

**SEC ADOPTS RULES IMPLEMENTING DODD-FRANK INVESTMENT ADVISER EXEMPTIONS AND REGISTRATION REQUIREMENTS**

Last week the Securities and Exchange Commission (“SEC”) adopted a series of technical rules that bring to mind the old adage that the “devil is in the details.” The new rules, adopted under the Investment Advisers Act of 1940 (“Advisers Act” or “Act”), implement key investment adviser exemptive, reporting and registration provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).<sup>1</sup> The new rules are of particular importance to private fund managers and others evaluating whether they must register as investment advisers with the SEC under the Advisers Act (and can avail themselves of an extension of the registration deadline) or can rely on an exception from the definition of “investment adviser” in the Act or on certain exemptions from registration created by the Dodd-Frank Act.

The new rules as adopted in final form by the SEC reflect numerous changes to the rules as proposed by the SEC in October and November of last year. The final rules, however, do not provide the relief from the Advisers Act sought by many commenters on the proposed rules and remain very consistent with the SEC’s stated goal of crafting narrow exceptions and exemptions from the substantive provisions of the Act. The new rules fall into two general categories: those relating to exemptions from Advisers Act registration with the SEC, including exemptions for private fund advisers and foreign private advisers, and those relating to the reporting and registration requirements for registered investment advisers and the new “exempt reporting advisers.”<sup>2</sup> This Memorandum provides an overview of the rules relating to the “private fund adviser” and “foreign private adviser” exemptions and the reporting and registration requirements. We discuss the venture capital fund adviser exemption from registration and the family office exception from the Advisers Act’s definition of investment adviser in separate client memoranda.

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<sup>1</sup> See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 22, 2011), available at <http://sec.gov/rules/final/2011/ia-3222.pdf> (“Exemptions Release”); Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3221, available at <http://sec.gov/rules/final/2011/ia-3221.pdf> (“Implementing Release”).

<sup>2</sup> The SEC proposed the exemptions rules in Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3111 (Nov. 19, 2010) (relating to the venture capital, private fund adviser and foreign private adviser exemptions) and Family Offices, Investment Advisers Act Release No. 3098 (Oct. 12, 2010) (relating to the family office exemption), and the reporting and registration rules in Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3110 (Nov. 19, 2010).

### **Extension of Compliance Date for Adviser Registration**

The SEC has indicated informally on a number of occasions in the recent past its desire to give the investment management industry more time to determine whether certain unregistered investment advisers will be subject to the Advisers Act as amended by the Dodd-Frank Act or to come into compliance with the Advisers Act. New Rule 203-1(e) under the Advisers Act formally extends the compliance date from July 21, 2011 to March 30, 2012 for SEC registration of investment advisers that previously relied on the “private adviser” exemption found in Section 203(b)(3) of the Advisers Act. The Dodd-Frank Act eliminated the “private adviser” exemption effective July 21, 2011, but an investment adviser that is relying on, and is entitled to rely on, the private adviser exemption on July 20, 2011, but that must thereafter register with the SEC, may delay registering until March 30, 2012. The SEC noted that advisers intending to register with the SEC effective March 30, 2012 need to file a complete application, both Part 1 and Part 2A of Form ADV, by February 14, 2012 at the latest, to be sure of being registered by the March 30th deadline.

### **Exemption for Private Fund Advisers**

New Rule 203(m)-1 under the Advisers Act generally provides an exemption from registration for an investment adviser solely to private funds that has less than \$150 million in assets under management in the United States. The Rule in final form incorporates a number of comments the SEC received on the proposed version of the Rule, but like the proposed rule, it is relatively narrow.

Like the proposed rule, the final Rule applies differently to U.S. and non-U.S. advisers. A U.S. investment adviser (*i.e.*, an adviser whose principal office and place of business is in the United States) seeking to rely on the Rule must act “solely as an investment adviser to one or more qualifying private funds” and manage private fund assets of less than \$150 million. A U.S. adviser whose aggregate private fund assets under management is less than \$150 million can advise an unlimited number of private funds and still qualify for the exemption. In a warning shot across the bow of the private fund manager industry, the SEC said when adopting the Rule that it may view two or more separately formed affiliated advisory entities, each with less than \$150 million in private fund assets under management, as “a single adviser for purposes of assessing the availability of exemptions from registration.”<sup>3</sup> The SEC cited past SEC staff letters as guidance for assessing whether the advisory businesses of two or more separately formed entities may be required to be integrated in this context.<sup>4</sup>

A non-U.S. investment adviser (*i.e.*, an adviser whose principal office and place of business is outside the United States) can rely on Rule 203(m)-1 so long as it has no client that is a “United States person”<sup>5</sup> other than qualifying private funds as defined below, and (1) all assets managed

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<sup>3</sup> See Exemptions Release at n.314.

<sup>4</sup> *Id.* at n.506, citing Richard Ellis, Inc., SEC No-Action Letter (Sep. 17, 1981).

<sup>5</sup> Under Rule 203(m)-1, a United States person is defined generally by incorporating the definition of a “U.S. person” found in Regulation S under the Securities Act of 1933.

by the investment adviser at a place of business in the United States are solely attributable to private funds and (2) the total value of those assets is less than \$150 million. In operating in this manner, the Rule affords a non-U.S. investment adviser perhaps its greatest opportunity to conduct its business outside of the full scope of the Advisers Act, as the Rule places no limitation on the type or number of non-U.S. clients a non-U.S. adviser may have, or on the amount of non-U.S. assets under management, so long as the adviser does not manage any non-private fund assets at a place of business in the United States. In adopting final Rule 203(m)-1, the SEC made clear that the analysis of a non-U.S. adviser's ability to rely on the private fund adviser exemption will likely depend on whether the adviser manages assets at a place of business in the United States.

In determining whether the \$150 million threshold is exceeded, an investment adviser needs to consider only those assets with respect to which the adviser provides "continuous and regular supervisory or management services." Thus, a non-U.S. adviser seeking to rely on Rule 203(m)-1 would seem well advised to conduct its global operations such that investment decisions with respect to non-U.S. clients (*i.e.*, its continuous and regular supervisory or management services for such clients) are made outside the U.S. In this regard, the SEC in adopting the Rule said that "research or due diligence services" performed in the United States would generally not constitute "continuous and regular supervisory or management services."

Important in assessing the availability of exemption provided by new Rule 203(m)-1 is the definition of "qualified private fund." The term for this purpose means any private fund (*e.g.*, a fund relying on the exception from the definition of "investment company" found in Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 ("Investment Company Act")) that is not registered under Section 8 of the Investment Company Act and has not elected to be treated as a business development company within the meaning of the Investment Company Act. Also coming within the term is an issuer that qualifies for an exception from the definition of investment company in Section 3 of the Investment Company Act in addition to those provided by Section 3(c)(1) or 3(c)(7), so long as the adviser seeking to rely on Rule 203(m)-1 treats the issuer as a private fund under the Advisers Act and the rules thereunder for all purposes. Including this latter category of issuer within the term qualifying private fund represents a change made by the SEC to proposed Rule 203(m)-1. The change appears to have been made in response to a commenter's concern that an issuer that met the Section 3(c)(1) or Section 3(c)(7) exception and some other Investment Company Act exception would be considered not to be a qualifying private fund within the meaning of the proposed rule. Under the proposed rule, a "private fund" was defined as a fund that meets either the 3(c)(1) or the 3(c)(7) exception but no other exception. This change would appear to be helpful to certain securitization vehicles, entities investing in real estate securities, and certain bank collective investment vehicles that, in our experience, may rely principally on exceptions from the definition of investment company found in Sections 3(c)(5)(C) and 3(c)(11), respectively, in the Investment Company Act, but also qualify for the 3(c)(1) and 3(c)(7) exceptions.

A number of commenters on proposed Rule 203(m)-1 inquired whether a single-investor fund could qualify as a private fund for purposes of the Rule. The SEC's answer is that such a determination is inherently factual, and that treating a single-investor fund as a private fund could enable an adviser to convert a client account into a single-investor fund in seeking to avoid registering under the Advisers Act. The SEC acknowledged, however, that some single-investor funds could be treated as private funds for purposes of the Rule (*e.g.*, a fund that seeks to raise capital from multiple investors but has only a single, initial investor for a period of time, or a fund in which all but one of the investors has redeemed its interest), but cautioned that a single-investor fund that serves no purpose other than the circumvention of the Advisers Act will not be respected by the SEC as a private fund. We also note that private fund advisers must make a notice filing consisting of certain sections of Form ADV Part 1, including Item 7 of Schedule D which requires, among other things, an adviser to provide information about the number of beneficial owners of private funds advised by the adviser.

Under Rule 203(m)-1 as adopted, a private fund adviser needs to determine its assets under management for purposes of the Rule in accordance with the definition of "regulatory assets under management" contained in amended Form ADV. The calculation of assets under management for this purpose is discussed below.

New Rule 203(m)-1 becomes effective on July 21, 2011.

### **Exempt Reporting Advisers**

The Rule 203(m)-1 exemption is far from a free pass from SEC oversight. Any adviser that qualifies for the exemption will be exempt from the comprehensive regulation and reporting requirements of the Advisers Act, but will remain subject, pursuant to new Rule 204-4 under the Advisers Act, to certain reporting requirements as an "exempt reporting adviser." Rule 204-4 is substantially similar to the rule as proposed, and requires generally that an exempt reporting adviser complete certain items in Part 1 of Form ADV and publicly file the ADV with the SEC (an exempt reporting adviser will not, however, be required to complete or to file a Part 2 to its Form ADV).

An exempt reporting adviser will be required to report basic identifying information about its owners and affiliates, business activities that may present conflicts of interest, information about the relevant Advisers Act exemption on which it is relying, private funds it manages, and disciplinary information regarding itself and its employees. An exempt reporting adviser is required to file an initial Form ADV with the SEC between January 1, 2012 and March 30, 2012; amendments and updates to the Form ADV will be required consistent with the requirements for registered investment advisers (*i.e.*, information must be updated at least annually, and other more frequent updates may be required to reflect certain changes to the adviser's business).

Rule 204-4 as adopted by the SEC requires that an adviser determine assets under management annually and not quarterly as originally proposed by the SEC. Thus, if a private fund adviser reports as part of its annual Form ADV amendment that it has \$150 million or more of private fund assets under management, the adviser would no longer be eligible for the private fund adviser exemption and would have to register under the Advisers Act, unless the adviser qualified for a different exemption. An adviser that fails to qualify for the private fund adviser exemption by exceeding the \$150 million threshold effectively will have up to 180 days to register with the SEC: the adviser must file an annual Form ADV amendment 90 days after the end of its fiscal year, and if its assets exceed \$150 million, it may rely on a 90-day transition period to register with the SEC.

Rule 204-4 becomes effective 60 days after being published in the Federal Register.

### **Foreign Private Advisers**

As noted earlier, the Dodd-Frank Act eliminated the “private adviser” exemption in Section 203(b)(3) effective July 21, 2011, and replaced that exemption with the “foreign private adviser” exemption. New Rule 202(a)(30)-1 under the Advisers Act implements the foreign private adviser exemption and defines certain terms in connection with the exemption. Section 202(a)(30) defines a “foreign private fund adviser” as an investment adviser that (1) has no place of business in the United States; (2) has fewer than 15 clients and investors in the United States in private funds advised by the investment adviser; (3) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than \$25 million; and (4) does not hold itself out generally to the public in the United States as an investment adviser.<sup>6</sup>

Rule 202(a)(30)-2 generally retains most of the safe harbors set out in Rule 203(b)3-1 under the Advisers Act as in effect prior to the passage of the Dodd-Frank Act that advisers have traditionally relied upon when determining the number of clients they advise for purposes of the rescinded private adviser exemption. An adviser can, for example, under Rule 202(a)(30)-2, treat a limited partnership as a single client if its advice is based on the investment objectives of the partnership and not those of individual limited partners. In addition, the definition of “investor” in Rule 202(a)(30)-2 incorporates the counting methods and look-through rules required by Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. Also, in determining the number of “clients” for purposes of Rule 202(a)(30)-2, a foreign adviser is not required to

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<sup>6</sup> The exemption under Section 202(a)(30) is also not available to an adviser that “acts as (i) an investment adviser to any investment company registered under the [Investment Company Act]; or (ii) a company that has elected to be a business development company pursuant to section 54 of [that Act], and has not withdrawn its election.” In addition, the SEC noted specifically in the Exemptions Release that although subparagraph (B) of Section 202(a)(30) refers to the number of “clients and investors in the United States in private funds,” whereas subparagraph (C) refers to the assets of “clients *in the United States* and investors in the United States in private funds” (emphasis added), it will interpret these provisions consistently so that only clients *in the United States* and investors in the United States should be included for purposes of determining eligibility for the exemption under subparagraph (B).

“double count” private funds and investors in those funds. Specifically, an adviser is not required to count a private fund as a client if the adviser counted any investor in the private fund as an investor in that private fund for purposes of determining the availability of the exemption provided by the Rule, and the adviser is not required to count a person as an investor if the adviser counts the person as a client of the adviser.

Rule 202(a)(30)-2 defines a “place of business” as an office where the adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients, and any other location that the adviser holds out to the general public as a location where the adviser conducts such activities. The SEC said in the release adopting the Rule that a place of business would not include an office in the United States “where a non-U.S. adviser solely conducts research, communicates with non-U.S. clients, or performs administrative services and back-office books and recordkeeping activities,” unless such office is intrinsic to the provision of investment advisory services.<sup>7</sup>

In adopting Rule 202(a)(30)-2, the SEC eliminated “knowledgeable employees” from the definition of “investor,” thus narrowing the definition of “investor” and enabling a foreign private adviser to not count knowledgeable employees toward the 14-U.S. client and investor limits. This change reflects the SEC’s view that “knowledgeable employees” of a private fund do not need the protections of the Investment Company Act and the agency’s recognition of the potential complexities of treating such persons differently for Advisers Act and Investment Company Act purposes.

Unlike a non-U.S. adviser relying on the private fund adviser exemption in Rule 203(m)-1, a non-U.S. adviser relying on the foreign private adviser exemption is not subject to the exempt reporting adviser requirements on Form ADV. A non-U.S. adviser relying on the foreign private adviser exemption, however, is not permitted a transition period in which to register with the SEC should it fail to comply with the exemption.

Rule 202(a)(30)-1 becomes effective on July 21, 2011.

### **Investment Adviser Affiliates**

When adopting the Advisers Act rules implementing the provisions of the Dodd-Frank Act, the SEC responded to inquiries it has received over time regarding the Advisers Act registration obligations of affiliated entities. In particular, the SEC said that it would treat advisory affiliates as separate entities for purposes of determining the registration obligations of these entities and that a relationship in which affiliates appeared to be operationally integrated could require one or both entities to register under the Advisers Act. In response to industry concerns that such an approach, following the elimination of the private adviser exemption in Section 203(b)(3) of the Advisers Act as written prior to the enactment of the Dodd-Frank Act, could undermine longstanding SEC interpretive positions relevant to U.S. registered advisers with foreign

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<sup>7</sup> See Exemptions Release at 121.

advisory affiliates, the SEC reaffirmed prior guidance set out in a long line of staff interpretive positions.<sup>8</sup> Under that guidance, a non-U.S. affiliate of a registered investment adviser is not required to separately register with the SEC if it advises solely non-U.S. clients or otherwise operates in a manner consistent with the structure and compliance procedures set out in the staff positions. The SEC also noted that it anticipates that the SEC staff will provide guidance, as appropriate, “based on facts that may be presented to the staff regarding the application of the [staff’s prior guidance] in the context of the new foreign private adviser exemption as well as the private fund adviser exemption.”<sup>9</sup>

The SEC did not provide clear guidance with respect to an approach supported by the industry under which multiple, affiliated advisory entities could file a single registration on Form ADV. The merits of such an approach, including reductions on duplicative information for investors to review and in costs to advisers in preparing multiple registrations, were contained in a number of comment letters on the SEC’s November 2010 rule proposals. The SEC acknowledged the benefits of the approach in adopting the new Advisers Act rules, but stopped short of providing definitive guidance on the issue.

### **Reporting and Registration Provisions**

The SEC, in addition to finalizing the rules described above, adopted new reporting requirements to Form ADV for all registered investment advisers. The SEC also amended existing, and adopted new, registration requirements, including requirements for a new “mid-sized” adviser, new Form ADV amendment requirements and changes to the calculation of an adviser’s assets under management. We discuss below certain important aspects of these requirements.

*New Reporting Requirements.* The information that will now need to be disclosed in Form ADV falls into three categories: additional information about an adviser’s private funds; information about an adviser’s advisory business and practices that could raise material conflicts of interest; and additional information about an adviser’s non-advisory activities and its financial industry affiliations.

The most significant of the new information to be reported relates to the private funds advised by an adviser in Question 7.B on Part 1 of Form ADV and the corresponding sections of Schedule D (click [here](#) for a link to the relevant pages of Form ADV Part 1 and Schedule D). Under the new rules, an adviser must provide information about, among other things: (1) the organization of the private fund; (2) any other advisers to the private fund; (3) the private fund’s

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<sup>8</sup> See, e.g., ABA Subcommittee on Private Investment Entities, SEC No-Action Letter (Dec. 8, 2005); Royal Bank of Canada, Staff No-Action Letter (Jun. 3, 1998); ABN AMRO Bank, N.V., SEC No-Action Letter (Jul. 7, 1997); Murray Johnstone Holdings Limited, Staff No-Action Letter (Oct. 7, 1994); Kleinwort Benson Investment Management Limited, SEC No-Action Letter (Dec. 15, 1993); Mercury Asset Management plc, SEC No-Action Letter (Apr. 16, 1993); and Unia de Bancos de Brasileiros S.A., SEC No-Action Letter (Jul. 28, 1992).

<sup>9</sup> See Exemptions Release at 128.

gross assets; (4) the private fund's investment strategy (based on an enumerated list of potential categories); and (5) the private fund's auditors, prime brokers, custodians, and administrators. In response to numerous comments on its November 2010 proposals, the SEC, however, chose not to require: (1) the reporting of a private fund's net assets (in favor of a gross assets approach); (2) information about a private fund's assets and liabilities organized by class and categorization in the fair value hierarchy established under Generally Accepted Accounting Principles; and (3) information about the specific percentage of a private fund owned by particular types of beneficial owners.

Also of note is the SEC's amendment of Rule 204-2 under the Advisers Act regarding performance recordkeeping. The amended Rule provides that an adviser that is currently exempt from registration under the pre-Dodd-Frank Act private adviser exemption in Section 203(b)(3), but required to register after the exemption is eliminated on July 21, 2011, is not obligated to keep certain performance-related records for any period when it was not registered with the SEC. To the extent that such an adviser preserved these performance-related records even though not required to keep them, it must continue to preserve them.

*Mid-sized Adviser.* Section 203A of the Advisers Act generally prohibits an investment adviser regulated by the state in which it maintains its principal office and place of business from registering with the SEC unless the adviser has at least \$25 million in assets under management, and preempts certain state laws that would otherwise regulate advisers registered with the SEC. The Dodd-Frank Act created a new category of "mid-sized adviser" — one with assets under management between \$25 million and \$100 million — and raised the threshold for Advisers Act registration to \$100 million. The SEC amended a number of rules to address this new category of adviser.

A mid-sized adviser will be prohibited from registering with the SEC if the adviser is required to be registered in the state in which it maintains its principal office and place of business, and, if registered, is subject to examination in that state. A mid-sized adviser will be required to register with the SEC, however, if the adviser is not regulated or required to be regulated as an investment adviser by its state's securities commissioner or if the adviser is not subject to examination by the state's securities commissioner.<sup>10</sup> Wyoming does not currently register investment advisers, and the SEC indicated that at the present time New York and Minnesota do not have an adviser examination program.<sup>11</sup> A mid-size adviser in those states will need to register with the SEC and continue to be subject to SEC regulation. Amended Rule 203A-1 under the Advisers Act provides a buffer for mid-sized advisers with assets under management close to \$100 million to determine whether and when to switch between state and SEC registration; a mid-sized adviser with assets under management of more than \$100 million but less than \$110 million is not required to register with the SEC, and an SEC-registered adviser is

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<sup>10</sup> The SEC in the Implementing Release also explained that a mid-sized adviser is required to register with the SEC if it is "an adviser to a registered investment company or business development company under the Investment Company Act." Furthermore, a mid-sized adviser may opt out of state registration and register with the SEC if the adviser is required to register in 15 or more states. See Implementing Release at n.22.

<sup>11</sup> *Id.*

not required to withdraw its registration until it has less than \$90 million of assets under management.

*Amendments to Form ADV.* The SEC will now require each investment adviser registered on January 1, 2012, regardless of size, to file an amendment to its Form ADV no later than March 30, 2012 that, among other things, confirms that the adviser remains eligible for SEC registration. A registered adviser's annual amendment to Form ADV must also indicate the basis for its SEC registration. An exempt reporting adviser, as part of its annual amendment to Form ADV, must also confirm that it remains eligible for the registration exemption on which it is relying.

*Regulatory Assets Under Management.* In finalizing the rules implementing the Dodd-Frank Act investment advisers provisions, the SEC adopted revisions to the Form ADV instructions to create a uniform standard for advisers to calculate their assets under management that will be used both for regulatory purposes under the Advisers Act and in determining eligibility for one or more Advisers Act registration exemptions. Most significantly, the revisions create a new term, "regulatory assets under management," to replace "assets under management" used in Part 1 of Form ADV. An investment adviser's regulatory assets under management are to be calculated on a gross basis, are to be valued at market value, or fair value if market value is unavailable, and are required to include (1) the value of any securities portfolios (*i.e.*, any portfolio at least 50% of the total value of which consists of securities) or any private fund for which the adviser provides continuous and regular supervisory or management services, regardless of the nature of the assets held by the private fund; (2) the adviser's proprietary assets, assets managed by the adviser for which no compensation is received, and assets of foreign clients; and (3) the amount of any uncalled capital commitments made to a private fund.

Of note is the SEC's explicit inclusion of an adviser's proprietary assets in "regulatory assets under management." A number of commenters to the SEC's November rule proposals opposed this approach, arguing that the approach would render irrelevant SEC staff interpretations establishing the principle that an entity that provides advice solely to its affiliates with whom it shares a common parent is not an investment adviser within the meaning of the Advisers Act, as the adviser in such a case is effectively advising itself and does not meet the element of the Advisers Act's definition of investment adviser that the adviser renders advice to "others." The SEC acknowledged this argument in adopting the new rules, saying that whether an investment adviser engages in the business of advising others will depend on the particular facts and circumstances and that the "calculation of regulatory assets under management, including the mandatory or optional inclusion of specified assets in that calculation, is applicable *after* the entity is determined to be an investment adviser."<sup>12</sup>

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<sup>12</sup> See Exemptions Release at n.343.

The effective date for the rules regarding reporting and registration is generally 60 days after their publication in the Federal Register; Rule 203A-5(a) (regarding certain transition rules for mid-sized advisers) and Rule 203-1 (regarding the delay in the effective date for registration of advisers relying on the private adviser exemption in the pre-Dodd-Frank Act Section 203(b)(3)) are effective July 21, 2011.

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