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To Our Investment Adviser Clients and Other Friends:

We are pleased to inform you that the California Commissioner of Corporations (the "Commissioner") adopted a new exemption (the "Exemption") from the investment adviser certification requirements for California investment advisers. The Exemption became effective on March 27, 2002, and appears in section 260.204.9 of the California Code of Regulations. For several years our firm was actively involved in promoting the adoption of the Exemption. Some of the main requirements of the Exemption are summarized below.

Before the Commissioner adopted the Exemption, an investment adviser conducting business in California and not registered as such with the Securities and Exchange Commission (the "SEC") was required to obtain a certificate (a "Certificate") from the Commissioner. An investment adviser that had fewer than fifteen clients (counting a hedge fund or other investment pool as one client) and had assets under management exceeding $25,000,000 could rely on the federal private adviser exemption to avoid registering with the SEC, but California law provided no similar exemption. The Exemption will now allow an investment adviser to conduct business in California without a Certificate and without being registered with the SEC, if the adviser:

(1) Does not hold itself out generally to the public as an investment adviser;

(2) Has fewer than fifteen "clients" (as defined by SEC rule under the Federal Investment Advisers Act of 1940, as amended (the "Advisers Act"), discussed in our memorandum entitled *Survey of Legal Issues for Investment Advisers*, a copy of which is posted on our web site, www.sfglaw.com);

(3) Is exempt from registering with the SEC as an investment adviser pursuant to the federal private adviser exemption (the adviser does not hold itself out to the public as an investment adviser, had fewer than fifteen clients in the prior twelve months, and does not act as an investment adviser to a registered investment company (mutual fund) or a business development company); and

(4) Either (a) has assets under management of $25,000,000 or more, or (b) provides investment advice only to venture capital companies.

The first two requirements of the Exemption are similar to the federal private adviser exemption. The fourth requirement limits the Exemption to larger advisory firms and venture capital firms. An investment adviser's assets under management include the securities for which it and its affiliates provide continuous and regular supervisory management and services. The definition of a venture capital company is complex and you should consult counsel if it is relevant to your business.

Before surrendering its Certificate or withdrawing its SEC investment adviser registration without obtaining a Certificate, an investment adviser should consider the following:

- An adviser that has previously held itself out to the public as an investment adviser may not be entitled to rely on the Exemption, because it may not be able to establish that it does not hold itself out to the public as an investment adviser.

- As soon as the assets under management of an uncertificated adviser that relies on the $25,000,000 assets under management condition of the Exemption drop below $25,000,000, the adviser must immediately cease doing business until it obtains a Certificate (which typically takes one to three months) or it registers with the SEC. An uncertificated adviser relying on this condition of the Exemption will need to monitor its assets under management closely and be prepared to take the necessary steps if its assets under management approach the $25,000,000 threshold.

- Section 16 of the Securities Exchange Act of 1934, as amended (the "1934 Act"), requires that a person who beneficially owns more than ten percent of the outstanding securities of a particular class file monthly reports disclosing its transactions in those securities, and disgorge deemed profits from purchases and sales of any of those securities within six months. Shares held by a registered investment adviser for the benefit of third persons or in a customer or fiduciary account in the ordinary course of business, without the purpose or effect of influencing the control of the issuer, are excluded from the calculation of that investment adviser's beneficial ownership. An adviser that surrenders its Certificate would not be eligible for that exclusion, and may, therefore, be subject to the reporting requirements and liability provisions of section 16.[1]

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[1] For example, assume an investment adviser has four accounts: a domestic hedge fund organized as a limited partnership, an offshore hedge fund organized as a corporation and managed by the adviser as a separate account, and two separately managed accounts for university endowments. Each account beneficially owns three percent of the outstanding shares of a class of an issuer. If the adviser holds a Certificate and otherwise complies with the section 16 exclusion, all of the shares held for the accounts of the offshore funds and separately managed accounts would be excluded from the calculation of the adviser's beneficial ownership under section 16, and the adviser would not be subject to the reporting requirements or liability provisions of section 16. If the adviser surrenders its Certificate (and is not SEC-registered), it is

- An adviser that surrenders its Certificate, that has or acquires beneficial ownership of more than five percent of any class of securities and is otherwise eligible to file the reports required by 1934 Act section 13(d) on Schedule 13G may be required to file such reports sooner after exceeding the five percent threshold and to amend such reports more frequently than if the adviser maintains its Certificate. Additionally, an adviser that surrenders its Certificate will not be eligible to file such reports on Schedule 13G, and must file reports on Schedule 13D, if the adviser's beneficial ownership exceeds twenty percent of the securities of a class.

- An adviser that surrenders its Certificate must promptly notify its clients and other investors and revise any disclosure documents stating that the adviser holds a Certificate. Prior to the surrender, such an adviser must amend any investment management agreement in which the adviser has represented that it holds a Certificate. Such an adviser should consider notifying its clients before surrendering its Certificate so that the clients have the opportunity to end their relationship with the adviser before the surrender becomes effective.

- All investment advisers, even those exempt from federal and state registration, are subject to the anti-fraud provisions of federal and state law. Therefore, an adviser that surrenders its Certificate must continue to comply with federal and state laws and regulations regarding insider trading, client trading, employee security transactions, client privacy, advertising and other matters.

Please contact us if you need advice regarding the Exemption or assistance surrendering your Certificate. If you have any questions, please contact Douglas Hammer, John Broadhurst, Carolyn Klasco, Christopher Rupright, Carolyn Reiser, John Milani, Monique Alonso, Joan Grant, Ellyn Roberts, Neil Koren, Anthony Caldwell, Latisha Brown or James Frolik.

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no longer eligible for the exclusion. Accordingly, it would be deemed to own beneficially twelve percent of the securities of that class and would be subject to section 16.