

# Strictly Business

A Business Law Blog for Entrepreneurs, Emerging Companies, and the Investment Management Industry.



## ABOUT THE AUTHOR

Alexander J. Davie is an attorney based in the Nashville, TN area. His practice focuses on corporate, finance, and real estate transactions. He works mainly with emerging companies, venture funds, entrepreneurs, and startups. His firm's website can be found at [www.alexanderdavie.com](http://www.alexanderdavie.com).

In his corporate practice, Mr. Davie has worked extensively with his clients on all aspects of their businesses, including company formation, business planning, mergers and acquisitions, vendor and customer contracts, corporate governance, debt and equity financings, and securities offerings. In addition, he has represented investment advisors, securities brokers, hedge funds, private equity funds, and real estate partnership syndicators in numerous private offerings of securities and in ongoing compliance. Prior to returning to private practice, Mr. Davie served as the general counsel to a private investment fund manager.

In his real estate practice, he has participated in property acquisitions, mortgage financings, and commercial leasing matters throughout the United States. He has represented developers, governmental entities, life insurance companies, banks, and owners of malls, shopping centers, industrial parks, and office towers. He has worked on a number of transactions involving the syndication of real estate partnerships, advising sponsors on both real estate and securities issues.

## Legislation Giving Private Equity Fund Managers Exemption from Registration Clears Key Committee

A bill called the Small Business Capital Access and Job Preservation Act recently cleared the Committee on Financial Services of the U.S. House of Representatives. The bill's intent is to exempt certain private equity funds from Investment Adviser registration.

As many of you know, the Dodd-Frank Act requires that managers of private funds to register as investment advisers, unless they manage less than \$150 million in assets or are venture capital funds within the definition of SEC regulations. Left out from these exemptions are private equity funds. In an effort to roll back some of the increased regulatory scrutiny on private equity funds, Rep. Robert Hurt (R - VA) introduced the Small Business Capital Access and Job Preservation Act earlier this year.

The bill would create a new category of exemption from IA registration for private equity funds. One condition to qualifying for this new exemption is that the fund must not borrow in excess of twice its invested capital commitments. This condition was added to attempt to assuage opponents who thought that highly leverage funds should be closely regulated. The SEC would have the final say on defining exactly what a private equity fund is, just as it did with defining the term "venture capital fund."

There does still seem to be some degree of controversy as to the limitation on leverage. It appears that opponents are concerned that PE funds could park their debt in the companies within their portfolios, thus having an effective debt to equity ratio higher than 2-1. This issue may or may not get addressed as the legislation moves forward. While I understand opponents may be concerned about fund

managers doing an end run around the registration requirements by having portfolio companies take on the increased debt, there is also a big difference between a fund taking on debt and a portfolio company taking on debt. When a portfolio company takes on debt, it puts that company at risk, but does not put the portfolio as a whole at risk. In contrast, when the fund itself takes on debt, the entire fund is at risk, thus creating potential systematic risk that the Dodd-Frank Act was supposed to be addressing. Perhaps one compromise would be to clarify the legislation so that any debt of a portfolio company that is in any way guaranteed by the fund would be considered debt of the fund.

Private equity funds certainly have legitimate grievances about the fact they are now facing a dramatic increase in regulation, despite the fact that they played no part in the financial crisis. Consequently, this bill is, in my opinion, a good idea once the definition of fund leverage is ironed out. If it passed, it will provide much-needed relief to private equity managers from the new IA registration requirements. Nonetheless, it appears from the text of the bill that private equity managers (like venture capital funds and small hedge funds) would still be considered

"[exempt reporting advisers](#)" and will be required to file a truncated Form ADV. Therefore, even if this legislation is adopted, private equity managers will be facing increased regulation.

Furthermore, it's very questionable whether this bill will ever be adopted, given our paralyzed political system. The bill may very well end up being used to score political points by both parties. Republicans may advance it for the purpose of claiming that they are repealing part of President Obama's legislative achievements, causing Democrats to oppose the bill and claim they are standing up to Republican attempts to roll back regulation on "Wall Street." On the other hand, if the bill's sponsors are serious about enacting it, they will present it as a needed technical change to the Dodd-Frank Act which is a win-win for all involved. I take it as a positive sign that the bill was reported out of committee on a voice vote, which indicates that the opposition is soft. If the less political approach is adopted, the bill may have a chance...if we ever move beyond this debt-ceiling debate.

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