capital funds. Calls for additional capital can be made several years after the investor's initial subscription. You assert that application of the PanAgora position to these arrangements would cause considerable hardship: to the investing plans, which would have to withdraw their assets from 3(c)(1) entities; to the sponsors of 3(c)(1) entities, which would have to find new investors willing to assume the capital commitments made by the withdrawing plans; and to the entities' other investors, who may have to invest additional monies to compensate for the monies withdrawn by the plans.

The Division believes that the position taken in PanAgora should apply regardless of whether a participant-directed defined contribution plan has made a capital commitment to a 3(c)(1) entity or has invested in a 3(c)(1) entity in any other manner. The PanAgora position is consistent with prior no-action letters stating that if a "company" (which would include an employee benefit plan) that invests in a 3(c)(1) entity facilitates individual investment decisions, then the company's securityholders should be deemed the beneficial owners of the

3(c)(1) entity's securities.<sup>1</sup> Thus, we believe that 3(c)(1) entities (including those that require capital commitments), and the sponsors of participant-directed defined contribution plans that invest in those entities, should have been aware prior to the staff's issuance of PanAgora that plan beneficiaries might have to be counted individually as beneficial owners of the 3(c)(1) entities' securities.<sup>2</sup>

Nevertheless, the Division recognizes that, prior to the PanAgora letter, many 3(c)(1) entities may have believed in good faith, based on the language of section 3(c)(1) and on general language in Intel Corporation (pub. avail. Nov. 18, 1992), that each qualified plan holding less than 10% of the entity's outstanding voting securities should be counted as a single beneficial owner. We therefore believe it is appropriate to allow 3(c)(1) entities additional time -- until December 31, 1995 -- to comply with PanAgora. This will provide 3(c)(1) entities with an opportunity to liquidate, in an orderly manner, investments by participant-directed defined contribution plans that may cause them to exceed the 100-person limit of section 3(c)(1).

Accordingly, until December 31, 1995, a 3(c)(1) entity may count as a single beneficial owner those participant-directed

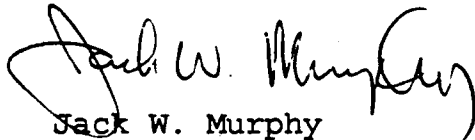
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<sup>1</sup> See, e.g., WR Investment Partners (pub. avail. Apr. 15, 1992) (the limited partners of a partnership were the beneficial owners of the partnership's interest in a 3(c)(1) entity because the general partner, which made all the investment decisions for the partnership, would consult with the limited partners about their individual investment objectives and vary, from investment to investment, each limited partner's percentage share of profits and losses based on individual circumstances); Six Pack (pub. avail. Nov. 13, 1989) (the partners of a general partnership were the beneficial owners of the partnership's investment in a 3(c)(1) entity because the partnership permitted each partner to determine the amount of his or her contribution to each particular investment, based on his or her individual investment objectives); Tyler Capital Fund, L.P./South Market Capital (pub. avail. Sept. 28, 1987) (the partners of a general partnership were the beneficial owners of the partnership's investment in a 3(c)(1) entity because the partnership created a separate sub-account for each new investment it made and permitted each partner to contribute on an investment-by-investment basis).

<sup>2</sup> You state that trustees of certain plans, before investing in funds that require a capital commitment, may survey participants to determine the amount that each is willing to invest. We believe that the no-action letters described in the preceding footnote clearly indicated how the staff would analyze such arrangements under section 3(c)(1), even before PanAgora.

defined contribution plans that were invested in the entity prior to April 29, 1994, the public availability date of the PanAgora letter. In addition, until December 31, 1995, a participant-directed defined contribution plan that invested in a 3(c)(1) entity prior to April 29, 1994 may continue to invest participants' money in the entity, including money belonging to participants who had not invested in the entity prior to April 29, 1994.

The staff remains willing to clarify the scope of the PanAgora position. Our conclusion in PanAgora was based on the fact that in that case "a defined contribution plan participant . . . [could] decide[] whether or how much to invest in a private investment company . . . ." <sup>3</sup> We might reach a different conclusion under different circumstances. For example, if a participant selects a generic investment option, only a portion of which is directed by the plan trustee to a particular 3(c)(1) entity, the rationale for counting each participant separately might not apply. While we are not taking a position on this issue at this time, we would welcome requests for interpretive or no-action relief from parties with these or other facts that are distinguishable from those presented in PanAgora.



Jack W. Murphy  
Associate Director (Chief Counsel)

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<sup>3</sup> PanAgora Group Trust (pub. avail. Apr. 29, 1994). Each of PanAgora's investment funds could constitute the sole investment vehicle for one of a plan's generic investment alternatives. Thus, for example, a plan participant who wished to invest all of his or her assets in PanAgora's Tactical Asset Allocation Fund could do so simply by selecting the plan's "balanced" generic investment option.

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November 10, 1994

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VIA MESSENGER

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

ACT 1940 Act  
SECTION 3(c)(1)  
RULE \_\_\_\_\_  
PUBLIC  
AVAILABILITY Dec. 28, 1994

RECEIVED  
OFFICE OF CHIEF COUNSEL  
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Re: Staff Letter Regarding the PanAgora Group Trust

Ladies and Gentlemen:

On behalf of the Latham & Watkins Thrift and Profit-Sharing Retirement Plans (collectively, the "Plan"), we are writing to request clarification regarding the effective date of The PanAgora Group Trust no-action letter (pub. avail. April 29, 1994) (the "PanAgora Letter"). The Plan is a participant-directed, defined contribution plan for which a major commercial bank serves as trustee and in which the sole participants are partners, associates, other attorneys and staff of Latham & Watkins, a large national and international law firm. A substantial majority of the partner-participants in the Plan are accredited investors within the meaning of Regulation D under the Securities Act of 1933. In addition to directing numerous investments in registered investment companies and in entities outside the scope of the Investment Company Act (the "Act"), partners who are accredited investors have directed the Plan from time to time to invest on their behalf in entities that would be investment companies within the meaning of the Act but for the exclusion from the definition of "investment company" set forth in Section 3(c)(1) thereof. However, the Plan has never acquired more than ten percent of the outstanding voting securities of such an entity. Consistent with the attribution rules of Section 3(c)(1)(A) of the Act and with the clear implication of the staff's interpretive position set forth in the Intel Corporation no-action letter (pub. avail. November 18, 1992), prior to the

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release of the PanAgora letter on April 29, 1994 the Plan believed that it should be treated as a single beneficial owner of the various Section 3(c)(1) entities in which it had made investments.<sup>1/</sup>

In the PanAgora Letter, the staff of the Division of Investment Management took the position that a participant in any defined contribution plan who has the ability to direct his or her account in the plan into an investment in a pooled investment vehicle should be counted as a beneficial owner of the pooled investment vehicle's outstanding securities for purposes of determining whether the pooled investment vehicle qualifies for the exclusion from the definition of investment company set forth in Section 3(c)(1).<sup>2/</sup> Shortly after the interpretive position set forth in the PanAgora Letter was made public, in response to widespread concern among legal practitioners in the fields of employee benefit and investment company law about the implications of the letter, the staff announced in a letter to Edward H. Fleischman of the law firm of Rosenman & Colin (pub. avail.

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<sup>1/</sup> The "Plan" actually consists of two substantially similar plans that have been separately established for certain administrative reasons. Although we believe that in light of their similarity the two plans should be treated as if they were a single plan for purposes of the issues presented by this letter, we are not seeking the Staff's concurrence in that view.

<sup>2/</sup> We believe that the interpretive position taken in the PanAgora Letter is inappropriate for at least two reasons. First, the interpretive position does not take into account the fact that by the plain wording of Section 3(c)(1) the attribution or look-through rules do not apply in the event that the investing entity owns less than ten percent of the outstanding voting securities of the entity relying on the Section 3(c)(1) exclusion. Second, the interpretive position does not take into account whether the defined contribution plan itself is excluded from the definition of investment company by operation of Section 3(c)(11) of the Act. We believe that this exclusion represents a clear policy choice by Congress that participants in such plans do not require the protections of the Act and the interpretive position set forth in the PanAgora letter is inconsistent with that choice. However, we are pursuing these views directly in correspondence with the Commission, and we of course recognize that the staff does not concur with our position.

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June 30, 1994) that the effective date of the letter would be delayed until January 1, 1995. The staff also requested that in the interim interested parties submit written comments about the applicability of the PanAgora Letter. The purpose of this letter is to suggest that, for the reasons set forth below, in addition to the tolling of its effective date, the staff should make the PanAgora Letter inapplicable to the performance by participant-directed, defined contribution plans of binding, written contractual arrangements to fund a Section 3(c)(1) entity entered into prior to the public availability of the PanAgora Letter on April 29, 1994.

In electing to delay the effectiveness of the PanAgora Letter, the staff alluded to the fact that the delay would afford participant-directed, defined contribution plans the opportunity to liquidate in an orderly way their investments in Section 3(c)(1) entities whose continued exclusion from the Act may have been jeopardized by such plans' continued investment therein. It would appear that the staff had in mind in this regard plans that had completed their investments in Section 3(c)(1) entities, which completed investments could be either redeemed by the Section 3(c)(1) entity or transferred to another entity which would be treated as a single beneficial owner. We submit, however, that based on the investment experience of the Plan as well as our own experience in the organization and structuring of leveraged buyout and venture capital funds, in a number of cases the staff's paradigm is inapplicable. Participant-directed, defined contribution plans, like other investors in Section 3(c)(1) entities, frequently have entered into binding contractual obligations to commit capital to Section 3(c)(1) entities that predate April 29, 1994 and that extend well beyond December 31, 1994. This is the case because leveraged buyout and venture capital funds do not typically draw down their investors' entire capital commitment at the time of formation of the fund. Instead, investors retain control of their capital until a capital call is made, either as part of a regularly scheduled series of capital calls or in connection with funding a specific investment, or both. The duration of the capital call period is of course the subject of negotiation at the time a given fund is formed, but in our experience it would not be unusual for parties to enter into funding arrangements that might continue for as long as five to eight years. This means that, notwithstanding the PanAgora Letter, many participant-directed, defined contribution plans may, prior to April 29, 1994, have entered into binding contractual capital commitments that well extend into 1999.

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The difficulty of applying the delayed effective date of the PanAgora Letter under these circumstances is obvious. In the first place, the already substantially illiquid nature of these investments is further magnified because any potential transferee must be persuaded to assume the remaining capital commitment in addition to acquiring the investment already made. From the fund sponsor's perspective, the sponsor has in many cases made representations to its investors that the fund would have a specified minimum amount of capital available to it over time to make an adequately diversified pool of investments. The fund may have closed its initial funding, only to discover that, due to the inability of participant-directed, defined contribution plans to continue their participation, the fund does not have the future capital resources available to it that it originally anticipated. Investments may previously have been made in the expectation that future capital would be available to diversify those original investments, which future capital may not be available in light of the PanAgora Letter. It is of course possible that the relevant partnership agreement may excuse further capital contributions or participation in the event that such contributions or participation cause the fund no longer to be excluded from the definition of investment company; however, the invocation of such a clause, if available, generally is a matter of considerable dislocation, even hardship, on the fund sponsor and its other investors. Although it may be possible to transfer the interest in the fund to another investor who assumes the capital funding responsibilities of the departing defined contribution plan, such transfers are invariably complex and raise serious issues of fairness toward the other investors who have remained contractually bound to fund the entity from the outset. The magnitude of this disruption would seem neither fair nor appropriate in light of the good faith reliance by the private bar on the Intel Corporation no-action letter referred to above and on the wording of Section 3(c)(1), each of which indicates that attribution is not appropriate when the investing entity is the beneficial owner of less than ten percent of the outstanding voting securities of the entity relying on Section 3(c)(1).

In light of the foregoing, we respectfully request that the interpretive position set forth in the PanAgora no-action Letter not apply to the performance by participant-directed, defined contribution plans of binding, written contractual arrangements to fund Section 3(c)(1) entities which were entered prior to April 29, 1994. Such arrangements should be permitted to play themselves out in accordance with their terms without the imposition of the hardship and dislocation that would result if

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the PanAgora letter were read to apply to such arrangements after December 31, 1994.

Please do not hesitate to contact the undersigned at (202) 637-2237 or Randall C. Bassett at the Los Angeles office of this firm at (213) 485-1234 should you have any questions about the matters discussed herein.

Very truly yours,



John D. Watson, Jr.  
of LATHAM & WATKINS

cc: Amy Doberman, Esq.



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December 13, 1994

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### VIA MESSENGER

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

Attention: Barry A. Mendelson, Esq.

Dear Mr. Mendelson:

The purpose of this letter is to respond to the comments you gave me in our telephone conversation of last week regarding certain of the issues raised by our letter to the Office of the Chief Counsel regarding the PanAgora Group Trust no-action letter.

First, you have asked that we provide the staff of the Division of Investment Management with a copy of a limited partnership agreement providing for a binding contractual obligation on the part of all limited partners, including a participant-directed, defined contribution plan, to commit a pre-determined amount of capital to the limited partnership over a specified number of years. As you and I discussed, the enclosed subscription agreement and accompanying partnership agreement have been redacted so as to maintain the confidentiality of the sponsor as well as of the limited partners. Nevertheless, to set the enclosed agreements in context, they pertain to a leveraged buyout fund in which a substantial majority of the limited partners are institutional investors. Certain limited partners are, however, participant-directed, defined contribution plans that, at the time that the limited partnership was being organized, offered plan participants who are accredited investors the opportunity to commit a portion of the assets included in

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Attention: Barry A. Mendelson, Esq.  
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their plan accounts toward a capital commitment by the plan, as a limited partner, in the leveraged buyout fund. For your convenience, the relevant portions of the partnership agreement providing for capital commitments are found principally in the subscription agreement and in Sections 9.03 and 9.04 of the enclosed partnership agreement.

Second, you asked me how the plan participant knows that, on a going forward basis, he or she will have assets available in the participant-directed, defined contribution plan to fund the participant's capital commitment. Typically, because only participants who are accredited investors are permitted to commit assets in their accounts to leveraged buyout funds like that provided for in the enclosed partnership agreement, such participants have accumulated sufficient assets in their plan accounts to ensure the ability to honor their capital calls. Alternatively, such participants may make significant annual optional contributions to their plan accounts -- as much as \$30,000 per year -- from which to fund capital commitments on a going forward basis, and thus they rely on expected future contributions to fund future capital requirements. In any event, based on our experience in leveraged buyout and venture capital funds, the capital commitments made by participant-directed, defined contribution plans tend to be honored to the same substantial degree as are the capital commitments made by traditional institutional investors.

I hope that the foregoing has been responsive to your concerns. Please do not hesitate to call me if you have any further questions on this matter.

Very truly yours,



John D. Watson, Jr.  
of LATHAM & WATKINS

Enclosure

cc: Amy Doberman, Esq. (w/encl.)