

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 27669; 812-13308]

American Capital Strategies, Ltd.; Notice of Application

January 19, 2007

Agency: Securities and Exchange Commission (the "Commission").

Action: Notice of an application for an order under section 61(a)(3)(B) of the Investment Company Act of 1940 (the "Act").

Summary of Application: Applicant, American Capital Strategies, Ltd., requests an order approving a proposal to grant certain stock options to directors who are not also employees or officers of the applicant (the "Non-employee Directors") under its 2006 Stock Option Plan (the "Plan").

Filing Dates: The application was filed on June 2, 2006 and amended on January 19, 2007.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicant with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on February 15, 2007, and should be accompanied by proof of service on applicant, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicant, 2 Bethesda Metro Center, 14<sup>th</sup> Floor, Bethesda, Maryland, 20814.

For Further Information Contact: Laura J. Riegel, Senior Counsel, at (202) 551-6873, or Nadya B. Roytblat, Assistant Director, at (202) 551-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a summary of the application. The complete application is available for a fee at the Public Reference Desk, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-0102 (telephone 202-551-5850).

Applicant's Representations:

1. Applicant, a Delaware corporation, is a business development company ("BDC") within the meaning of section 2(a)(48) of the Act.<sup>1</sup> Applicant's primary business objectives are to increase its net operating income and net asset value by investing its assets in senior debt, subordinated debt, with and without detachable warrants, and equity of small to medium sized businesses with attractive current yields and potential for equity appreciation. Applicant's investment decisions are either made by its board of directors (the "Board"), based on recommendations of an investment committee comprised of senior officers of applicant, or, for investments that meet certain objective criteria established by the Board, by the executive officers of applicant, under authority delegated by the Board. Applicant does not have an external investment adviser within the meaning of section 2(a)(20) of the Act.

2. Applicant requests an order under section 61(a)(3)(B) of the Act approving its proposal to grant certain stock options under the Plan to its Non-employee Directors.<sup>2</sup> Applicant has a nine member Board. Six of the seven current members of the Board are not “interested persons” (as defined in section 2(a)(19) of the Act) of the applicant (“Disinterested Directors”).<sup>3</sup> The Board approved the Plan at a meeting held on March 23, 2006 and amended the Plan at meetings held on April 6, 2006 and December 7, 2006. Applicant’s stockholders approved the Plan at the annual meeting of stockholders held on May 11, 2006.

3. Applicant’s officers and employees, and Non-employee Directors are eligible to receive options under the Plan. Under the Plan, a maximum of 320,000 shares of applicant’s common stock, in the aggregate, may be issued to Non-employee Directors and 40,000 shares of applicant’s common stock may be issued to any one Non-employee Director. Each of the six Non-employee Directors serving on the Board as of May 11, 2006 will be granted options to purchase 40,000 shares of applicant’s common stock (the “Initial Grants”) on the date that the Commission issues an order on the application (“Order Date”). The options issued under the Initial Grants will vest in three equal parts on each of the first three anniversaries of May 11, 2006. Any person who becomes a Non-employee Director after May 11, 2006 will be entitled to receive options to purchase 40,000 shares of applicant’s common stock (the “Other Grants”) on the later of the date

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<sup>1</sup> Section 2(a)(48) defines a BDC to be any closed-end investment company that operates for the purpose of making investments in securities described in sections 55(a)(1) through 55(a)(3) of the Act and makes available significant managerial assistance with respect to the issuers of such securities.

<sup>2</sup> The Non-employee Directors receive a \$75,000 per year retainer payment and \$2,500 for each Board or committee meeting attended, and reimbursement for related expenses. Additionally, under the terms of a disinterested director retention plan that applicant established in 2006, Non-employee Directors are generally entitled to receive a payment upon termination of service as a director equal to a multiple of the number of years of service as a Non-employee Director and the retainer payment then in effect.

such person becomes a Non-employee Director and the Order Date. The options issued under the Other Grants will vest in three equal parts on each of the first three anniversaries of the date such person becomes a Non-employee Director.

4. Under the terms of the Plan, the exercise price of an option will not be less than 100% of the current market value of, or if no such market value exists, the current net asset value per share of, applicant's common stock on the date of the issuance of the option.<sup>4</sup> Options granted under the Plan will expire ten years from the date of grant and may not be assigned or transferred other than by will or the laws of descent and distribution. In the event of the death or disability of a Non-employee Director during such director's service, all such director's unexercised options will immediately become exercisable and may be exercised for a period of three years following the date of death (by such director's personal representative) or one year following the date of disability, but in no event after the respective expiration dates of such options. In the event of the termination of a Non-employee Director for cause, any unexercised options will terminate immediately. If a Non-employee Director's service is terminated for any reason other than by death, disability, or for cause, the options may be exercised within one year immediately following the date of termination, but in no event later than the expiration date of such options.

5. Applicant's officers and employees are eligible or have been eligible to receive options under applicant's six other stock option plans under which Non-employee Directors are not entitled to participate (the "Employee Plans"). The remaining

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<sup>3</sup> The Board presently has two vacancies. All of the Non-employee Directors are Disinterested Directors.

<sup>4</sup> Under the Plan, "current market value" (defined as "fair market value") is generally the closing sales price of applicant's shares as quoted on the Nasdaq Stock Market, or alternatively, on the exchange where applicant's shares are traded, on the day the option is granted.

16,990,212 shares of applicant's common stock subject to issuance to officers and employees under the Employee Plans and the Plan represent 11.5% of the 147,613,188 shares of applicant's common stock outstanding as of December 31, 2006. Non-employee Directors are eligible or have been eligible to participate in applicant's Disinterested Director stock option plans (together with the Employee Plans, the "Other Plans") under which 225,000 shares of applicant's common stock remain for issuance, representing 0.2% of shares of applicant's common stock outstanding as of December 31, 2006. The 320,000 shares of applicant's common stock that may be issued to Non-employee Directors under the Plan represent 0.2% of shares of applicant's common stock outstanding as of December 31, 2006. Therefore, the maximum number of applicant's voting securities that would result from the exercise of all outstanding options issued and all options issuable to directors, officers, and employees under the Other Plans and the Plan would be 17,535, 212 shares of applicant's common stock, or approximately 11.9 % of shares of applicant's common stock outstanding as of December 31, 2006. Applicant has no outstanding warrants, options, or rights to purchase its voting securities, other than the options granted or to be granted to its directors, officers, and employees under the Other Plans and the Plan.

Applicant's Legal Analysis:

1. Section 63(3) of the Act permits a BDC to sell its common stock at a price below current net asset value upon the exercise of any option issued in accordance with section 61(a)(3). Section 61(a)(3)(B) provides, in pertinent part, that a BDC may issue to its non-employee directors options to purchase its voting securities pursuant to an executive compensation plan, provided that: (a) the options expire by their terms within

ten years; (b) the exercise price of the options is not less than the current market value of the underlying securities at the date of the issuance of the options, or if no market exists, the current net asset value of the voting securities; (c) the proposal to issue the options is authorized by the BDC's shareholders, and is approved by order of the Commission upon application; (d) the options are not transferable except for disposition by gift, will or intestacy; (e) no investment adviser of the BDC receives any compensation described in section 205(a)(1) of the Investment Advisers Act of 1940, except to the extent permitted by clause (b)(1) or (b)(2) of that section; and (f) the BDC does not have a profit-sharing plan as described in section 57(n) of the Act.

2. In addition, section 61(a)(3) provides that the amount of the BDC's voting securities that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance may not exceed 25% of the BDC's outstanding voting securities, except that if the amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights issued to the BDC's directors, officers, and employees pursuant to an executive compensation plan would exceed 15% of the BDC's outstanding voting securities, then the total amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance will not exceed 20% of the outstanding voting securities of the BDC.

3. Applicant represents that its proposal to grant certain stock options to Non-employee Directors under the Plan meets all the requirements of section 61(a)(3)(B). Applicant states that the Board is actively involved in the oversight of applicant's affairs and that it relies extensively on the judgment and experience of its Board. In addition to their duties as Board members generally, applicant states that the Non-employee

Directors provide guidance and advice on operational issues, underwriting policies, credit policies, asset valuation and strategic direction, as well as serving on committees.

Applicant believes that the availability of options under the Plan will provide significant at-risk incentives to Non-employee Directors to remain on the Board and devote their best efforts to ensure applicant's success. Applicant states that the options will provide a means for the Non-employee Directors to increase their ownership interests in applicant, thereby ensuring close identification of their interests with those of applicant and its stockholders. Applicant asserts that by providing incentives such as options, applicant will be better able to maintain continuity in the Board's membership and to attract and retain the highly experienced, successful and dedicated business and professional people who are critical to applicant's success as a BDC.

4. Applicant states that the maximum amount of voting securities that would result from the exercise of all outstanding options issued to the directors, officers, and employees under the Other Plans and the Plan would be 14,258,728 shares of applicant's common stock, or approximately 9.7% of applicant's shares of common stock outstanding as of December 31, 2006, which is below the percentage limitations in the Act. Applicant asserts that, given the relatively small amount of common stock issuable to Non-employee Directors upon their exercise of options under the Plan, the exercise of

such options would not, absent extraordinary circumstances, have a substantial dilutive effect on the net asset value of applicant's common stock.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Florence E. Harmon  
Deputy Secretary