

CAPITAL SOUTHWEST CORP
Form 40-APP
May 03, 2010

File No. 812-13671

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

APPLICATION FOR AN ORDER PURSUANT TO SECTION 6(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING AN EXEMPTION FROM SECTIONS 23(a), 23(b) AND 63 OF THE ACT, AND PURSUANT TO SECTIONS 57(a)(4) AND 57(i) OF THE ACT AND RULE 17d-1 UNDER THE ACT AUTHORIZING CERTAIN JOINT TRANSACTIONS OTHERWISE PROHIBITED BY SECTION 57(a)(4)

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May 3, 2010

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Exhibits :

EXHIBIT CAPITAL SOUTHWEST CORPORATION 2010 RESTRICTED STOCK AWARD PLAN
A

EXHIBIT RESOLUTION OF THE BOARD OF DIRECTORS OF CAPITAL SOUTHWEST CORPORATION
B AUTHORIZING THE FILING OF THIS APPLICATION

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of

CAPITAL SOUTHWEST
CORPORATION
12900 Preston Road, Suite 700
Dallas, Texas 75230

File No. 812-13671

Investment Company Act of 1940, as
amended

APPLICATION FOR AN ORDER PURSUANT
TO SECTION 6(c) OF THE INVESTMENT
COMPANY ACT OF 1940 GRANTING AN
EXEMPTION FROM SECTIONS 23(a), 23(b)
AND 63 OF THE 1940 ACT, AND PURSUANT
TO SECTIONS 57(a)(4) AND 57(i) OF THE 1940
ACT AND RULE 17d-1 UNDER THE 1940 ACT
AUTHORIZING CERTAIN JOINT
TRANSACTIONS OTHERWISE PROHIBITED
BY SECTION 57(a)(4)

I. INTRODUCTION

Capital Southwest Corporation (“Capital Southwest” or the “Company”), an internally managed, non-diversified, closed-end investment company that has elected to be regulated as a business development company (“BDC”)1 within the meaning of Section 54(a) of the Investment Company Act of 1940, as amended (the “1940 Act”), hereby applies for an order of the U.S. Securities and Exchange Commission (the “Commission”) pursuant to Section 6(c) of the 1940 Act2 granting an exemption from Sections 23(a), 23(b) and 63 of the 1940 Act and pursuant to Sections 57(a)(4) and 57(i) of the 1940 Act and Rule 17d-13 under the 1940 Act authorizing certain joint transactions otherwise prohibited by Section 57(a)(4) (the “Order”). The Order would permit Capital Southwest to include awards of restricted stock (“Restricted Stock”) under the terms of the Capital Southwest Corporation 2010 Restricted Stock Award Plan (the “Plan”) and to allow its employees to participate in the Plan.

II. CAPITAL SOUTHWEST CORPORATION

A. Background

Capital Southwest was organized as a Texas corporation on April 19, 1961. Until September 1969, it operated as a licensee under the Small Business Investment Act of 1958. At that time, it transferred to its wholly-owned subsidiary, Capital Southwest Venture Corporation (“CSVC”), certain assets and its license as a small business investment company (“SBIC”). CSVC is a closed-end, non-diversified investment company of the management type registered under the Investment Company Act of 1940. Prior to March 30, 1988, it was registered as a closed-end, non-diversified investment company under the 1940 Act. On that date, it elected to become a business development company (“BDC”) subject to the provisions of the 1940 Act, as amended by the Small Business Incentive Act of 1980. Capital Southwest Management Company (“CSMC”), a wholly-owned subsidiary of Capital Southwest, is the management company for Capital Southwest and CSVC. CSMC generally incurs all normal operating and administrative expenses, including, but not limited to, salaries and related benefits, rent, equipment and other administrative costs required for its day-to-day operations. Capital Southwest trades on the NASDAQ Global Select Market under the symbol “CSWC.” As of April 13, 2010, there were 3,741,638 shares of Capital Southwest’s common stock issued and outstanding.

As of April 13, 2010, Capital Southwest had an aggregate of nine employees and Capital Southwest's wholly-owned consolidated subsidiaries had 505 employees.

¹ Section 2(a)(48) generally 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 1940 Act and makes available significant managerial assistance with respect to the issuers of such securities.

² Unless otherwise indicated, all section references herein are to the Investment Company Act of 1940.

³ Unless otherwise indicated, all rule references herein are to rules promulgated under the Investment Company Act of 1940.

B. The Business of Capital Southwest

Capital Southwest is an internally managed, non-diversified closed-end management investment company that has elected to be treated as a BDC under the 1940 Act. Capital Southwest provides debt and equity growth capital to privately-held middle-market companies. Capital Southwest's investment objective is to achieve capital appreciation through long-term investments in businesses believed to have favorable growth potential. Investment interests are focused on expansion financings, management buyouts, minority recapitalizations, industry consolidations and early-stage financings in a broad range of industry segments. Capital Southwest also makes available significant managerial assistance to the companies in which it invests and believes that providing material assistance to investee companies is critical to their business development activities.

III. CAPITAL SOUTHWEST'S CURRENT INCENTIVE COMPENSATION

Capital Southwest currently does not have an equity-based compensation plan pursuant to which Restricted Stock may be awarded. Capital Southwest proposes to implement the Plan in the form set forth in Exhibit A hereto upon receipt of the Order and approval of the Plan by shareholders. The Plan was approved by the Board of Directors as a whole, including a majority of the Non-Employee Directors and the required majority as defined in Section 57(o) of the 1940 Act (the "Required Majority"), on April 19, 2010. If the Commission issues the Order, Capital Southwest will submit the Plan to a vote of its shareholders at its 2010 annual meeting of shareholders on July 19, 2010, and the Plan will become effective upon such approval. Accordingly, no Restricted Stock may be issued pursuant to the Plan unless and until the Commission approves this Order. If the Commission issues the Order, Capital Southwest intends to award Restricted Stock to certain of its employees and certain employees of its wholly-owned consolidated subsidiaries under the Plan. After adoption of the Plan, the Plan will not be modified without obtaining an order of the Commission or approval of the Commission. The Plan provides that no grants may be made under the Plan in contravention of the 1940 Act.

A. The Existing Stock Option Plans

In April 1999, Capital Southwest adopted the 1999 Stock Option Plan (the "1999 Plan") for the purpose of advancing the interests of Capital Southwest by providing for the grant of stock options to its executives. The 1999 Plan authorized the issuance of up to 140,000 shares of Capital Southwest's common stock, subject to adjustment for certain capital events such as stock splits, reverse stock splits, reorganizations, stock dividends and similar transactions. The 1999 Plan terminated on April 19, 2009, and no additional awards may be made under the 1999 Plan. Options to purchase 107,900 shares of Capital Southwest's common stock were granted under the 1999 Plan.

Additionally, on July 20, 2009 Capital Southwest adopted the Capital Southwest 2009 Stock Incentive Plan (the "2009 Plan" and collectively with the 1999 Plan, the "Existing Stock Option Plans") for the purpose of advancing the interest of Capital Southwest by providing for the grant of stock options to its employees. The 2009 Plan authorizes the issuance of up to 187,000 shares of Capital Southwest's common stock (subject to adjustment for certain capital events such as stock splits, reverse stock splits, reorganizations, stock dividends, and similar transactions) upon the exercise of stock options. Awards may be made under the 2009 Plan to employees and officers of Capital Southwest. Unless terminated sooner by the Board of Directors, the 2009 Plan will terminate on July 20, 2019, and no additional awards may be made after that date. To date, options to purchase 38,750 shares of Capital Southwest's common stock have been granted under the 2009 Plan.

Capital Southwest's Existing Stock Option Plans enable the Company to provide to its officers and employees (1) incentive compensation commensurate with the creation of shareholder value; (2) opportunities for increased stock ownership by executives; and (3) competitive levels of total compensation over a long time horizon. Options are granted at the Nasdaq Stock Market's closing price of the Company's common stock on the date of grant and thus have

no ultimate value unless the value of the Company's common stock appreciates. The Company has never granted options with an exercise price that is less than the closing price of the Company's common stock on the grant date, nor has it granted options which are priced on a date other than the grant date. Capital Southwest believes stock options provide a significant incentive for the option holders to enhance the value of the Company's common stock by continually improving the Company's performance and its investment results.

Options granted under the Existing Stock Option Plans generally vest in five annual installments beginning on the first anniversary of the date of grant and have a term of ten years. Under the 1999 Plan, upon termination of employment or retirement, option holders have 30 days to exercise vested options to purchase shares except in the case of death or disability (subject to a 6-month limitation). Under the 2009 Plan, upon termination of employment or retirement, incentive stock option holders have three months and non-statutory stock option holders have one month to exercise vested options to purchase shares except in the case of death or disability (subject to a 6-month limitation). Prior to the exercise of options, holders have no rights as shareholders with respect to the shares subject to such option, including voting rights and the right to receive dividends or dividend equivalents.

From time to time, the compensation committee has recommended and the Board of Directors has granted qualified and non-qualified stock options to executive officers and investment associates. Stock option award levels vary among participants based on their positions within the Company.

B. Employee Stock Ownership Plan

Capital Southwest maintains an Employee Stock Ownership Plan (“ESOP”) for employees as part of the ESOP of one of its wholly-owned portfolio companies in which its most highly compensated officers participate. Employees who have completed one year of credited service, as defined in the ESOP, are eligible to participate in the ESOP. Contributions to the ESOP are discretionary, within limits established by the Internal Revenue Code. Funds contributed to the trust established under the ESOP are applied by the trustees to the purchase, in the open market at prevailing market prices, of Capital Southwest common stock. A participant’s interest in contributions to the ESOP fully vests after five years (three years effective April 1, 2008) of credited service, and such vested interest is distributed to a participant at retirement, death or total disability, or after a one year break in service resulting from termination of employment for any other reason. Thus, the ESOP rewards long-term employees, aligning their interests with those of the Company’s long-term shareholders.

C. Retirement Plans

Capital Southwest maintains a qualified defined benefit, non-contributory retirement plan (the “Retirement Plan”) for its employees and employees of certain of its wholly-owned portfolio companies. All officers of Capital Southwest participate in this retirement plan. The Company also maintain a Restoration of Retirement Income Plan (the “Restoration Plan”) that provides benefits to participants in the Retirement Plan as are necessary to fulfill the intent of the Retirement Plan without regard to the limitations imposed by the Internal Revenue Code of 1986. The Restoration Plan is unfunded and non-qualified. The retirement benefits payable to our under the Retirement Plan depend on the participant’s years of service under the Retirement Plan and their final average monthly compensation determined by averaging the five consecutive years of highest compensation prior to retirement. Capital Southwest believes that the Retirement Plan and the Restoration Plan are important parts of its compensation program and that they assist Capital Southwest in retaining its executive officers because their retirement benefits increase for each year of employment.

D. Cash Bonus Program

Capital Southwest pays discretionary cash bonus awards to its employees annually. The Company’s bonus program (the “Program”) is not a profit sharing plan for purposes of Section 57(a)(4) because the compensation paid to participating employees under the Program is not based on the Company’s profitability. Thus, the amount a participant will receive each year under the Program will not be tied to Capital Southwest’s gross or net income, or any other indicia of the Company’s overall financial performance. Rather, awards under the Program are discretionary cash bonus awards based on the individual performance of the recipient. The total amount of awards made annually varies at the discretion of the Compensation Committee of the Board, which is comprised solely of Non-Interested Directors (the “Compensation Committee”), depending on the extent and duration of the Company’s growth, the participant’s

contribution to achieving overall Company growth over both long-term and short-term time horizons and the participant's creativity and effectiveness.

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IV. REASON FOR REQUEST

A. Compensation Practices in Capital Southwest's Industry

Capital Southwest believes that the market for superior investment professionals is highly competitive. Capital Southwest must compete for talent with commercial banks and investment banks, which are generally able to pay higher cash compensation and to award many different types of stock-based incentive compensation to their employees. Moreover, Capital Southwest must compete for professionals with private equity funds, which generally offer a portion of their various carried interests to induce professional talent to associate with their funds. Capital Southwest's success depends largely on its ability to attract top professional talent, which requires it to offer fair compensation packages to its professionals that are competitive with those offered by the types of competitors mentioned above. Capital Southwest does not have carried interests. While Capital Southwest recognizes that employee retention is critical for all companies, Capital Southwest also believes that the highly specialized nature of its business, the competitiveness of its market and the small size of its employee base relative to its assets and revenues make employee retention even more critical for Capital Southwest. In that regard, the ability to offer equity-based compensation to its professionals, which both aligns employee performance with shareholder interests and provides a retention tool, is vital to Capital Southwest's future growth and success.

Capital Southwest wishes to provide for the periodic issuance of shares of Restricted Stock to its employees as well as employees, of its wholly-owned consolidated subsidiaries (the employees are hereafter called the "Participants" and each a "Participant"). The Plan would enable Capital Southwest to offer compensation packages to the Participants that are competitive with those offered by its competitors and other investment management businesses. Capital Southwest believes that granting Restricted Stock under the Plan to employees is fair and reasonable. Capital Southwest also believes that granting Restricted Stock to employees under the Plan is consistent with that described in prior applications for which the Commission has granted exemptive orders for the issuance of Restricted Stock to employees.

B. Use of Restricted Stock

Capital Southwest believes that the characteristics of its business, the dependence it has on key personnel to conduct its business effectively and the highly competitive environment in which it operates require the use of equity-based compensation in its compensation system. Retention and recruitment of the best people is vital to the future success and growth of Capital Southwest's business and is in the best interests of Capital Southwest's shareholders. Appropriate compensation plans that support the Company's objectives and align the interests of shareholders and employees are essential to long term success in the investment business in general and critical to Capital Southwest's business in particular. Most of the leading asset management, private equity and commercial finance firms in the United States provide equity-based compensation in one form or another.

Capital Southwest strongly believes that the most appropriate form of equity-based compensation that it can offer is Restricted Stock. Relative to other forms of equity-based compensation, Restricted Stock will allow Capital Southwest to (i) manage dilution associated with equity-based compensation, and (ii) match the return expectations of the business more closely with its equity-based compensation plan. Capital Southwest believes the Restricted Stock will have a clear and meaningful benefit to its shareholders and its business prospects that supports approval of this application.

1. Managing Dilution

Dilution is an important consideration for shareholders, and Restricted Stock is inherently less dilutive and more predictable than stock options. Because Restricted Stock has intrinsic value, it takes fewer shares of restricted stock to generate a similar level of economic benefit to employees. In other words, Capital Southwest believes that the number of shares of Restricted Stock that it will grant will only be a fraction of the number of shares that would be subject to options were Capital Southwest to offer equivalent economic incentives only through a stock option plan.

2. Matching Return Expectations

Restricted Stock motivates behavior that is more consistent with the type of return expectations that Capital Southwest has established for its shareholders. Capital Southwest's strategy is to originate high quality, long-term assets and to support the risk management activity of its portfolio companies over a long period of time. Further, Capital Southwest's business plan is to execute a methodical and conservative accumulation of assets that have a risk-based pricing premium relative to similar securities. To this end, Restricted Stock places more value on the quality of originated assets over the quantity of originated assets, and thus, Restricted Stock is a better compensation tool for Capital Southwest to align employee interests with shareholder interests. Shares of Restricted Stock that vest over time or are based upon performance targets will allow Capital Southwest to set objectives and provide meaningful rewards over time to employees who effectuate the targeted outcome of income and principal stability.

Capital Southwest's management and the Board of Directors have considered each of the factors discussed above and believe that the issuance of Restricted Stock as a form of equity-based compensation is in the best interests of Capital Southwest's shareholders, employees and business.

V. THE PLAN

The Plan, a copy of which is attached to this Application as Exhibit A, authorizes the issuance of shares of Restricted Stock subject to certain forfeiture restrictions. The Plan will make Restricted Stock grants available to all employees at the sole discretion of the Compensation Committee based on the economic value added by the Participant. The restrictions on the Restricted Stock relate to continued employment (lapsing either an annual or other period basis or on a "cliff" basis, i.e., at the end of a stated period of time) or other restrictions deemed by the Compensation Committee from time to time to be appropriate and in the best interests of Capital Southwest and its shareholders. The Restricted Stock will be subject to restrictions on transferability and other restrictions as required by the Compensation Committee from time to time. 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 (i.e., prior to the lapse of the applicable forfeiture restrictions), the Restricted Stock generally may not be sold, transferred, pledged, hypothecated, margined or otherwise encumbered by the Participant. Upon 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.

Subject to adjustment as provided in the Plan, the maximum number of shares of common stock reserved for issuance in connection with the Plan is 47,000. The Plan limits the total number of shares that may be awarded to any single Participant in a single year to 6,250. Capital Southwest has agreed to limit the maximum number of shares of Restricted Stock that may be issued under the Plan to 10% of the total number of Shares authorized and outstanding at any time. In addition, no Participant may be granted more than 25% of the shares of common stock reserved for issuance under the Plan.

The Plan will be administered by the Compensation Committee, which 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 Capital Southwest. The Compensation Committee will consider performance criteria including economic value added, achievement of profit, loss or expense ratio, cash flow, book value, net income, operating earnings, return on capital, return on net assets, return on shareholders' equity, return on assets, shareholder returns, productivity, expenses, margins, operating efficiency, customer satisfaction, earnings per share, and trading price per share of common stock. The Compensation Committee will have the general responsibility to ensure that the Plan is operated in a manner that best serves the interests of Capital Southwest and its shareholders. All compensation decisions made by the Committee will be evidenced in the minutes of the committee meetings at which such decisions occur.

Subject to receipt of the Order, the Plan has been approved by the Compensation Committee, as well as the Board of Directors as a whole, including a majority of the Disinterested Directors and the Required Majority. The Board of Directors, including the Required Majority, found that an appropriate compensation plan involving the issuance of Restricted Stock that supports Capital Southwest's objectives and aligns the interests of shareholders and employees is essential to long-term success in the investment business in general and critical to Capital Southwest's business in particular and will have a clear and meaningful benefit to Capital Southwest and its shareholders. The Board of Directors, including the Required Majority, also found that the issuance of Restricted Stock will allow Capital Southwest to align its business plan, shareholder interests and employee interests based on the nature of Capital Southwest's business as well as the characteristics of Restricted Stock allowing Capital Southwest's employees to become owners of the stock with an interest in preserving asset value, maintaining and increasing within acceptable risk parameters the current income stream and seeking opportunities for capital gains resulting from increases in the values of portfolio companies. The Board of Directors, including the Required Majority, considered, among other things, the impact of Restricted Stock grants on outside shareholders, including the impact of dilution that the Plan would have with the limit on outstanding Restricted Stock of 10% of Capital Southwest's outstanding common stock.

Capital Southwest will comply with all disclosure requirements applicable to BDCs, including, the amended 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.

VI. APPLICABLE LAW AND NEED FOR RELIEF

Under Section 63, the provisions of Section 23(a), which generally prohibit 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 for services as a part of the Plan.

Section 23(b) prohibits a registered closed-end investment company from selling any common stock of which it is the issuer at a price below the stock's current net asset value, except with the consent of a majority of the company's common shareholders at the time of issuance or under certain other enumerated circumstances not applicable to the subject of this Application. Section 63(2) provides that, notwithstanding Section 23(b), a BDC may sell any common stock of which it is the issuer at a price below the current net asset value of such stock and may sell warrants, options or rights to acquire any such common stock at a price below the current net asset value of such stock if, generally (i) holders of a majority of the BDC's outstanding voting securities, and the holders of a majority of the BDC's voting securities who are not interested persons of the BDC, approved the BDC's policy and practice of making such sales of securities at the last annual meeting of shareholders within one year immediately prior to any such sale; (ii) a required majority of the BDC's directors (i.e., a majority of directors who have no financial interest in the transaction, plan or arrangement and who are not interested persons of the BDC) have determined that such sale would be in the best interests of the BDC and its shareholders; and (iii) a required majority of the BDC's directors have determined immediately prior to the issuance of such securities that the price at which such securities are to be sold is not less than a price which closely approximates the market value of those securities.

Because Restricted Stock that would be granted under the Plan may not meet the terms of Section 63(2), in the absence of the Order, Sections 23(b) and 63(2) would prevent the issuance of the Restricted Stock.

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. Employees of a BDC are Section 57(b) persons. Section 57(a)(4) generally prohibits a 57(b) person from effecting a transaction in which the BDC is a joint participant absent such order. Rule 17d-1, the analog to Section 57(a)(4) for registered investment companies, is made applicable to BDCs by Section 57(i). Rule 17d-1 proscribes participation in a "joint enterprise or other joint

arrangement or profit-sharing plan,” which includes, pursuant to paragraph 17d-1(c), a stock option or purchase plan. Thus, although a compensation plan involving grants of Restricted Stock is not specifically covered by Section 57(a)(4) or Rule 17d-1, the issuance 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).

Pursuant to Section 57 of the 1940 Act, an internally managed BDC may provide compensation to its officers, directors and employees in a number of ways. Pursuant to Section 57(j), an internally managed BDC may issue options to its officers, directors and employees. As discussed above, Capital Southwest issues options pursuant to an executive compensation plan to provide additional incentive compensation to its officers and employees. Pursuant to Section 57(n) an internally managed BDC may adopt a profit sharing plan. Capital Southwest has not adopted a profit-sharing plan and, in fact, Sections 57(n)(2) and 61(a)(3)(B)(iv) of the 1940 Act provide that an internally managed BDC may not adopt both an executive compensation plan pursuant to which it has outstanding options and a profit sharing plan.

Section 6(c) provides, in part, that the Commission may, by order upon application, conditionally or unconditionally exempt any person, security or transaction, or any class or classes thereof, from any provision of the 1940 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 1940 Act.

Section 57(a)(4) and Rule 17d-1 provide that the Commission may, by order upon application, grant relief under Section 57(a)(4) and Rule 17d-1 permitting certain joint enterprises or arrangements and profit-sharing plans. Rule 17d-1(b) further provides that in passing upon such an application, the Commission will consider (i) whether the participation of the BDC in such enterprise, arrangement or plan is consistent with the policies and purposes of the 1940 Act and (ii) the extent to which such participation is on a basis different from or less advantageous than that of other participants.

VII. REQUESTED ORDER

Capital Southwest requests an Order of the Commission pursuant to Section 6(c) of the 1940 Act granting an exemption from Sections 23(a), 23(b) and 63 of the 1940 Act and pursuant to Sections 57(a)(4) and 57(i) of the 1940 Act and Rule 17d-1 under the Act authorizing certain joint transactions otherwise prohibited by Section 57(a)(4) to permit Capital Southwest to issue shares of Restricted Stock to Participants pursuant to the Plan. Additionally, to the extent that Capital Southwest creates or acquires additional wholly-owned consolidated subsidiaries, and to the extent that such future subsidiaries have employees to whom the relief requested herein would otherwise apply, Capital Southwest asks that such relief, if granted, be extended to such employees of any future subsidiaries. Capital Southwest asks that the Order also apply to future employees of Capital Southwest's wholly-owned subsidiaries that are eligible to receive Restricted Stock under the Plan.

VIII. CAPITAL SOUTHWEST'S LEGAL ARGUMENTS

The Commission and Congress have recognized the need for certain types of investment companies, including closed-end investment companies, small business investment companies ("SBICs"), and BDCs, to offer equity-based compensation to its employees.

Capital Southwest believes that its ability to offer equity-based compensation in the form of Restricted Stock is necessary for Capital Southwest to attract and retain talented employees and officers, and to align that talent with shareholders' interests. Capital Southwest believes that its request for an order is consistent with the policies underlying the provisions of the 1940 Act permitting the use of equity compensation by BDCs as well as prior exemptive relief granted by the Commission.

A. Similarity to Issuances Currently Permitted under the 1940 Act for Employees and Non-Employee Directors

Congress recognized the importance of equity-based compensation as a means of attracting and retaining qualified directors in the Small Business Investment Incentive Act of 1980 (the "1980 Amendments"). The 1980 Amendments

permit BDCs to issue to their officers, employees and general partners warrants, options and rights to purchase voting securities of such companies pursuant to executive compensation plans as long as such companies complied with certain conditions.⁴ Capital Southwest believes that the issuance of Restricted Stock to employees for purposes of investor protection under the 1940 Act, is substantially similar to what is currently permitted under Section 61.

⁴ See Section 61(a)(3) of the 1940 Act.

B. Prior Commission Orders Relating to Equity-Based Compensation for Employees and Non-Employee Directors

1. Orders Relating to Use of Equity Based Compensation by Business Development Companies

MCG Capital Corporation. MCG Capital Corporation (“MCG”) filed an application on September 2, 2005, and an amendment to the application on January 31, 2006, requesting an order under Section 6(c) of the 1940 Act granting an exemption from Sections 23(a), 23(b) and 63 of the 1940 Act; and under Sections 57(a)(4) and 57(i) of the 1940 Act and Rule 17d-1 under the 1940 Act. The order granted on April 4, 2006 (the “MCG Order”) permits MCG to issue restricted stock to MCG’s non-employee directors, employees and employees of MCG’s wholly-owned consolidated subsidiaries.⁵

Hercules Technology Growth Capital, Inc. Hercules Technology Growth Capital, Inc. (“Hercules”) filed a similar application on July 7, 2006, and subsequent amendments to the application on April 4, 2007 and May 1, 2007, requesting an order under Section 6(c) of the Act granting 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. The order granted on May 23, 2007 (the “Hercules Order”) permits Hercules to issue restricted stock to Hercules’ employees and non-employee directors and to employees of Hercules’ wholly-owned consolidated subsidiaries. ⁶

Main Street Capital Corporation. Main Street Capital Corporation, an internally managed BDC filed an application on July 27, 2007, and an amendment to the application on December 4, 2007, requesting an order under Section 6(c) of the 1940 Act granting an exemption from Sections 23(a), 23(b) and 63 of the 1940 Act; and under Sections 57(a)(4) and 57(i) of the 1940 Act and Rule 17d-1 under the 1940 Act. The order granted on January 16, 2008 (the “Main Street Order”) permits the applicant to issue restricted stock as compensation to its non-employee directors, employees and employees of Main Street Capital’s wholly-owned subsidiaries.⁷

Kohlberg Capital Corporation. Kohlberg Capital filed a similar application on February 27, 2007, and subsequent amendments to the application on February 22, 2008 and March 10, 2008, requesting an order under Section 6(c) of the Act granting 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. The order granted on April 23, 2008 (the “Kohlberg Order”) permits Kohlberg Capital to issue restricted stock to Kohlberg Capital’s officers and employees and employees of Kohlberg Capital’s wholly-owned subsidiaries. ⁸

⁵ See MCG Capital Corporation, Investment Company Act Release Nos. 27258 (March 8, 2006) (notice) and 27280 (April 4, 2006) (order).

⁶ See Hercules Technology Growth Capital, Inc., Investment Company Act Release Nos. 27815 (May 2, 2007) (notice) and 27838 (May 23, 2007) (order).

⁷ See Main Street Capital Corporation et al, Investment Company Act Release Nos. 28082 (Dec. 21, 2007)(notice) and 28120 (Jan. 16, 2008)(order).

⁸ See Kohlberg Capital Corporation, Investment Company Act Release Nos. 28168 (March 24, 2008) (notice) and 28199 (April 23, 2008) (order).

2. Orders Relating to Use of Equity-Based Compensation by Internally-Managed Closed-End Investment Companies

The important role that equity compensation can play in attracting and retaining qualified personnel has been expressly recognized by the Commission with respect to internally-managed closed-end investment companies.

Baker, Fentress & Company and Adams Express Company, et. al. In 1998, the Commission issued an order granting Baker, Fentress & Company (“Baker Fentress”) exemptive relief from Sections 17(a) and (d), 18(d), and 23(a), (b) and (c) of the 1940 Act and Rule 17d-1 under the 1940 Act. More recently, in 2005, the Commission issued a similar order granting Adams Express Company and Petroleum and Resources Corporation (“Adams Express”) exemptive relief from Sections 17(d), 18(d), and 23(a), (b) and (c) of the 1940 Act and Rule 17d-1 under the 1940 Act. These orders permitted the companies to implement broad equity-based compensation plans that included the issuance of restricted stock to their employees.

C. Similarity to Issuance Currently Permitted by Orders from the Commission

Congress recognized the importance of equity-based compensation as a means of attracting and retaining qualified management personnel in the Small Business Investment Incentive Act of 1980 (the “1980 Amendments”). The 1980 Amendments permit BDCs to issue to their officers, employees, and general partners warrants, options and rights to purchase voting securities of such companies pursuant to executive compensation plans as long as such company complied with certain conditions.¹⁰ Capital Southwest believes that the issuance of Restricted Stock to employees of Capital Southwest, for purposes of investor protection under the 1940 Act, is substantially similar to what is currently permitted under Section 61. Capital Southwest further believes that the terms of its proposal are fair and reasonable and do not involve any overreaching.

Capital Southwest believes that the granting of shares of Restricted Stock to employees under the Plan is fair and reasonable because of the skills and experience such employees provide to Capital Southwest. Such skills and experience are necessary for the management and oversight of Capital Southwest’s investments and operations. Furthermore, as noted above, the ability to offer its employees equity-based compensation is necessary to enhance Capital Southwest’s ability to obtain and retain high quality individuals to work for it and its Subsidiaries.

The issuance of Restricted Stock to employees as part of the Plan would permit Capital Southwest to devote more of its cash resources to additional investments. Perhaps most importantly, however, as a method of compensation which is of most value if Capital Southwest’s stock continues to increase in value, such Restricted Stock Awards serve the best interest of the shareholders of Capital Southwest by reinforcing the alignment of the interests of the employees and shareholders of Capital Southwest. Capital Southwest believes that granting the shares of Restricted Stock will provide significant incentives for employees to remain with Capital Southwest and to devote their best efforts to the success of Capital Southwest’s business in the future, as they have done in the past. The issuance of shares of Restricted Stock will also provide a means for Capital Southwest’s employees to increase their ownership interest in Capital Southwest, thereby helping to ensure a close identification of their interests with those of Capital Southwest and its shareholders.

D. Standards for Exemption Under Section 6(c)

⁹ See Baker, Fentress & Company, Investment Company Act Release No. 23619 (Dec. 22, 1998) (the “