

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 28176; 812-13348]

Patriot Capital Funding, Inc.; Notice of Application

February 28, 2008

Agency: Securities and Exchange Commission (“Commission”).

Action: Notice of an application for an order under section 6(c) of the Investment Company Act of 1940 (the “Act”) for an exemption from sections 23(a), 23(b) and 63 of the Act, and under sections 57(a)(4) and 57(i) of the Act and rule 17d-1 under the Act permitting certain joint transactions otherwise prohibited by section 57(a)(4) of the Act.

Summary of the Application: Patriot Capital Funding, Inc. (“Applicant”) requests an order to permit Applicant to issue restricted shares of its common stock under the terms of its employee compensation plan.

Filing Dates: The application was filed on November 29, 2006, and amended on February 15, 2008. Applicant has agreed to file an amendment during the notice period, the substance of which is reflected in the notice.

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 March 24, 2008, 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 Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicant, c/o Richard P. Buckanavage, President and Chief Executive Officer, Patriot Capital Funding, Inc., 274 Riverside Avenue, Westport, CT 06880.

For Further Information Contact: Shannon Conaty, Senior Counsel, at (202) 551-6827, or Janet M. Grossnickle, Branch Chief, 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 may be obtained for a fee at the Commission's Public Reference Desk, 100 F Street, NE, Washington, DC 20549-1520 (tel. 202-551-5850).

Applicant's Representations:

1. Applicant, a Delaware corporation, is an internally managed, non-diversified, closed-end investment company that has elected to be regulated as a business development company ("BDC") under the Act.<sup>1</sup> Applicant is a specialty finance company that provides customized financing solutions to small- and medium-sized companies. Applicant's investments are primarily senior secured commercial loans, subordinated debt instruments and junior secured term loans. Shares of Applicant's common stock are traded on The NASDAQ Stock Market, Inc. Global Select Market

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<sup>1</sup> Applicant was organized on November 4, 2002. When Applicant commenced business operations in 2003, its business was conducted through two separate entities, Patriot Capital Funding, Inc. and Wilton Funding, LLC. On July 27, 2005, Wilton Funding, LLC merged with and into Patriot Capital Funding, Inc. and the surviving entity, Applicant, elected to be regulated as a BDC. 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. On August 2, 2005, Applicant completed its initial public offering.

under the symbol "PCAP." As of December 31, 2007, there were 20,650,455 shares of Applicant's common stock issued and outstanding. As of that date, Applicant had 14 employees, including the employees of its one wholly-owned consolidated subsidiary, Patriot Capital Funding LLC I.

2. Applicant currently has a six-member board of directors (the "Board") of whom two are "interested persons" of Applicant within the meaning of section 2(a)(19) of the Act and four are not interested persons (the "non-interested directors"). The four non-interested directors are neither employees nor officers of Applicant (the "non-employee directors").

3. Applicant currently intends, upon receipt of the order, to discontinue its stock option plan and offer all employees holding outstanding options the opportunity to cancel those options in exchange for shares of restricted stock (i.e., stock that, at the time of issuance, is subject to certain forfeiture restrictions, and thus is restricted as to its transferability until such forfeiture restrictions have lapsed) (the "Restricted Stock"). Conversion of options into shares of Restricted Stock will not be mandatory and each employee will have the ability to choose to cancel and convert or to keep his or her outstanding options. As of December 31, 2007, total outstanding stock options represent 11.8% of Applicant's total outstanding shares of common stock.<sup>2</sup> The number of shares of Restricted Stock that will be issued in connection with this cancellation and conversion is intended to replicate the value of interests the individual has in the stock option plan and such valuation will be based on assumptions approved by the Board and an

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<sup>2</sup> As a result of allowing each individual employee to make the choice whether to convert his or her options, Applicant anticipates that options will remain outstanding once the cancellation and conversion are completed.

appropriate option pricing model (*e.g.*, Black Scholes), which will be selected by the Board.<sup>3</sup>

4. Applicant believes that its successful operation depends on its ability to offer compensation packages to its professionals that are competitive with those offered by its competitors and other investment management businesses. Applicant believes its ability to offer a compensation plan providing for the periodic issuance of shares of Restricted Stock is vital to its future growth and success. Applicant wishes to adopt an equity-based compensation plan (the “Plan”) for its employees as well as employees of its wholly-owned subsidiaries (the “Participants”).

5. The Plan will authorize the issuance of shares of Restricted Stock subject to certain forfeiture restrictions. These restrictions may relate to continued employment (lapsing either on an annual or other periodic basis or on a “cliff” basis, *i.e.*, at the end of a stated period of time), the performance of Applicant, or other restrictions deemed by the Board to be appropriate. The Restricted Stock will be subject to restrictions on transferability and other restrictions as required by the Board. The Restricted Stock will not be transferable except for disposition by gift, will or intestacy. Except to the extent restricted under the terms of the Plan, a Participant granted Restricted Stock will have all the rights of any other shareholder, including the right to vote the Restricted Stock and the right to receive dividends. During the restriction period, the Restricted Stock generally may not be sold, transferred, pledged, hypothecated, margined, or otherwise encumbered by the Participant. Except as the Board otherwise determines, upon

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<sup>3</sup> The opportunity to convert options into shares of Restricted Stock will be offered to employees through a tender offer process and employees will be provided with the disclosure that is required by Schedule TO under the Securities Exchange Act of 1934 (the “Exchange Act”). The same pricing model will be used for all of Applicant’s employees and officers.

termination of a Participant's employment during the applicable restriction period, Restricted Stock for which forfeiture restrictions have not lapsed at the time of such termination shall be forfeited.

6. The maximum amount of Restricted Stock that may be issued under the Plan will be 10% of the outstanding shares of common stock of Applicant on the effective date of the Plan plus 10% of the number of shares of Applicant's common stock issued or delivered by Applicant (other than pursuant to compensation plans) during the term of the Plan.<sup>4</sup> The Plan limits the total number of shares that may be awarded to any single Participant in a single year to 300,000 shares. In addition, no Participant may be granted more than 25% of the shares reserved for issuance under the Plan. Upon the recommendation of the compensation committee of the Board (the "Committee") which is comprised solely of non-interested directors, the Board will award shares of Restricted Stock to the Participants from time to time as part of the Participants' compensation based on a Participant's actual or expected performance and value to Applicant.

7. Each issuance of Restricted Stock under the Plan will be approved by the required majority, as defined in section 57(o) of the Act,<sup>5</sup> of Applicant's directors on the basis that the issuance is in the best interests of Applicant and its shareholders. The date on which the required majority approves an issuance of Restricted Stock will be deemed the date on which the subject Restricted Stock is granted. The Plan will be submitted for

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<sup>4</sup> For purposes of calculating compliance with this limit, Applicant will count as Restricted Stock all shares of Applicant's common stock that are issued pursuant to the Plan (including any shares issued in connection with the termination of its stock option plan) less any shares that are forfeited back to Applicant and cancelled as a result of forfeiture restrictions not lapsing.

<sup>5</sup> The term "required majority," when used with respect to the approval of a proposed transaction, plan, or arrangement, means both a majority of a BDC's directors or general partners who have no financial interest in such transaction, plan, or arrangement and a majority of such directors or general partners who are not interested persons of such company.

approval to Applicant's shareholders and will become effective upon such approval, subject to issuance of the order.

Applicant's Legal Analysis:

Sections 23(a) and (b), Section 63

1. Under section 63 of the Act, the provisions of section 23(a) of the Act generally prohibiting a registered closed-end investment company from issuing securities for services or for property other than cash or securities are made applicable to BDCs. This provision would prohibit the issuance of Restricted Stock as a part of the Plan.

2. Section 23(b) generally prohibits a closed-end management investment company from selling its common stock at a price below its current net asset value ("NAV"). Section 63(2) makes section 23(b) applicable to BDCs unless certain conditions are met. Because Restricted Stock that would be granted under the Plan would not meet the terms of section 63(2), sections 23(b) and 63 would prevent the issuance of the Restricted Stock.

3. Section 6(c) provides that the Commission may, by order upon application, conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities or transactions, from any provision of the Act, if and to the extent that the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

4. Applicant requests an order pursuant to section 6(c) of the Act granting an exemption from the provisions of sections 23(a) and (b) and section 63 of the Act.

Applicant states that the concerns underlying those sections include: (i) preferential

treatment of investment company insiders and the use of options and other rights by insiders to obtain control of the investment company; (ii) complication of the investment company's structure that makes it difficult to determine the value of the company's shares; and (iii) dilution of shareholders' equity in the investment company. Applicant states that the Plan does not raise the concern about preferential treatment of Applicant's insiders because the Plan is a bona fide employee compensation plan of the type that is common among corporations generally. In addition, section 61(a)(3) of the Act permits a BDC to issue to its officers, directors and employees, pursuant to an executive compensation plan, warrants, options and rights to purchase the BDC's voting securities, subject to certain requirements. Applicant states that, for reasons that are unclear, section 61 and its legislative history do not address the issuance by a BDC of restricted stock as incentive compensation. Applicant states, however, that the issuance of Restricted Stock is substantially similar, for purposes of investor protection under the Act, to the issuance of warrants, options, and rights as contemplated by section 61. Applicant also asserts that the Plan would not become a means for insiders to obtain control of Applicant because the number of shares of Applicant issuable under the Plan would be limited as set forth in the application. Moreover, no individual Participant could be issued more than 25% of the shares reserved for issuance under the Plan. Applicant's current intention, subject to the receipt of the order, is to discontinue its stock option plan and offer all employees holding outstanding options the opportunity to cancel those options in exchange for shares of Restricted Stock. If, however, Applicant chooses to reinstate the stock option plan (or adopt another such plan) and issues stock options in the future, it will do so pursuant to section 61 and in compliance with the terms and conditions of the application.

5. Applicant further states that the Plan will not unduly complicate Applicant's structure because equity-based employee compensation arrangements are widely used among corporations and commonly known to investors. Applicant notes that the Plan will be submitted to Applicant's shareholders for their approval. Applicant represents that a concise, "plain English" description of the Plan, including its potential dilutive effect, will be provided in the proxy materials that will be submitted to Applicant's shareholders. Applicant also states that it will comply with the proxy disclosure requirements in Item 10 of Schedule 14A under the Exchange Act. Applicant further notes that the Plan will be disclosed to investors in accordance with the requirements of the Form N-2 registration statement for closed-end investment companies, and pursuant to the standards and guidelines adopted by the Financial Accounting Standards Board for operating companies. In addition, Applicant will comply with the disclosure requirements for executive compensation plans under the Exchange Act.<sup>6</sup> Applicant thus concludes that the Plan will be adequately disclosed to investors and appropriately reflected in the market value of Applicant's shares.

6. Applicant acknowledges that, while awards granted under the Plan would have a dilutive effect on the shareholders' equity in Applicant, that effect would be outweighed by the anticipated benefits of the Plan to Applicant and its shareholders. Applicant asserts that it needs the flexibility to provide the requested equity-based

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<sup>6</sup> Applicant will comply with the amendments to the disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate governance matters, and security ownership of officers and directors to the extent adopted and applicable to BDCs. See Executive Compensation and Related Party Disclosure, Securities Act Release No. 8655 (Jan. 27, 2006) (proposed rule); Executive Compensation and Related Party Disclosure, Securities Act Release No. 8732A (Aug. 29, 2006) (final rule and proposed rule), as amended by Executive Compensation Disclosure, Securities Act Release No. 8765 (Dec. 22, 2006) (adopted as interim final rules with request for comments).



employee compensation in order to be able to compete effectively with other financial services firms for talented professionals. These professionals, Applicant suggests, in turn are likely to increase Applicant's performance and shareholder value. Applicant also asserts that equity-based compensation would more closely align the interests of Applicant's employees with those of Applicant's shareholders. In addition, Applicant states that Applicant's shareholders will be further protected by the conditions to the requested order that assure continuing oversight of the operation of the Plan by Applicant's Board.

Section 57(a)(4), Rule 17d-1

7. Section 57(a) proscribes certain transactions between a BDC and persons related to the BDC in the manner described in section 57(b) ("57(b) persons"), absent a Commission order. Section 57(a)(4) generally prohibits a 57(b) person from effecting a transaction in which the BDC is a joint participant absent such an order. Rule 17d-1, made applicable to BDCs by section 57(i), proscribes participation in a "joint enterprise or other joint arrangement or profit-sharing plan," which includes a stock option or purchase plan. Employees and directors of a BDC are 57(b) persons. Thus, the issuance of shares of Restricted Stock could be deemed to involve a joint transaction involving a BDC and a 57(b) person in contravention of section 57(a)(4). Rule 17d-1(b) provides that, in considering relief pursuant to the rule, the Commission will consider (i) whether the participation of the company in a joint enterprise is consistent with the Act's policies and purposes and (ii) the extent to which that participation is on a basis different from or less advantageous than that of other participants.

8. Applicant requests an order pursuant to section 57(a)(4) and rule 17d-1 to permit the Plan. Applicant states that the Plan, although benefiting the Participants and Applicant in different ways, are in the interests of Applicant's shareholders because the Plan will help Applicant attract and retain talented professionals, help align the interests of Applicant's employees with those of its shareholders, and in turn help produce a better return to Applicant's shareholders.

Applicant's Conditions:

Applicant agrees that the order granting the requested relief will be subject to the following conditions:

1. The Plan will be approved by Applicant's shareholders in accordance with section 61(a)(3)(A)(iv) of the Act.

2. Each issuance of Restricted Stock to officers and employees will be approved by the required majority, as defined in section 57(o) of the Act, of Applicant's directors on the basis that such issuance is in the best interests of Applicant and its shareholders.

3. The amount of voting securities that would result from the exercise of all of Applicant's outstanding warrants, options, and rights, together with any Restricted Stock issued pursuant to the Plan, at the time of issuance shall not exceed 25% of the outstanding voting securities of Applicant, except that if the amount of voting securities that would result from the exercise of all of Applicant's outstanding warrants, options, and rights issued to Applicant's directors, officers, and employees, together with any Restricted Stock issued pursuant to the Plan, would exceed 15% of the outstanding voting securities of Applicant, then the total amount of voting securities that would result from

the exercise of all outstanding warrants, options, and rights, together with any Restricted Stock issued pursuant to the Plan, at the time of issuance shall not exceed 20% of the outstanding voting securities of Applicant.

4. The maximum amount of Restricted Stock that may be issued under the Plan will be 10% of the outstanding shares of common stock of Applicant on the effective date of the Plan plus 10% of the number of shares of Applicant's common stock issued or delivered by Applicant (other than pursuant to compensation plans) during the term of the Plan.

5. The Board will review periodically the potential impact that the issuance of Restricted Stock under the Plan could have on Applicant's earnings and NAV per share, such review to take place prior to any decisions to grant Restricted Stock under the Plan, but in no event less frequently than annually. Adequate procedures and records will be maintained to permit such review. The Board will be authorized to take appropriate steps to ensure that the grant of Restricted Stock under the Plan would not have an effect contrary to the interests of Applicant's shareholders. This authority will include the authority to prevent or limit the granting of additional Restricted Stock under the Plan. All records maintained pursuant to this condition will be subject to examination by the Commission and its staff.

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

Florence E. Harmon  
Deputy Secretary