Memorandum

November 15, 2005

To: Public File S7-37-04

From: Rochelle Kauffman Plesset
Senior Counsel, Division of
Investment Management

Re: Definition of Eligible Portfolio Company under the Investment Company Act of 1940, Investment Company Act Release No. IC-26647

On June 8, 2005, staff from the Division of Investment Management ("Division") met with attorneys representing Allied Capital Corporation ("Allied") regarding rules that were proposed by the Commission in November 2004, which would define eligible portfolio company under the Investment Company Act.[1] At this meeting, which was held at the request of Allied's counsel, Allied's counsel presented to the staff alternatives to the proposed rule. On August 2, 2005, at the request of Division staff and staff from the Commission's Office of Economic Analysis ("OEA"), a conference call was held with representatives of Allied and its counsel in order for the Commission staff to obtain more information about these proposed alternatives.[2]

Attached are two handouts, drafted by Allied, that set forth these alternatives.

[1] David Starr of Williams & Jensen and Cynthia Krus of Sutherland, Asbill & Brennan represented Allied. Meyer Eisenberg, Elizabeth Osterman, and Rochelle Kauffman Plesset represented the Division.

[2]Participating in this conference call on behalf of Allied were Suzanne Sparrow of Allied, David Starr, David Franasiak and Joel Oswald, all of Williams & Jensen, and Steven Boehm of Sutherland, Asbill & Brennan. Commission staff participating in the call were Jonathan Sokobin and Michael Piwowar, both from OEA, and Elizabeth Osterman and Rochelle Kauffman Plesset, both of the Division.

Agreed factors for determining eligible portfolio company:

- Pink sheets
- Bulletin board
- Private (non-listed)
- companies in process of being de-listed; and
- Exchange/NASDAQ up to $40 million market cap

PLUS

OPTION A

- Move $40 million to $75 million (equal to existing S-3 eligibility level)
- Companies over $75 to $250 million if:
  (1) 50% or less institutional ownership as of the first day of the month preceding the month of the BDC investment; **OR**
  (2) average daily trading volume during prior calendar year (as calculated under Reg M) of the BDC investment $500,000 or less; **OR**
  (3) the BDC equity or debt investment exceeds the portfolio company's proceeds from the sale of common and preferred stock in registered offerings during prior two full calendar years.

OPTION B

- Move $40 million to $75 million
- Companies over $75 million to $250 million not to exceed **50%** of all the eligible portfolio assets.

According to OEA analysis: the $250 million threshold without the additional proposed limits would add 1,795 exchange and NASDAQ companies to the 5,642 Pinksheet and Bulletin Board companies for a total of 7,437 companies (as opposed to the 8,000 companies Congress said it intended to qualify) (or 62% of the total of 11,862 public companies identified by OEA). The suggested limitations would reduce these numbers below original intent.

(1) $75 million -- used for purposes of shortform registration (Form S-3). In 1992, when the SEC reduced this threshold from $150 million to $75 million it stated that "one indicia of market interest and following of a company is the number of research analysts covering the company. Approximately two-thirds of the estimated newly eligible companies are followed by at least three research analysts." That was the sole reasoning.

Today there is less analyst coverage for smaller securities -- 1% percent of those companies with market cap of $75 million or less have three or more analysts covering the company.

(2) $75 million to $250 million -- of those companies more than 50% have zero analysts covering the company, and more than 75% have less than three analysts.

(3) "Not actively Traded Securities"
Regulation M prohibits certain activities to prevent practices that undermine fairness of securities offerings. For example, Rule 100 restricts certain persons from purchasing shares during certain restricted periods. Actively traded securities are exempt. These are stocks with at last $1 million average daily trading volume **and** market cap of at least $150 million (pending proposal to increase definition of actively traded to $1.2 million ADTV **and** $180 million market cap). The focus of the rule as initially designed was trading volume, the SEC explained in its proposed release at the time that the market cap test was layered to simply stop short-term unusual trading volumes from avoiding the restrictions.

The suggested $500,000 average daily trading volume limit is significantly less than the threshold used in Reg M, and represents a reasonable threshold for securities not actively traded.