

ACT ~~1940 ICA~~  
SECTION ~~2(a)(46)(A)~~ 55(a)  
RULE \_\_\_\_\_  
PUBLIC \_\_\_\_\_  
AVAILABILITY ~~7/13/98~~

July 13, 1998  
Our Ref. No. 98-388-CC  
Plymouth Commercial  
Mortgage Fund  
File No. 814-00129

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Your letter of July 7, 1998 requests assurance that we would not recommend enforcement action to the Commission under Section 55(a) of the Investment Company Act of 1940 (the "Act") if, under certain circumstances, Plymouth Commercial Mortgage Fund ("Plymouth") considers domestic sole proprietorships as satisfying subsection (A) of Section 2(a)(46) of the Act.

Facts

Plymouth is a closed-end management investment company that has elected to be regulated as a business development company ("BDC"). Plymouth invests primarily in impaired loans secured by mortgages on commercial real estate.<sup>1</sup> These loans are sold in packages of individual loans, a significant portion of which may be business loans to natural persons ("Loans"). You state that Plymouth's ability to invest in these packages is limited because it is unclear whether the Loans are issued by a qualified issuer, as discussed below. You represent that this limitation places material constraints on Plymouth's ability to avail itself of appropriate investment opportunities.

Analysis

A BDC is a closed-end management investment company that invests primarily in small, developing or financially troubled businesses, and that generally makes available significant managerial assistance to the companies in which it invests.<sup>2</sup> Section 55(a) of the Act requires a BDC to invest at least 70% of the value of its total assets in certain securities that, in some cases, must be issued by a business that satisfies subsection (A) of Section 2(a)(46) of the Act.<sup>3</sup> Subsection (A) requires that

<sup>1</sup> You state that Plymouth considers a loan to be impaired when, based on current information and events, it is probable that the lender will be unable to collect all amounts due according to the contractual terms of the loan agreement.

<sup>2</sup> See Sections 2(a)(46), 2(a)(48), and 54-65 of the Act.

<sup>3</sup> Section 2(a)(46) of the Act defines an "eligible portfolio company," in relevant part, as an issuer that (1) is organized under the laws of, and has its principal place of business in, any State or States; (2) is neither an investment company as defined in the Act, nor excluded from the definition of investment company by Section 3(c) of the Act; and (3) meets one of four additional requirements relating to the company's access

the security's issuer be "organized under the laws of, and [have] its principal place of business in, any State or States" (a "Qualified Issuer"). You request our position on whether a business operated by a natural person in the United States ("domestic sole proprietorship") is not a Qualified Issuer because it is not organized under the laws of a State.

You contend that treating domestic sole proprietorships as Qualified Issuers would be consistent with the purpose of the provisions of the Act that regulate BDCs. You state that Congress added the BDC provisions to the Act for the purpose of "encouraging the furnishing of capital to small, developing businesses or financially troubled businesses organized and operated throughout the United States."<sup>4</sup> You represent that it would be inconsistent with this purpose to exclude domestic sole proprietorships, which you state represented approximately 72% of all non-farm businesses operated in the U.S. in 1996, from being Qualified Issuers. You represent that the Small Business Administration ("SBA"), whose purpose, like that of the BDC provisions, is to facilitate small business access to capital, permits sole proprietorships to be eligible for SBA-sponsored financing. You state that Plymouth would treat Loans as being issued by a Qualified Issuer only if the Loans are excluded from coverage under the Truth in Lending Act and Regulation Z of the Federal Reserve Board regulations,<sup>5</sup> thereby ensuring that the Loans are for business purposes.

We agree that it would be consistent with the BDC provisions of the Act not to exclude domestic sole proprietorships from being Qualified Issuers.<sup>6</sup> We believe that Congress intended the BDC provisions of the Act to facilitate

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to conventional financing, control of the company by a BDC or a group of BDCs acting together, the maximum size of the company, or other criteria established by the Commission by rule.

<sup>4</sup> Small Business Investment Incentive Act of 1980, H. R. Rep. No. 1341, 96th Cong., 2d Sess. 29 (1980).

<sup>5</sup> See Truth in Lending Act of 1968, 15 U.S.C. §§ 1601-13, 1631-65, 1671-77 (1994) and the Federal Reserve Board's Regulation Z, 12 C.F.R. § 226 (1997) (both require that certain disclosures be made to borrowers when a loan is for a personal, family or household purpose).

<sup>6</sup> For purposes of this letter, we take no position on whether any particular Loan or other security satisfies the requirements of Section 55(a) of the Act. See generally Plymouth Commercial Mortgage Fund (pub. avail. Dec. 3, 1996) (staff stated that it would not recommend enforcement action to the Commission if certain loans were treated as satisfying the requirements of Section 55(a)(3)(C) of the Act).

access to capital for small businesses regardless of whether they are sole proprietorships. Indeed, the Commission previously has stated that sole proprietorships are among the types of small businesses that are the intended beneficiaries of the BDC provisions of the Act.<sup>7</sup> We also believe that this position is consistent with the purpose of Section 2(a)(46)(A) of the Act, which we believe Congress intended to ensure that Qualified Issuers were limited to domestic businesses.<sup>8</sup> We therefore would not recommend enforcement action to the Commission under Section 55(a) of the Act if Plymouth considers domestic sole proprietorships as satisfying subsection (A) of Section 2(a)(46) of the Act.



Wendy Finck Friedlander  
Senior Counsel

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<sup>7</sup> See *The Small Business Incentive Act of 1992, Legislation Proposed by the SEC to Improve the Current System of Financing Small Businesses that would Revitalize the Economy to Develop and Expand, Creating Job Opportunities for our Nation's Workers: Hearings before the Subcomm. on Securities of the Comm. on Banking, Housing and Urban Affairs, 102nd Cong., 2nd Sess. 11-12 (1992)* (In response to a request for a description of the small businesses intended to benefit from proposed legislation, Richard C. Breeden, then-Chairman of the SEC, stated: "[O]f the total small businesses in the country . . . most of them are not corporations that could be issuing stock. Out of the total number of business tax returns filed in the country, about 3.3 million come from corporations, 1.6 million from partnerships, and 14.3 million from *sole proprietorships*. . . . [V]ery frequently, a small business is a man or woman who has started a business and does not yet have an elaborate corporate structure created." (emphasis added)).

<sup>8</sup> See S. Rep. No. 96-958, 96th Cong., 2d Sess. 15 (1980) (stating that the requirements of Section 2(a)(46)(A) are "consistent with the bill's purpose of furnishing capital to businesses organized and operating in the United States.")

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## 1940 Act -- Section 2(a)(46)(A)

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July 7, 1998

### Via Messenger

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Special Counsel  
Office of Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
Room 5115, Mail Stop 5-6  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: Plymouth Commercial Mortgage Fund--Treatment of Notes  
Issued by Sole Proprietorships as "BDC Qualifying Assets"

Dear Mr. Bullard:

On behalf of our client, Plymouth Commercial Mortgage Fund ("Plymouth"), we respectfully request a letter from the Staff ("Staff") of the Securities and Exchange Commission (the "Commission"), advising that the Staff will not recommend that the Commission take any enforcement action if Plymouth treats certain notes issued by natural person, U.S. citizen obligors resident in the U.S. and evidencing loans that were made for purposes related to businesses located in the U.S. as securities purchased from an issuer described in subparagraph (A) of Section 2(a)(46) of the Investment Company Act of 1940, as amended (the "1940 Act"), so as to permit classification of such notes as assets of the type described in Section 55(a)(1)(A) or 55(a)(3) of the 1940 Act, provided that they otherwise fit the description of those categories.

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## BACKGROUND

### Organization and Capitalization

Plymouth was organized as a business trust under Delaware law on August 23, 1996. Plymouth's operations as a closed-end management investment company began on September 27, 1996, with its acquisition of all the outstanding interests in SWF 1995 Limited Partnership, a Texas limited partnership ("SWF-95"), through an offer made to SWF-95's investors to exchange their equity and subordinated debt interests therein for common shares of beneficial interest ("Shares") in Plymouth (the "Exchange Offer"). Immediately following the consummation of the Exchange Offer, a registration statement on Form 10 for the Shares was filed with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934, as amended, along with a "Notification of Election to Be Subject to Sections 55 through 65 of the Investment Company Act of 1940" on Form N-54A by means of which Plymouth elected to be regulated as a business development company (a "BDC") pursuant to Section 54(a) of the 1940 Act. That election remains in effect.

In December 1996, Plymouth obtained a no-action letter from the Staff with respect to, among other things, Plymouth's treating already-outstanding notes, evidencing impaired loans it purchases initially from institutional holders thereof, as assets of the type described in Section 55(a)(3) of the 1940 Act where such purchase is incident to the financially distressed obligor's subsequent issuance of a new note to Plymouth or another lender.<sup>1/</sup>

Plymouth raised \$7 million in cash through a private offering of Shares that closed on December 26, 1996. As of December 31, 1997, Plymouth had total assets of approximately \$17 million.

### Business of Plymouth

**General.** Plymouth's investment objective is to achieve a high level of current income. It seeks to achieve this objective by acquiring and restructuring "impaired" loans<sup>2/</sup> that were originally made to finance small businesses. Plymouth invests primarily in loans secured by mortgages on commercial real estate. Its portfolio consists of notes evidencing impaired

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<sup>1/</sup> Plymouth Commercial Mortgage Fund, SEC No-Action Letter [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,363, at 77,826 (December 3, 1996).

<sup>2/</sup> Generally, a loan is considered "impaired" when "based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement." Fin. Acct. Stds. Bd., Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan*, ¶ 8 (May 1993).

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loans which Plymouth has purchased in packages of multiple individual loans ("loan packages"), made available at auction<sup>3/</sup> or in negotiated sales by certain governmental (e.g., Federal Deposit Insurance Corporation) or non-governmental (e.g., commercial banks, private intermediaries) entities.

Plymouth's investments are managed by Greystone Advisers, Inc., a Delaware corporation (the "Adviser"). The advisory personnel of Greystone have significant experience in, and devote their efforts exclusively to, the purchase and management of impaired loans.

Once Plymouth purchases a loan package, representatives of the Adviser contact each loan's borrower to attempt to collect on the obligation. Because Plymouth purchases the loan at a discount to the outstanding balance of principal and accrued interest, the Adviser can offer inducements (e.g., debt forgiveness, longer principal amortization, or lower interest rates) to the borrower to help with the payment of the obligation. For a majority of the obligors, the inducements are sufficient to allow them to fulfill their restructured loan obligations without suffering legal action such as foreclosure or bankruptcy. If representatives of the Adviser are unsuccessful in negotiating a fair settlement, foreclosure may be pursued.

In the event the loan is restructured (rather than foreclosed upon or immediately resold to a third party), Plymouth typically will sell the loan to a third-party investor at a discount from the then-outstanding principal amount (but at a premium to Plymouth's remaining cost basis) after the borrower has established a history of regular monthly payments to Plymouth on the restructured loan. Alternatively, Plymouth may encourage the borrower to obtain a new loan from a third-party lender, either promptly or after establishing a favorable payment history, in order to repay the outstanding loan (less the amount of Plymouth's debt forgiveness) originally purchased by Plymouth. Either of these workout options will be effected in a manner consistent with the no-action relief previously granted to Plymouth by the Staff.<sup>4/</sup>

Plymouth's goal is to be fully invested at all times in impaired loans. However, to the extent Plymouth has uninvested cash, it invests the cash in U.S. government or agency issues that typically are backed by the full faith and credit of the U.S. government, or in other high-grade instruments.

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<sup>3/</sup> These auctions are conducted in a manner designed not to involve a public offering of securities.

<sup>4/</sup> See note 1, *supra*.

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As required by Section 2(a)(48)(B) of the 1940 Act, Plymouth makes available significant managerial assistance within the meaning of Section 2(a)(47) of the 1940 Act and in a manner consistent with no-action relief previously granted to Plymouth by the Staff.<sup>5/</sup>

#### **Acquisition of Loans for Which a Natural Person is the Obligor**

The loan packages on which Plymouth bids typically include both loans with natural persons as obligors and loans with companies as obligors. Within a loan package, the breakdown between these types of obligors can vary.

The general industry practice is to bundle groups of loans based on the type of loan (*i.e.*, the type of collateral supporting it), principal and interest amounts outstanding, performance (*i.e.*, performing, sub-performing, or non-performing), or current status (*i.e.*, charge-off, deficiency, or judgment). The type of obligor (*i.e.*, a natural person or a company) is not a relevant consideration in determining whether a loan is appropriate for inclusion in a particular package of loans.

#### **DISCUSSION**

Section 55(a) of the 1940 Act provides in effect that at least 70% of the value of the investment assets of a BDC such as Plymouth must be invested in assets meeting certain requirements (assets satisfying these requirements are referred to hereinafter as "BDC Qualifying Assets"). Among those requirements is one that the issuer must meet some or all parts of the definition of "eligible portfolio company" in Section 2(a)(46) of the 1940 Act, including subparagraph A thereof (*i.e.*, being "organized under the laws of . . . any State or States").

Unless Plymouth could include the notes reflecting business-purpose loans with natural person, U.S. citizen obligors resident in the U.S. and evidencing loans that were made for purposes related to businesses located in the U.S. (the "Notes") as BDC Qualifying Assets, its business would continue to be limited to a narrow segment of the secondary market for commercial real estate loans. This limitation not only places material constraints on Plymouth's ability to avail itself of attractive opportunities to create value for its shareholders, but also excludes sole proprietorships from access to the potential sources of capital for small businesses that the BDC provisions of the 1940 Act intended to make available to them. As discussed below, approximately half of all commercial real estate loans available for purchase in the secondary market are made to natural person obligors, a percentage that is, in fact, lower than the overall percentage of sole proprietorships among U.S. businesses as a whole.

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<sup>5/</sup> See note 1, *supra*.

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To date, Plymouth has not treated the Notes as BDC Qualifying Assets since, as noted above, Section 2(a)(46)(A) on its face would seem to permit only loans with artificial entity obligors (*i.e.*, creatures of state law) to qualify for inclusion in that "basket." This result occurs notwithstanding that there is no practical significance to the small business borrower or Plymouth arising from the distinction between these two types of obligors. By having to exclude the Notes from its BDC Qualifying Assets, Plymouth is deprived of valuable investment flexibility without any corresponding benefit to small business borrowers, the intended beneficiaries of the 1980 amendments to the 1940 Act (the "1980 Amendments") that engendered the BDC regulatory regime.

### **It Is Virtually Impossible to Avoid Acquiring Loans with Natural Person Obligor**

In Plymouth's experience, outstanding loans offered for sale on the secondary market are never packaged together based upon whether the obligor is a natural person or a company. Indeed, that distinction is probably meaningless to any prospective purchaser other than a BDC, and it simply would never occur to sellers of impaired loans to group them into packages according to the natural/artificial status of the obligor. Moreover, since Plymouth is probably the only participant in the secondary market for impaired loans to which the obligor's status as a natural person or company is significant, it is unlikely that any seller could be persuaded to respond favorably to a request for the loans to be grouped together into bid packages on that basis, given the highly competitive nature of the impaired loan resale market at this time.

The reality, then, is that a large number of the attractive packages of impaired loans being offered for sale contain loans with natural person obligors, and those loans represent a significant portion of the value of those packages. As a result, and despite its best efforts, the Adviser is finding it difficult to find enough loan packages that are sufficiently weighted toward loans with company obligors to provide the type of return for its shareholders that it could obtain without such limitation.

Plymouth has prepared an analysis of the loan packages it has considered for bid for the year ended December 31, 1997, and a summary of that analysis is attached hereto as Exhibit A. As demonstrated in Exhibit A, strictly on the basis of the number of loans, the overall ratio of those with natural person obligors to those with company obligors is 53% to 47%. When weighted for the dollar amount of the assets, the ratio is 41% to 59%. With "bad assets" constituting over 40% of the value of the loan packages reflected in Exhibit A, the inadequacy of the "30% basket" in this context becomes evident.

Publicly available information underscores the relative significance of small businesses operating through natural persons. According to information made available by the U.S. Small Business Administration ("SBA") and based on projected Internal Revenue Service

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tax return data, approximately 72% of all non-farm businesses operated in the U.S. in 1996 were sole proprietorships.<sup>6/</sup>

Plymouth's difficulties arising from the large number of natural person obligors are exacerbated by how frequently loan auctions occur and the uncertainty of winning a particular loan package. In determining whether to bid on a given package for Plymouth, the Adviser can, of course, look only at the ratio of Plymouth's assets then extant. However, the nature of the business requires, and Exhibit A demonstrates, that multiple bids often must be submitted at or about the same time. In addition, new bids usually must be submitted before Plymouth knows whether its outstanding bids have been accepted. Thus, individual proposed bids can be compared to the then-current ratio of BDC Qualifying Assets to "bad assets" only in isolation, without regard to the potential effect of new packages that may come on board as assets of Plymouth between bidding and the time to fund the purchase.

#### **Why Certain Loans Secured by Commercial Real Estate Have Natural Person Obligors**

Federal income tax law, and practical considerations, favor participation directly by a natural person, rather than participation directly by a company (and perhaps indirectly by one or more natural persons), in loans secured by commercial real estate. Most basically, the holding of real estate and the making of a note secured by the real estate by a natural person directly rather than through a corporation (to use the most common type of company) avoids the two-level corporate income tax imposed under the Internal Revenue Code of 1986, as amended (the "Code"), as well as franchise or other taxes imposed at the state and local levels. Gains from property held in a "C" corporation are taxed at both the corporate and shareholder level. Depending on the circumstances, that double taxation can exceed 60% of income.

In addition, losses are more frequent in the early years of many real estate ventures, and most real estate investors desire to take advantage of those losses personally. That goal presents a problem in both "C" corporations as well as corporations that are taxed pursuant to Subchapter S of the Code. In "C" corporations, losses do not pass through to shareholders; in "S" corporations, shareholders often have no basis against which to offset such losses. A natural person obligor as borrower, of course, would have a basis in the property and could deduct losses personally.

In certain cases, one or more non-corporate forms of business organization (*e.g.*, limited partnership, limited liability company ("LLC"), or business trust) could provide the liability protection and favorable tax results desired by a small business entrepreneur. Indeed, a

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<sup>6/</sup> U.S. Small Business Administration, Office of Advocacy, *Small Business Answer Card 1997* (last modified Jan. 30, 1998) <<http://www.sba.gov/ADVO/stats/answer.html>>.

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single-member non-corporate entity, such as an LLC, can provide limited liability while providing the same tax treatment a sole proprietor would receive. However, as a practical matter, the initial and ongoing administrative and legal expenses associated with formal business organizations, even simple ones like single-member LLCs, makes the approach daunting or even prohibitive for many small business entrepreneurs, especially in the early stages of a business venture.

**“Truth-in-Lending” Requirements Ensure That the Loans to Natural Persons Are Purchased by Plymouth for Business Purposes**

The loans with natural person obligors that Plymouth acquires in packages are business loans. This result is assured by the operation of the Truth in Lending Act (“T.I.L.A.”)<sup>7/</sup> and Regulation Z of the Federal Reserve Board regulations.<sup>8/</sup> In effect, the foregoing require lending institutions to determine whether an extension of credit is for a “personal, family [or] household purpose,” in which case the disclosures required by T.I.L.A. and Regulation Z must be given to the borrower.<sup>9/</sup> Loans made for business or commercial purposes, on the other hand, are excluded from the coverage of those laws. Ordinarily only loans determined to fall within that exclusion are included in the loan packages on which Plymouth bids.

**Applicable Law**

Section 55(a) of the 1940 Act makes it unlawful for a BDC to acquire any assets other than those described in paragraphs (1) through (7) thereof unless, at the time the acquisition is made, assets described in paragraphs (1) through (6) thereof (collectively, “BDC Qualifying Assets”) represent at least 70 percent of the value of its total assets other than assets described in paragraph (7) thereof (the “70% test”). Paragraphs (1) through (4) of Section 55(a) describe BDC Qualifying Assets which are either securities of an “eligible portfolio company,” as defined by Section 2(a)(46) of the 1940 Act, or securities of an issuer described in subparagraphs (A) and (B) of Section 2(a)(46) that is not necessarily an eligible portfolio company because of its failure to meet at least one of the four alternative criteria in subparagraph (C) of Section 2(a)(46). Paragraph (5) of Section 55(a) describes BDC Qualifying Assets which are “[s]ecurities received in exchange for or distributed on or with respect to securities described in paragraphs (1) through (4) of [Section 55(a)], or pursuant to the exercise of options, warrants, or rights relating to securities described in such paragraphs.” Paragraph (6) of Section 55(a) describes BDC Qualifying Assets consisting of “[c]ash, cash items, Government securities, or high quality debt

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<sup>7/</sup> Truth in Lending Act of 1968, 15 U.S.C. §§ 1601-13, 1631-65, 1671-77 (1994).

<sup>8/</sup> Regulation Z, 12 C.F.R. § 226 (1997).

<sup>9/</sup> *Id.* at § 226.1.

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securities maturing in one year or less from the time of investment in such high quality debt securities.” Finally, paragraph (7) of Section 55(a) describes various “noninvestment assets necessary and appropriate to . . . operations as a [BDC],” which are excluded from both the numerator and the denominator of the 70% test and which, like the BDC Qualifying Assets described in paragraphs (1) through (6) of Section 55(a), may be acquired by a BDC at any time without regard to its current status under the 70% test.

Although the 70% test set forth in Section 55(a) of the 1940 Act is a transaction test (*i.e.*, a condition that must be satisfied at the time of taking the affirmative action of purchasing an investment asset other than a BDC Qualifying Asset) rather than a maintenance test (*i.e.*, a condition that must be satisfied at times other than when a particular affirmative action is taken), the Staff also takes the position that a 50% test applies on a maintenance basis to BDCs:

The Division [of Investment Management] is of the view that Section 58 of the 1940 Act requires a BDC to obtain the approval of its stockholders for a change of its business purpose if more than *half* of its total assets are not invested in the types of securities designed to meet its business purpose, in accordance with Sections 2(a)(48) and 55(a)(1)-(3) of the 1940 Act, within the earlier of (i) two years after termination or completion of sales or (ii) two and one-half years after commencement of its initial public offering.<sup>10/</sup>

Section 2(a)(46) of the 1940 Act defines “eligible portfolio company” as any issuer which--

(A) *is organized under the laws of*, and has its principal place of business in, any State or States;

(B) is neither an investment company as defined in Section 3 (other than a small business investment company which is licensed by the Small Business Administration to operate under the Small Business Investment Act of 1958 and which is a wholly-owned subsidiary of the [BDC]) nor a company which would be an investment company except for the exclusion from the definition of investment company in Section 3(c); and

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<sup>10/</sup> Guidelines for Form N-2, Release No. IC-19399, Fed. Sec. L. Rep. (CCH) ¶ 51,227, at 39,342 (May 14, 1993) (emphasis added) (citation omitted).

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(C) satisfies one of the following:

(i) It does not have any class of securities with respect to which a member of a national securities exchange, broker, or dealer may extend or maintain credit to or for a customer pursuant to rules or regulations adopted by the Board of Governors of the Federal Reserve System under Section 7 of the Securities Exchange Act of 1934;

(ii) It is controlled by a [BDC] . . . ;

(iii) It has total assets of not more than \$4,000,000, and capital and surplus (shareholders' equity less retained earnings) of not less than \$2,000,000 . . . ; or

(iv) It meets such other criteria as the Commission may, by rule, establish as consistent with the public interest, the protection of investors, and the purposes fairly intended by the policy and provisions of [the 1940 Act]

(emphasis supplied).

### Legal Analysis

Plymouth proposes to rely on one or more of Section 55(a)(1)(A) or 55(a)(3) of the 1940 Act<sup>11</sup> to treat the Notes as BDC Qualifying Assets. The no-action assurance requested herein with respect to the Notes is limited to assets which would otherwise be of the type described in Section 55(a)(1)(A) or 55(a)(3) of the 1940 Act but for the uncertainty as to whether their issuers meet the Section 2(a)(46)(A) requirement of being "organized under the laws of . . . any State or States." Interpretive guidance with respect to subparagraph (A) of Section 2(a)(46) is needed because that provision may be read to exclude a natural person from being deemed to be an eligible portfolio company for purposes of the 70% test solely due to that status, even where every other requirement of that section is met.

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<sup>11</sup> On October 11, 1996, following the submission of Plymouth's no-action request to the Staff which resulted in the December 31, 1996 no-action relief cited in note 1, *supra* (and described in the surrounding text), the National Securities Markets Improvement Act of 1996 ("NSMIA") amended Section 55(a)(1)(A) of the 1940 Act to include securities purchased "from any other person, subject to such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Although Plymouth currently intends to rely solely on Section 55(a)(3) to treat the Notes as BDC Qualifying Assets, it would like to maintain the flexibility to rely instead on the amended Section 55(a)(1)(A) to treat the Notes as BDC Qualifying Assets.

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An enterprise that consists of an individual conducting business and holding property in his or her name and who is directly and personally liable for the obligations of the business, such as one that might issue a Note, is referred to as a "sole proprietorship."<sup>12/</sup> In a sole proprietorship, although a fictitious or "doing business as" name may be used, the individual owner is liable for the debts of the business and is the obligor on its notes. However, a sole proprietorship operates in most material ways like any other form of business organization. Thus, products and services may be bought and sold, contractual relationships established with other parties, and patents or copyrights obtained for proprietary information.<sup>13/</sup> In addition, the proprietor can hire any number of employees or agents.<sup>14/</sup>

In the absence of subparagraph (A) of Section 2(a)(46), the use of the term "any issuer" in the introductory phrase of Section 2(a)(46) would suggest that a sole proprietorship could be an eligible portfolio company. This interpretation is consistent with other provisions of the 1940 Act. Thus, Section 2(a)(22) of the 1940 Act defines "issuer" as "every *person* who issues or proposes to issue any security, or has outstanding any security which it has issued" (emphasis added), and Section 2(a)(28) of the 1940 Act defines "person" as "a natural person or a company."

The phrase "organized under the laws of . . . any State" in Section 2(a)(46)(A) also is not inconsistent with the inclusion of sole proprietorships as BDC Qualifying Assets. Sole proprietorships are subject to specific regulatory restrictions generally applicable to business entities in the jurisdictions and general rules of contract, torts, property, and agency apply.<sup>15/</sup>

The legislative history of the 1980 Amendments<sup>16/</sup> includes no evidence of a Congressional intent to deny the benefits for small businesses intended to be conferred by the advent of BDCs to those businesses that happen to be organized as sole proprietorships. In discussing the addition of paragraphs 46, 47, and 48 to Section 2(a) of the 1940 Act, the House Report on the bill that became the 1980 Amendments states that the bill's purpose was "encouraging the furnishing of capital to small, developing businesses or financially troubled

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<sup>12/</sup> Richard D. Harroch, *Start-Up Companies: Planning, Financing and Operating the Successful Business* § 1.05[1] (1997) (citations omitted).

<sup>13/</sup> *Id.*

<sup>14/</sup> *Id.*

<sup>15/</sup> *Id.* at § 1.05[3].

<sup>16/</sup> S. Rep. No. 96-958 (1980); H.R. Rep. No. 96-1341 (1980).

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businesses organized and operated throughout the United States.”<sup>17/</sup> The structure of the businesses to which the capital was intended to be furnished was simply not identified as a consideration.

The SBA also apparently believes that the form in which a small business is conducted is not a relevant consideration in determining eligibility to benefit from its programs. Thus, the definition of “small business concern,” which comprises a category of enterprises eligible for SBA-sponsored financing, includes no requirement that the person in question be formally organized as a creature of state law.<sup>18/</sup>

The status of sole proprietorships as functionally equivalent to other business organizations is also recognized under the Code. Treas. Reg. §1.414(c)-2(a) provides that for certain purposes relating to pension plans, etc., “the term ‘organization’ means a sole proprietorship, a partnership, . . . a trust, an estate or a corporation.”<sup>19/</sup> The regulations under Section 1060 of the Code, dealing with asset acquisitions, also reflect this view. Subparagraph (b) of Treas. Reg. §1.1060-1T, in providing examples of what constitutes a “trade or business,” specifically includes a “sole proprietor.”<sup>20/</sup>

The Multistate State Tax Compact,<sup>21/</sup> which is intended to address the problems of state taxation of interstate commerce, defines “taxpayer” to include any “corporation, partnership, firm, association, governmental unit or agency or *person* acting as a business entity in more than one State” (emphasis supplied). Thus, a sole proprietorship would be a person for purposes of state taxation in that context.

### **Requested Relief**

In seeking the Staff’s concurrence in the interpretation of Section 2(a)(46)(A) set forth above, Plymouth represents that the real property that has been pledged as collateral for Notes will relate to loans excluded from the coverage of T.I.L.A. and Regulation Z, thereby ensuring that the loans have been made for business or commercial purposes within the meaning of the provisions thereof. Accordingly, we respectfully request a letter from the Staff advising

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<sup>17/</sup> H.R. Rep. No. 96-1341, at 29 (1980).

<sup>18/</sup> *E.g.*, 15 U.S.C.A. §§ 632(a), 662(5) (1997).

<sup>19/</sup> Treas. Reg. 1.414(c)-2(a) (as amended in 1994).

<sup>20/</sup> Temp. Treas. Reg. 1.1060-1T(B)(3) (Example 2).

<sup>21/</sup> Multistate Tax Compact, 1 State Tax Guide (CCH) ¶ 350, 1016 (Aug. 4, 1967).

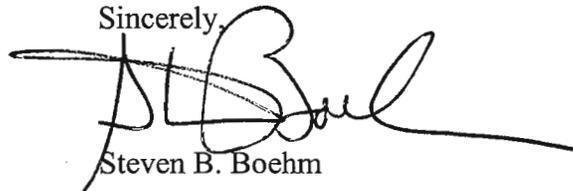
Sutherland, Asbill & Brennan LLP

Mercer E. Bullard, Esq.  
July 7, 1998  
Page 12

that it will not recommend that the Commission take any enforcement action if Plymouth treats the Notes as securities purchased from an issuer described in Section 2(a)(46)(A) of the 1940 Act for purposes of classifying them as BDC Qualifying Assets of the type described in Section 55(a)(1)(A) or 55(a)(3) of the 1940 Act, provided that they otherwise fit the description of those categories.

If you require any additional information or have any questions concerning this request, please do call the undersigned at 202/383-0176 or David L. Abrams at 202/383-0181.

Sincerely,

A handwritten signature in black ink, appearing to read 'S. Boehm', with a long horizontal flourish extending to the right.

Steven B. Boehm

cc: Wendy Finck Friedlander, Esq./SEC  
Kenneth L. Bennight, Esq./Plymouth  
David L. Abrams, Esq./SA&B

Attachment

## PLYMOUTH COMMERCIAL MORTGAGE FUND

Asset Analysis on Loan Portfolios Reviewed  
for the year ending December 31, 1997

Bid Date	Seller	Number of Loans				Unpaid Principal Balance					
		Total Number Assets	Loans From Artificial Entities	Percent of Total	Loans From Natural Persons	Percent of Total	Portfolio Book Value	Loans From Artificial Entities	Percent of Total	Loans From Natural Persons	Percent of Total
01/26/97	Mirror Finance	8	4	50%	4	50%	3,104,905	1,612,518	51%	1,492,387	48%
02/19/97	FDIC	9	6	66%	3	33%	2,099,576	1,367,736	65%	731,840	34%
03/26/97	FLEET	6	2	33%	4	66%	3,456,282	1,561,470	45%	1,894,812	54%
03/26/97	FLEET	4	3	75%	1	25%	2,044,727	1,462,080	71%	582,647	28%
03/26/97	FLEET	8	5	62%	3	37%	5,389,511	3,584,828	66%	1,804,683	33%
03/17/97	ONTRA	9	2	22%	7	77%	2,041,963	608,648	29%	1,433,315	70%
03/14/97	FIRST UNION	27	13	48%	14	51%	14,014,216	7,050,531	50%	6,963,685	49%
04/29/97	BANK ONE	5	2	40%	3	60%	1,564,473	401,724	25%	1,162,749	74%
04/29/97	SICURID	5	4	80%	1	20%	3,816,579	3,114,619	81%	701,960	18%
04/29/97	BANC ONE	5	1	20%	4	80%	3,258,579	843,369	25%	2,415,210	74%
04/29/97	BANC ONE	8	1	12%	7	87%	1,875,837	346,904	18%	1,528,933	81%
04/29/97	BANC ONE	5	3	60%	2	40%	1,381,257	707,997	51%	673,260	48%
05/11/97	NORWEST	4	2	50%	2	50%	1,139,115	845,000	74%	294,115	25%
05/08/97	NAB	9	8	88%	1	11%	967,026	451,781	46%	515,245	53%
06/27/97	GMAC	28	6	21%	22	78%	7,388,374	1,745,110	23%	5,643,263	76%
06/10/97	BSC AMERICA	2	0	0%	2	100%	666,684	0	0%	666,684	100%
06/11/97	BSC AMERICA	4	2	50%	2	50%	609,254	437,405	71%	171,849	28%
06/11/97	BSC AMERICA	4	1	26%	3	75%	468,981	38,958	7%	430,022	91%
06/11/97	BSC AMERICA	4	2	50%	2	50%	409,471	162,408	39%	247,067	60%
06/27/97	PDIC	10	7	70%	3	30%	6,594,964	5,861,747	89%	733,217	11%
07/15/97	FINANCIAL	10	8	80%	2	20%	1,819,659	1,471,842	80%	348,217	19%
07/09/97	MIRROR	1	2	100%	0	0%	859,376	859,376	100%	0	0%
07/09/97	MIRROR	3	2	66%	1	33%	501,934	845,236	68%	156,698	31%
07/09/97	MIRROR	6	3	50%	3	50%	1,712,299	459,828	26%	1,253,471	73%
07/09/97	MIRROR	3	3	100%	0	0%	1,597,145	1,597,145	100%	0	0%
08/05/97	PDIC	3	1	33%	2	66%	946,720	851,578	89%	95,141	10%
09/23/97	PAMEX	6	5	83%	1	16%	6,984,462	5,472,811	78%	1,511,650	21%

EXHIBIT A

Unpaid Principal Balance

Number of Loans

Bid Date	Seller	Total Number Assets	Loans From Artificial Entities		Percent of Total	Loans From Natural Persons		Percent of Total	Portfolio Book Value	Loans From Artificial Entities		Percent of Total	Loans From Natural Persons		Percent of Total
			Loans From Artificial Entities	Percent of Total		Loans From Natural Persons	Percent of Total			Loans From Artificial Entities	Percent of Total		Loans From Natural Persons	Percent of Total	
10/26/97	SUMMIT	10	6	60%	4	40%	3,685,125	2,920,936	79%	764,189	20%				
10/26/97	SUMMIT	6	3	50%	3	50%	1,378,502	737,778	53%	640,724	46%				
10/26/97	PAMEX	24	12	50%	12	50%	2,196,224	1,835,599	83%	360,625	16%				
10/14/97	JE ROBERTS	17	5	29%	12	70%	2,615,133	1,131,980	43%	1,483,143	56%				
10/09/97	PAMEX	7	5	71%	2	28%	3,000,385	2,429,313	80%	571,072	19%				
10/09/97	PAMEX	25	9	36%	16	64%	5,093,580	2,239,686	43%	2,853,894	56%				
10/09/97	PAMEX	42	23	54%	19	45%	17,708,373	9,869,013	55%	7,839,360	44%				
10/14/97	JE ROBERTS	13	11	84%	2	15%	3,431,789	3,086,007	89%	345,782	10%				
10/09/97	PAMEX	14	9	64%	5	35%	5,730,874	3,674,860	64%	2,056,013	35%				
10/09/97	PAMEX	67	21	31%	45	67%	12,607,381	5,808,199	46%	6,799,181	53%				
11/19/97	FDIC	5	2	40%	3	60%	836,492	476,129	56%	360,363	43%				
11/19/97	FDIC	18	2	11%	16	88%	1,803,459	764,886	42%	1,038,572	57%				
11/09/97	GMAC	8	8	100%	0	0%	7,465,615	7,465,615	100%	0	0%				
06/27/97	GMAC	46	21	45%	25	54%	8,972,438	4,527,070	50%	4,445,368	49%				
06/27/97	GMAC	20	7	35%	13	65%	5,117,901	1,865,577	36%	3,252,324	63%				
11/18/97	FDIC	20	6	30%	14	70%	10,008,042	5,436,611	54%	4,631,430	46%				
12/12/97	MEENAN &	8	2	25%	6	75%	2,406,707	976,685	40%	1,430,022	59%				
12/09/97	LANDAUER	6	5	83%	1	16%	5,554,626	5,034,693	90%	519,933	9%				
12/12/97	MEENAN &	10	4	40%	6	60%	1,817,412	924,295	50%	893,116	49%				
11/19/97	FLEET	32	22	68%	10	31%	11,428,636	9,233,554	80%	2,195,081	19%				

1997 Totals:

Total Loans Reviewed: 595

Total Book Values: 189,627,966

Total Loans From Artificial Entities: 282

Total Values From Artificial Entities: 112,195,662

Total Loans From Natural Persons: 313

Total Values From Natural Persons: 76,432,412

Percent of Total by Value: 59.0% / 41.0%

Percent of Total by Loans: 47.0% / 53.0%