

collaborative research and development arrangement and other investments that are not made to preserve capital and liquidity. As proposed, rule 3a–8 permitted an R&D company to acquire investments that are not capital preservation investments if, immediately after the acquisition, no more than 10 percent of the company's total assets consisted of other investments or no more than 20 percent of the company's total assets consisted of other investments so long as at least 75 percent of those investments were made pursuant to collaborative research and development arrangements. The Proposing Release also explained that the Commission intended that the proposed rule's limits on other investments would be calculated at the time other investments are acquired.³⁶

The Proposing Release requested comment on the proposed limits.³⁷ We also requested comment on whether the percentage limits should be applicable at any time, rather than being calculated only at the time other investments are acquired.³⁸ The commenters that addressed these issues all suggested that we make the limits applicable at all times and that we raise the applicable percentage limit when at least 75 percent of the R&D company's other investments were made pursuant to collaborative research and development arrangements.

Specifically, two commenters expressed concern that the rule as proposed could be interpreted to require the R&D company to determine its compliance with the percentage limits at the time of every acquisition it ever made, including acquisitions made years prior to relying on the rule.³⁹ These commenters also recommended raising the 20 percent limit to 30 percent. Another commenter suggested that compliance with the percentage limits should be required at all times to avoid the possibility that the value of an R&D company's other investments could greatly exceed the value of its capital preservation investments and its primary business. This commenter also suggested increasing the 20 percent limit to 25 percent.

The Commission agrees that it would enhance investor protection if the percentage limits were applicable at all times that an R&D company seeks to

rely on the rule. We also note that this approach is consistent with the way both the Act and the Commission have formulated asset tests for purposes of determining a company's status under the Act.⁴⁰ We also believe that it would be more appropriate to address our concerns about market fluctuations in the value of investments made pursuant to collaborative research and development arrangements by raising the applicable percentage limit.

Although specifically requested in the Proposing Release,⁴¹ the commenters that recommended raising the 20 percent limit 30 percent did not provide any information or data to support their request and to demonstrate the need for R&D companies to include a non-controlling investment as a part of a collaborative research and development arrangement. The Commission continues to be concerned that non-controlling investments constituting a significant portion of a company's assets, even if those investments potentially can be characterized as "strategic," may indicate that the company's primary business is that of an investment company.⁴² We believe, however, that raising the 20 percent limit to 25 percent would reflect an appropriate balance between this concern and the needs for R&D companies both to have greater flexibility to enter into strategic alliances and to deal with fluctuations in the value of strategic investments.⁴³ Accordingly, the Commission is adopting a 25 percent limit that would be applicable at all times that an R&D company seeks to rely on the rule.⁴⁴

E. Collaborative Research and Development Arrangements

Rule 3a–8 as proposed defined a collaborative research and development arrangement as a business relationship which (i) is designed to achieve narrowly focused goals that are directly related to, and an integral part of, the issuer's research and development activities; (ii) calls for the issuer to conduct joint research and development activities with one or more other parties, and (iii) is not entered into for the purpose of avoiding regulation under the Act. For the reasons discussed

below, the Commission is adopting the definition of a collaborative research and development arrangement substantially as proposed. The Commission is making a technical clarification to the definition to the effect that an investment in securities made pursuant to a collaborative research and development arrangement must be an investment in securities of a company (or of a company controlled primarily by, or which controls primarily, the company) with which the R&D company is engaged in the collaborative research and development arrangement.⁴⁵

1. "Joint Research and Development"

Two commenters requested clarification of the term "joint research and development activities" within the proposed definition. One commenter was concerned that the term "joint" could be interpreted to require the companies to be equally involved in the research and development throughout the entire research and development process. This commenter noted that research and development activities within collaborative arrangements often are guided by a joint steering committee with members from both companies, with one company or the other primarily responsible for conducting research and development at different stages. The Commission would consider an arrangement involving research and development activities done sequentially or through a joint steering committee to be "joint" within the meaning of the definition.

2. Other Relationships

The Proposing Release requested comment on whether other relationships, such as a licensor-licensee relationship with respect to a patent or other intellectual property rights, should be included in the definition of a collaborative research and development arrangement. One commenter suggested that licensor-licensee and similar contractual relationships should be included if they relate to product development activities because such relationships are legitimate and common. While we do not dispute the legitimacy or prevalence of licensing agreements, we do not believe that a licensing or similar agreement, by itself, demonstrates a sufficient nexus to the licensor's primary business to justify treating an investment in the licensee differently from any other speculative investment.

⁴⁰ See, e.g., 15 U.S.C. 80a–3(a); 17 CFR 270.3a–1; and the ICOS Order, *supra* note 2.

⁴¹ See Proposing Release, *supra* note 3, at III.A.4.b.

⁴² See *id.*

⁴³ We note that the rule is designed to serve as a nonexclusive safe harbor. We are willing to consider, on a case-by-case basis, the status of R&D companies that cannot meet certain of the requirements of the rule.

⁴⁴ Rule 3a–8(a)(4)(i)–(ii).

⁴⁵ Rule 3a–8(b)(6). The Commission recognizes that a collaborative research and development arrangement may involve additional parties as well.

³⁶ See *id.*

³⁷ See *id.*

³⁸ See *id.*

³⁹ One of these commenters responded to a request for clarification from members of the Commission staff concerning its comment on this issue made in its comment letter. These discussions are summarized in a memorandum available in the public file. See *supra* note 16.