JAMES E. MITCHELL
ATTORNEY AT LAW
3187-D AIRWAY AVENUE
COSTA MESA, CALIFORNIA 92626
TELEPHONE (714) 432-5300
FAX (714) 432-5303

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September 1, 2004

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File Number S7-30-04

Dear Mr. Katz,

Hedge funds have become an important subject. Their tremendous growth in both numbers and assets create a need for review by the Commission. However, the wide diversity among hedge funds based on organizational structure, size, nature of clients or partners, and investments strategies, make it very difficult to do a single cost/benefit analysis with respect to all entities that fit the definition in the Proposed Rule. Therefore, I respectfully suggest that the Commission seek to identify those types of funds or hedge fund activities which present the greatest concerns, those types of funds or activities which are of least concern, and then seek to minimize the costs and burden of the Proposed Rule on the latter group.

An Example of Diversity

In December of 1979, I formed a California limited partnership to invest in stocks and bonds. I put up $500,000.00 as general partner, and six friends and relatives put up $190,000.00 to become limited partners. Gradually, through word of mouth, we attracted additional limited partners until we reached our maximum of 99 partners and started a waiting list. At the end of 2003, our 24th full year, our assets totaled $75,537,191.00. As general partner, I continue to have the largest investment in the partnership. I do not have any other advisory clients.

Some of the things that distinguish us from other hedge funds or investment partnerships are:

1. A long history of above average results (only one down year in the last 24 years) with no complaints from limited partners or others.

2. We make most of our investments in an obscure area of the market: financially conservative, non-high tech securities listed only on the OTC Bulletin Board or in the Pink Sheets.

3. We are not looking for new clients.

4. The limited partners are charged lower fees than in most other partnerships. Many hedge funds have a non-contingent fee of 1% or more per annum plus a performance fee. In our partnership, there are no non-contingent fees, only a performance fee. (The first 8% per annum of net gains are divided among the limited partners and the general partner in proportion to their capital accounts. If there are net gains in excess of 8%, the general partner receives one-quarter of the excess. However, the 8% return which the limited partners must receive before the general partner gets paid is cumulative. In other words, if the partnership does not make 8% in one year, then in subsequent years, the partnership must make 8% plus enough extra to cover the deficit in the first year, before the general partner is entitled to compensation for his services. Meanwhile, the partnership has low overhead expenses because office rent, salaries and other indirect expenses are borne by the general partner.)

This arrangement has resulted in the limited partners paying no fees for management in 6 out of the last 24 years, and very low fees in other years while deficits in the 8% were being made up.

I am not complaining. I believe our fees are fair to both the general partner and the limited partners, most of whom are friends or long-time acquaintances. However, this level of income and its sporadic nature make me extremely sensitive to new rules or regulations which may increase our expenses.

There are two additional features of our partnership which make it extremely unlikely to generate problems that might be of concern to the Commission:

1. Not only does the general partner own a significant portion of the limited partnership's capital, but that interest represents a majority of my family's net worth. Therefore, I have a powerful incentive to try to manage the partnership intelligently and conservatively. As a result:

   (a) we are widely diversified (currently over 400 securities),
   (b) we have never owned derivatives, and

(c) although we have typical powers to use margin or sell short, we use these powers sparingly, if at all.

2. Our books are audited by a major international accounting firm. The limited partners receive a copy of the audit report annually.

Issues of Concern:
I. Retention of Non-Accredited Investors

The proposed amendment to Rule 205-3 under the Advisors Act to avoid requiring certain hedge fund investors to divest their current interests in the funds should be adopted. This is because (a) it is safe to assume that most hedge funds are honest, and (b) most investors would be upset and would not understand if they were forced to divest investments because their net worth was not high enough.

Like some other funds, we have admitted a small number of non-accredited investors. In our case nearly all of the non-accredited investors are members of one of two classes: (a) long-time family friends of the general partner, or (b) children or grandchildren of accredited investors who received their partnership interest as a gift from the accredited investor. With respect to the first group, they may or may not be sophisticated investors, but they are in an unusually good position to judge the character and responsibility of the general partner. With respect to the second group, the actual investment decision was made by an accredited investor.

There would be one unfortunate consequence of permitting existing non-accredited investors to remain, while closing the door for the future. The person currently at the top of our waiting list is an heir of a long-time partner whose estate was settled last year. Several of the heirs wanted to remain in our partnership but we were up against our limit of 99 partners. Her cousin took our last opening. She received cash and went on our waiting list. Because of her young age, I doubt that she is an accredited investor.

Issues of Concern:
II. Timely Delivery of Audit Reports

Our partnership is not a fund of funds. For a few years we had a fund of funds as a limited partner, but we don't any longer. In this sense, we are a plain vanilla hedge fund. Nevertheless, there is a concern and it relates to Sarbannes-Oxley.

As a matter of good business practices, and because many of our partners prefer it, we intend to continue using a major accounting firm to do our audits. In our experience, since the passage of Sarbannes-Oxley, major accounting firms are under tremendous time pressure to satisfy the requirements of their major clients. They want to start work on smaller accounts like ours as late as possible. And, our limited partners want their K-1 tax information as early as possible. In this tug-of-war over time, there is trouble just getting the tax returns done in a timely manner. The audit reports are always completed last.

This may not be a problem for hedge funds which have grown large enough to be major clients of the leading accounting firms, or for funds using small accounting firms that do not audit lots of public companies. But it is a problem for smaller funds using the largest accounting firms.

I respectfully suggest either (a) 120 days to complete the audit plus 15 days for the partnership to distribute the report to its partners, or (b) some provision for delays due solely to the accountants which are outside the control of the hedge fund advisor.

Issues of Concern:
III. Compliance Period

Our work load is seasonal. Partly because we focus on Pink Sheets securities and we are widely diversified, we follow a large number of securities issued by companies that are not SEC reporting. From approximately April through July, we receive hundreds of annual reports from companies that we hear from only once a year. We refer to this as "annual report season". These reports need to be reviewed as soon as possible.

From the beginning of January to the beginning of "annual report season" we are busy getting ready for the auditors, then meeting with the auditors, and finally distributing tax returns and audit reports to partners. All of this is in addition to our regular year-round job of managing the investment partnership.

This is a long way of saying that for us, six months should be sufficient time to register and revise our compliance systems if the 6 months is from July 1st to December 31st. If the compliance period starts in the first half of the year, we will need more time.

Issues of Concern:
IV. Amendments to Rule 204-2 – Performance Documentation

Our track record goes back over 24 years. I have no doubts as to the accuracy of our track record because I know how carefully it was put together year after year. However, I do have two concerns.

My first concern is the difficulty of finding and organizing our documentation. Our partnership has moved four times, changing accounting firms twice, and changed personnel handing filing numerous times since 1979. Fortunately, it has been our policy to save everything, and we have never suffered a fire, flood or other disaster.

My second concern is that I am not yet familiar with what the Commission considers adequate documentation. What I anticipate we do have is records of our beginning portfolio for each year, our records of purchases and sales during the year, and our ending portfolio with the closing prices. But what if a broker's month-end statement for, say, October, 1984 is missing? Or, what about pricing of Pink Sheets securities? As an example, at the end of 1988, we owned 126 shares of Farmers & Merchants Bank of Long Beach (*FMBL) which were then about $800.00 per share bid. What if we have our records as to how we valued the shares, but we can't find our copy of the printed Pink Sheets we relied upon? Is it enough that our accountants reviewed our year end pricing for 1988 and were satisfied?

It seems to me to be entirely appropriate to require new registrants to retain whatever records they do have that support the performance they earned prior to their registration, but excuse them from your recordkeeping rule to the extent that those records are incomplete or otherwise do not meet the requirements of Rule 204-2.

Issues of Concern:
V. Cost/Benefit Analysis of Proxy Voting Records

I have never been an advisor of individual investment accounts, and I don't know what problems caused the initial adoption of Rule 206 (4)-6. However, it is not difficult to do a hypothetical cost/benefit analysis and conclude that such a rule should be adopted for an advisors individual accounts. Also, it is my understanding that advisors can escape the burden of this rule by requiring their clients to vote all proxies.

The cost/benefit analysis is different for partnership accounts. The costs may be similar, but the benefits are difficult to imagine. And, there is no way for the advisor/general partner to escape the burden because the limited partnership is the beneficial owner of the securities.

With securities owned by a hedge fund or partnership, the advisor/general partner is a part owner of the securities, and in most cases has incentive compensation based on the growth of the fund. Therefore, the advisor has major incentives to vote fund shares in a manner beneficial to the fund. It is difficult to imagine circumstances where the interests of the general partner and the limited partners would conflict in regard to the voting of proxies.

Under the laws of every state I am aware of, it is part of the law governing limited partnerships that limited partners have no voice in the management of the partnership. They have no say in what securities are bought and sold, no say in how the shares are voted, and in many cases, are not told what securities the fund owns.

In our case, we operate on a tight budget as described above. We own over 400 securities. In most cases we receive two or more proxies per security. The majority of these proxies come in during "annual report season" when we are at our busiest. Keeping records of how all of these proxies are voted represents an added cost with little or no benefit. So far no one has bothered to ask how we voted a proxy in over 24 years of operation. If one of our limited partners did ask to see our voting records, we would decline because we only disclose our ten largest equity positions. No one other than an SEC examiner is ever likely to look at these records. Why not limit the record keeping to those few instances where there is a proxy contest or to those securities which are disclosed to the limited partners?

Issues of Concern:
VI. Cost/Benefit Analysis by Type of Fund

Registration as an investment advisor, developing more extensive internal policies and procedures, and complying with rules like the proxy voting rule will cost money. And the burden is likely to fall most heavily on those funds which are attempting to keep their fees to investors low and their expenses modest. So what are the benefits? It depends on the type of fund. Apparently, a decision has already been made that venture capital funds need not be included. But, there are other groups of low risk funds to consider.

How many problems have there been (and, therefore, what benefits are to be gained) by requiring registration by funds which (a) have been in existence for five years or more, (b) have been audited by a major accounting firm for five years or more, (c) do not buy or sell derivatives or options, (d) do not use margin or sell short in excess of 10% of assets, and (e) have total assets of $250 million or less?

Let us make a modest proposal. If hedge funds are divided into groups, it is difficult to justify imposing new regulations on the lowest risk groups based on a cost/benefit analysis. On the other hand, the Commission, and therefore the public, is likely to benefit from the Commission having as much information as possible about all investments entities (possibly including even venture capital funds). Therefore, it is suggested that you exempt low risk categories of hedge funds such as those meeting criteria (a) through (e) in the previous paragraph, but require them to file a copy of their audit report with the Commission together with a brief questionnaire on their activities to be signed under oath. This information would permit the Commission to do statistical analysis of the various types of hedge funds and to further refine the boundaries between higher and lower risk types. At the same time, it would minimize costs for funds in categories that are unlikely to require the attention of the Commission.

If the Commission concludes that it does not have sufficient information to distinguish between high risk and low risk hedge fund activities, there is an alternative solution: require all hedge funds to submit audit reports and answers to questionnaires. And, defer adoption of the proposed rule until the data has been analyzed.

Very truly yours,

James E. Mitchell

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