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Douglas J. Scheidt, Esq.
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0506

Advisers Act/206(3)

Re: Investment Advisers Act of 1940, as amended, Section 206(3)

Dear Mr. Scheidt,

We respectfully request that the Division of Investment Management advise us that it will not recommend enforcement action if Gardner Russo & Gardner crosses trades among accounts that it manages in the manner described below.

I. Facts

Gardner Russo & Gardner ("GRG") is registered as an investment adviser with the U.S. Securities and Exchange Commission (the "Commission") and, pursuant to discretionary investment management agreements, acts as investment manager to various client accounts (the "Accounts"), including two private investment funds, Semper Vic Partners, L.P. ("Semper Vic") and Semper Vic Partners (QP), L.P. ("Semper Vic QP", and collectively with Semper Vic, the "Funds"). A partner and portfolio manager of GRG (the "Partner") is the general partner of each Fund. The Partner has a 6.237% ownership interest in Semper Vic and a 1.4405% ownership interest in Semper Vic QP to further align his interests with the Funds' investors. Due to the timing of capital inflows and outflows into and out of Accounts, GRG from time to time finds that it is disposing of a particular security for one Account that it is attempting to acquire for another. GRG believes that it is often beneficial for all clients affected to be able to cross such trades to reduce transaction costs and to minimize the impact to the market for those securities. GRG would like to effect trades (the "Transactions") between Accounts, including the Funds, without obtaining the consent of its clients and of each of the Funds (i.e. either each investor in each Fund or a representative of the investors) prior to each Transaction. GRG will not receive additional compensation for effecting the Transactions.

II. Issue

Is a registered investment adviser required to treat a trade between a client account and an account for which the adviser acts as the discretionary manager and in which a partner and portfolio manager of the adviser has an ownership interest (including as a general partner of the account) as a principal trade under Section 206(3) of the Investment Advisers Act of 1940, as amended (the "Advisers Act")?

III. Legal Analysis

Section 206(3) of the Advisers Act specifically prohibits an adviser "acting as principal for his own account, knowingly to sell any security to or purchase any security from a client...without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction." Section 206(3) imposes a prior disclosure and consent requirement on any adviser that acts as principal in a transaction with a client. Principal transactions pose the potential for conflicts between the interests of the adviser and the client and create the potential for advisers to engage in self-dealing.[1]

The Commission has addressed this recently in Gintel Asset Management Inc., Investment Advisers Act Release No. 2079, 2002 WL 31499839 (November 8, 2002). In that administrative action, Robert Gintel owned a majority of the investment adviser and 34% of a fund that engaged in transactions with Mr. Gintel's other clients. The Commission stated that the transactions in question were principal transactions specifically because Gintel "held a substantial ownership stake" in the adviser and the fund.[2] The Commission concluded that the adviser had violated Section 206(3) of the Advisers Act because it had never given advance notice nor obtained consent from clients involved in the transactions and "Gintel owned over 30 percent" of the Fund.

Having investment discretion over an account either through an investment management agreement or through the holding of a general partnership interest is not a "substantial ownership stake" and should not give rise to characterizing an account as a principal account. We believe that without the partner, the portfolio manager or adviser having a "substantial ownership stake" in the economics of an account, the conflicts and opportunity for self-dealing that gave rise to Section 206(3) do not exist. Further, treating the transaction as a principal transaction would hamper the fair treatment of the account by requiring burdensome consent procedures to be in place, which might result in the account being unable to participate in certain advantageous cross trading opportunities due to difficulties in obtaining such consents in a timely fashion.

While the Commission has not articulated exactly what percentage ownership interest in an account is a "substantial ownership stake" resulting in a principal transaction, the Commission's articulation of "over a 30 percent" interest in an account as a "substantial ownership stake" in Gintel would suggest that a "control" position by the adviser is necessary for the transaction to be deemed a principal transaction.[3]

Both Section 2(a)(9) of the Investment Company Act of 1940, as amended (the "Company Act") and Section 202(a)(12) of the Advisers Act define control as "the power to exercise a controlling influence over the management or policies of a company..." "Section 2(a)(9) of the Company Act creates a presumption of control if a person owns 25% or more of a company's voting securities."[4] The Advisers Act does not contain a corresponding provision. However, an analogy can be made with respect to the "assignment of investment advisory contracts." Section 202(a)(1) of the Advisers Act states that an assignment has occurred if there is a transfer of a controlling block of the assignor's outstanding voting securities. The Commission has repeatedly found that there was no change of control/assignment where less than 25% of an assignor's outstanding voting securities were acquired either directly or indirectly by any one person.[5] This would seem to indicate that the adviser (and its principals) would need to own at

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[1] See Investment Advisers Act Release No.1732, 1998 SEC Lexis 1483 (July 17, 1998).
[2] See Gintel Asset Management, Inc., Investment Advisers Act Release No. 2079, 2002 WL 31499839 (November 8, 2002).
[3] See Lemke, Thomas P. and Lins, Gerald T., Regulation of Investment Advisers (Thomson West 2004), at 2:90 and 2:91 (articulating a "control" test for an account to be considered a principal account citing Gintel).
[4] See Dean Witter, Discover & Co.1993 SEC No-Action Letter, Lexis 225 (February 8, 1993).
[5] See Central Corporate Report Services, Inc. 1981 SEC No-Action Letter, Lexis 3217 (March 9, 1981); See Zurich Insurance Company, Scudder Kemper Investments, Inc. 1998 SEC No-Action Letter, Lexis 811 (August 31, 1998).

least 25% of an account in order for the adviser to control such account, and for transactions involving the account to be deemed principal transactions.

The Commission found in Strong/Corneliuson Capital Management, Inc., Investment Advisers Act Release No. 1425, 1994 SEC Lexis 2100 (July 12, 1994), that the respondents violated section 206(1) and (2) of the Advisers Act because they effected trades between an offshore fund in which they had a significant ownership interest (between 18 and 25%) and other advisory clients to which they provided investment advice. The Commission found that the respondents violated sections 206(1) and (2) because and they failed to disclose in Item 9, Part II of their Form ADV that, they had a significant interest in the offshore fund.[6] Notably, the Commission did not allege violations of Section 206(3) for these holdings.

IV. Conclusion

Provided that appropriate disclosure is made in the Part II of its Form ADV and to clients, GRG believes that the Transactions do not require client consent under Section 206(3) of the Advisers Act merely because the Partner is the general partner of each Fund and holds an insignificant interest in such Funds. A general partner without a substantial economic stake in a partnership is no different than an adviser effecting transactions on behalf of its clients in separate account subject to an investment management agreement that grants the adviser investment discretion. We believe that in order for the Transactions to require client consent, GRG (together with the Partner and any other affiliates) must own 25% or more of an account that is engaging in a trade with another Account.

We respectfully request that the Commission confirm that it will not recommend enforcement action if GRG effects the Transactions among the Accounts, including the Funds, without obtaining the prior consent of affected clients assuming the facts provided in this letter or otherwise complying with Section 206(3) of the Advisers Act. If you have any questions, please do not hesitate to call us at (717)299-1385.

Sincerely,

Anne D. Gardner

Anne D. Gardner
Chief Compliance Officer

Thomas A. Russo
Partner and Portfolio Manager

[6] See Strong/Corneliuson Capital Management, Inc., Investment Advisers Act Release No. 1425.