

CAPITAL SOUTHWEST CORP  
Form 40-17G  
July 08, 2009

File No. 811-1056

**U.S. SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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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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**CAPITAL SOUTHWEST CORPORATION**

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July 7, 2009

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**Exhibits :**

EXHIBIT A	CAPITAL SOUTHWEST CORPORATION 2009 STOCK INCENTIVE PLAN
EXHIBIT B	RESOLUTION OF THE BOARD OF DIRECTORS OF CAPITAL SOUTHWEST CORPORATION
	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

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)

File No. 811-1056

Investment Company Act of 1940, as amended

**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") 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 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<sup>3</sup> 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 (the "Awards") under the terms of the Capital Southwest Corporation 2009 Stock Incentive Plan (the "Plan") and to allow its non-employee directors (the "Non-Employee Directors") 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 (the "1940 Act"). 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 CSC, is the management company for CSC 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."

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<sup>1</sup> 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.

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

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

Capital Southwest currently has a six member board of directors (the “Board”) of whom two are considered to be “interested persons” of Capital Southwest within the meaning of Section 2(a)(19) of the 1940 Act and four are not interested persons (the “Disinterested Directors”). Capital Southwest has four Non-Employee Directors. Currently Capital Southwest’s Non-Employee Directors are all Disinterested Directors, but it is possible that Capital Southwest may have Non-Employee Directors in the future who are interested persons of Capital Southwest.

## **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. MANAGEMENT**

### **A. Capital Southwest’s Board of Directors**

The business and affairs of Capital Southwest are managed under the direction of the Board. To carry out this purpose, the Board is responsible for, among other things, overseeing the process by which investments are selected and managed, appointing senior executives of Capital Southwest, the administration of management and the allocation of Capital Southwest’s resources. The Board, including each Non-Employee Director, is also responsible for overseeing the management of Capital Southwest’s investment portfolio on an ongoing basis. Each of the directors has experience in business and/or finance, which allows them to contribute guidance and analyses to management regarding Capital Southwest’s investments. The Board meets regularly. Additional meetings may be held from time to time when needed and vary in length depending on the circumstances. In the fiscal year ended March 31, 2009, the board met 15 times

### **B. Activities of the Non-Employee Directors**

In addition to their duties as directors generally, Capital Southwest looks to the Non-Employee Directors for advice on specific matters including, among other things, credit and underwriting policies, asset valuation and strategic direction. The professional experiences and expertise of the Non-Employee Directors make them valuable resources for Capital Southwest’s management, which communicates regularly with the Non-Employee Directors on an individual basis. Management also solicits their ideas and advice with respect to operational matters as well as potential investments and transactions.

In addition to their regular and special Board meetings, each of the Non-Employee Directors serves on at least one of the committees of the Board. Messrs. Ligon, Henderson and Wilson serve on the audit committee. Messrs. Burton, Ligon, Henderson and Wilson serve on the nominating committee and the compensation committee. The audit committee is responsible for approving Capital Southwest’s independent accountants, reviewing with such independent accountants the plans and results of the audit engagement, approving professional services provided by the independent accountants, reviewing the independence of the independent accountants and reviewing the adequacy of Capital Southwest’s internal accounting controls. The compensation committee determines compensation for Capital Southwest’s executive officers.

### **C. Current Non-Employee Directors**



The following persons are the current Non-Employee Directors of Capital Southwest:

1. *Donald W. Burton*

Mr. Burton is the Chairman, President and General Partner of various South Atlantic Venture Fund Partnership entities and is also the General Partner of the Burton Partnerships. Mr. Burton has served as a director of Capital Southwest since 2008 and is also a director of Knology, Inc. and Cluster A Mutual Funds managed by Black Rock Advisors.

2. *Graeme W. Henderson*

Mr. Henderson is self-employed as a private investor and consultant and has been a director of Capital Southwest since 1976. He also serves as a director of Lifemark Group.

3. *Samuel Ligon*

Mr. Ligon is self-employed as a private investor and consultant and has served as a director of Capital Southwest since 2003. Mr. Ligon also serves as a director of Heelys, Inc., Jokari/US, Inc. and Smith Abrasives, Inc.

4. *John H. Wilson*

Mr. Wilson is the President of U.S. Equity Corporation, a venture capital investment firm. He has been a director of Capital Southwest since 1988. Mr. Wilson also serves as a director of Encore Wire Corporation and Palm Harbor Homes, Inc.

Capital Southwest may add additional Non-Employee Directors from time to time.

**D. Compensation of Directors**

As compensation for serving on the Board, each of Capital Southwest's Non-Employee Directors receives an annual fee of \$32,000 and an additional \$1,000 for each board meeting attended, not to exceed \$4,000 per year. Directors receive no compensation for committee meetings. This compensation structure places an annual maximum compensation of \$36,000 on non-employee directors. Their compensation is substantially below market. Non Employee Directors are ineligible for the existing retirement plan or Employee Stock Option Plan.

Capital Southwest has concluded that it must provide the Non-Employee Directors with additional incentives in order to attract and retain highly qualified and motivated individuals to assist in its development. Capital Southwest believes that it is competing for qualified and motivated director candidates against non-BDC public companies which are permitted to offer equity compensation such as the Awards to their directors. Rather than increasing cash compensation for Non-Employee Directors, Capital Southwest would like to grant them Awards, further aligning their interests with the shareholders. Upon receipt of the Order and approval of the Plan by shareholders, Capital Southwest proposes to issue Awards to the Non-Employee Directors pursuant to the Plan. The Plan contains no provision for automatic grant of any Award to Non-Employee Directors.

**IV. CAPITAL SOUTHWEST'S CURRENT INCENTIVE COMPENSATION**

Capital Southwest currently does not have an equity-based compensation pursuant to which restricted stock may be awarded. Additionally, Capital Southwest currently has no equity-based compensation plan that includes Non-Employee Directors. 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. Capital Southwest will submit the Plan to a vote of its shareholders at its 2009 annual meeting of shareholders on July 20, 2009 with the provision that the Plan will

include Awards and apply to Non-Employee Directors only following receipt of the Order. If the Order is not issued, no Awards will be issued and the Plan will be automatically amended to delete all references to Non-Employee Directors in the Plan.

**A. Capital Southwest Corporation's 2009 Stock Incentive Plan**

Capital Southwest's Board approved the Plan for the purpose of attracting and retaining the services of officers, employees and Non-Employee Directors of Capital Southwest. Non-Employee Directors of Capital Southwest are not presently eligible to participate in the existing Employee Stock Incentive Plan. The Plan was approved by the Board 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, by written consent on June 2, 2009. If shareholders approve the Plan but the relief requested herein is not granted, the Board may make grants other than Awards to eligible employees.

If the relief requested herein is granted and shareholders approve the Plan, then grants, including Awards, may be made and the four current Non-Employee Directors would become eligible to participate in the Plan. Additional Non-Employee Directors would become eligible to participate upon their election or appointment to the Board. The Plan will not be modified with respect to provisions concerning Awards or Non-Employee Directors without obtaining an order of the Commission or approval of the Commission.

### **B. The Existing Stock Option Plan**

Capital Southwest's existing Stock Option Plan enables the Company to provide to its executives (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 stock on the date of grant and thus have no ultimate value unless the value of the Company's 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 are generally exercisable on or after the first anniversary of the date of grant in five to ten annual installments and have a term of ten years. Upon termination 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). 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. The board does retain the right to make option holders whole in certain situations, e.g. liquidating dividend or distributions.

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.

### **C. 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.

## **V. REASON FOR REQUEST**

Capital Southwest believes that, because the market for qualified director candidates is highly competitive, Capital Southwest's successful performance depends on its ability to offer fair compensation packages to its directors that are competitive with those offered by other investment management businesses and public companies. In that regard, the ability to offer equity-based compensation, including Awards, to both its employees and Non-Employee Directors which both aligns the interests of Non-Employee Directors with shareholder interests and provides a retention tool, is vital to Capital Southwest's future growth and success.



The Plan would enable Capital Southwest to offer compensation packages to employees and Non-Employee Directors that are competitive with those offered by its competitors and other investment management businesses. Capital Southwest believes that granting Awards under the Plan to both employees and Non-Employee Directors is fair and reasonable. Non-Employee Directors provide Capital Southwest with the skills and experience necessary for management and oversight of Capital Southwest's investments and operations. The Awards to be granted to Non-Employee Directors are a necessary adjunct to the Non-Employee Directors' fees and provide fair and reasonable compensation for the services and attention they devote to Capital Southwest. Capital Southwest's Non-Employee Directors make a significant contribution to the management of Capital Southwest's business and to the analysis and supervision of its portfolio investments. The Non-Employee Directors serve as valuable resources for Capital Southwest's management regarding operational matters and strategic direction. The Non-Employee Directors also serve on the Board's three committees. Capital Southwest believes that these commitments of time and attention by its Non-Employee Directors are consistent with those described in prior applications for which the Commission has issued exemptive orders for the issuance of Awards to Non-Employee Directors. Capital Southwest also believes that granting Awards 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 Awards to employees.

## **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 Awards.

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 Awards 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 Awards to the Non-Employee Directors.

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 and directors 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 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 Awards is not specifically covered by Section 57(a)(4) or Rule 17d-1, the issuance of Awards 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 Awards and to include Non-Employee Directors as recipients of Awards pursuant to the Plan. Capital Southwest also asks that the Order apply to any future Non-Employee Directors.

## **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. Capital Southwest believes that its ability to offer equity-based compensation in the form of Awards is necessary for Capital Southwest to attract and retain talented employees, officers and directors, including Non-Employee Directors, 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 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 directors 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.<sup>4</sup> Capital Southwest believes that the issuance of Awards to Non-Employee Directors of Capital Southwest, for purposes of investor protection under the 1940 Act, is substantially similar to what is currently permitted under Section 61.

### **B. Prior Commission Orders Relating to Awards and Non-Employee Director Compensation**

#### **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 Awards to MCG’s non-employee directors, employees and employees of MCG’s wholly owned consolidated subsidiaries.<sup>5</sup>

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<sup>4</sup> See Section 61(a)(3) of the 1940 Act.

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

*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 March 26, 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 Awards to Hercules’ non-employee directors and employees and employees of Hercules’ wholly-owned consolidated subsidiaries.<sup>6</sup>

*Kohlberg Capital Corporation.* Kohlberg Capital filed a similar application on February 27, 2007, and subsequent amendment 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 I Order”) permits Kohlberg Capital to issue Awards to Kohlberg Capital’s officers and employees and employees of Kohlberg Capital’s wholly-owned subsidiaries.<sup>7</sup>

*Kohlberg Capital Corporation.* Kohlberg Capital filed an application on February 27, 2007, and amended on February 13, 2008 and March 21, 2008, requesting an order under Section 61(a)(3)(B) of the Act approving the proposal to grant stock options to Non-Employee Directors. The order granted on April 23, 2008 (together with the Kohlberg I Order, the “Kohlberg Order”) permits Kohlberg Capital’s Non-Employee Directors to receive stock options.<sup>8,9</sup>

## 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) and Rule 17d-1. 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) and Rule 17d-1. These orders permitted the companies to implement broad equity-based compensation plans that included the issuance of restricted stock to their employees.<sup>10</sup>

### C. Standards for Exemption Under Section 6(c)

Section 6(c), which governs Capital Southwest’s request for exemptive relief from Section 23 and 63 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 provisions of the 1940 Act, if and to the extent

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

<sup>7</sup> See *Kohlberg Capital Corporation*, Investment Company Act Release Nos 28168 (March 24, 2008) (notice) and 28199 (April 23, 2008) (order).

<sup>8</sup> See *Kohlberg Capital Corporation*, Investment Company Act Release Nos 28228 (March 28, 2008) (notice) and 28239 (April 23, 2008) (order).

<sup>10</sup> See *Baker, Fentress & Company, Investment Company* Act Release No. 23619 (Dec. 22, 1998) (the “Baker Fentress Order”) and *Adams Express Company, et. al.*, Investment Company Act Release No. 26780 (March 8, 2005) (the “Adams Express Order”). Capital Southwest notes that, in each of their respective applications, Adams Express and Baker Fentress cited the legislative history of the 1980 Amendments as standing for the idea that Congress had recognized the importance of equity-based compensation as a means of attracting and retaining qualified personnel. Both Adams Express and Baker Fentress received orders from the Commission permitting the issuance of equity-based compensation, including direct grants of stock.

that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the 1940 Act's policy and provisions.

### 1. Necessary or Appropriate in the Public Interest

As indicated above, both the Commission and Congress have long recognized the importance of equity-based compensation in attracting and retaining qualified personnel, including directors. Capital Southwest submits that maintaining the ability of a BDC to provide capital and management expertise to privately-held companies by attracting and retaining highly qualified employees, officers and directors is in the public interest, including the interests of Capital Southwest's shareholders. Capital Southwest competes for talented directors and employees with banks, private equity funds, and other financial services companies that are not investment companies registered under the 1940 Act, all of which pay substantially higher cash compensation to directors. These organizations are able to offer all types of equity-based compensation to their directors and employees, including Awards, and, therefore, have an advantage over Capital Southwest in attracting and retaining highly qualified personnel. Non-Employee Directors provide Capital Southwest with the skills and experience necessary for management and oversight of Capital Southwest's investments and operations and may also have specific experience with respect to industries in which Capital Southwest invests. For Capital Southwest to compete on a more equal basis with such organizations, it must be able to attract and retain talented employees and directors, including Non-Employee Directors, and offer them comparable compensation packages.

### 2. Consistency with the Protection of Investors

Investors will be protected to at least the same extent that they are currently protected under Section 61(a)(3). The Plan was approved by the Board in accordance with Section 61(a)(3)(A)(iv) on June 2, 2009. The Plan has been submitted to Capital Southwest's shareholders for their approval or disapproval at the annual meeting. If the Plan is approved by shareholders, it will be implemented for employees (except that Awards will not be granted unless the relief requested herein is granted). Capital Southwest's shareholders will have the opportunity to decide for themselves the value of the prospective benefits offered by the Plan. Capital Southwest is subject to the standards and guidelines adopted by the Financial Accounting Standards Board for operating companies relating to the accounting for and disclosure of restricted stock, and the requirements under the Securities and Exchange Act of 1934, as amended (the "1934 Act"), relating to executive compensation disclosure for operating companies.<sup>11</sup>

If the Order is granted and shareholders approve the Plan, we expect to issue Awards under the Plan and Non-Employee Directors automatically will be eligible for grants under the Plan. Capital Southwest acknowledges that while Awards granted under the Plan would have a dilutive effect on the shareholders' equity in Capital Southwest, that effect would be minimal and would far be outweighed by the anticipated benefits of the Plan to Capital Southwest and its shareholders.

### 3. Consistency with the Purposes of the 1940 Act

As indicated earlier, Capital Southwest is at a disadvantage in competing with other financial services companies in attracting and retaining management directors because they cannot offer shares of the company as part of a compensation plan. The Commission previously recognized the problem of restricting equity compensation in the context of SBICs in 1971 and granted a limited exemption from the 1940 Act's provisions to permit SBICs to issue qualified stock options. Congress amended the 1940 Act in 1980 to permit BDCs also to issue warrants, options, and rights. The Commission again recognized these problems in the context of closed-end investment companies in 1985 and granted a limited exemption from the 1940 Act's provisions to permit certain internally managed closed-end investment companies to issue incentive stock options. In 1998, the

<sup>11</sup> In addition, Capital Southwest will comply with the amendments to the disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate 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).

Commission issued the Baker Fentress Order and in 2005, the Commission issued the Adams Express Order, both permitting numerous types of equity compensation, including the issuance of restricted stock by a registered closed-end investment company. In 2006, 2007 and 2008, the Commission issued the MCG Order, the Hercules Order and the Kohlberg Orders, respectively, permitting equity compensation, including the issuance of restricted stock by a BDC. In each of these instances, it was found that equity compensation would not offend the 1940 Act's policies and purposes.

In the present case, Capital Southwest is merely requesting that it be allowed to issue Awards in substantially the same manner and subject to substantially similar restrictions under which it is currently permitted to issue warrants, options, and rights to purchase under Section 61(a)(3). In terms of the issuance of shares of restricted stock to employees and Non-Employee Directors, Capital Southwest is merely requesting that it be allowed to issue such Awards in a substantially similar manner and subject to substantially similar restrictions as the Commission has, by way of an order, permitted BDCs and closed-end funds to issue restricted stock. Capital Southwest further submits that the Plan would not violate the purposes behind Sections 23(a) and (b). The concerns underlying the enactment of those provisions included (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 made it difficult to determine the value of the company's shares; and (iii) dilution of shareholders' equity in the investment company.

The Plan does not raise concerns about preferential treatment of Capital Southwest's insiders because the Plan is a bona fide compensation plan of the type that is common among corporations generally, and that is contemplated by Section 61 of the 1940 Act and approved by the Commission in orders given to MCG, Hercules, Kohlberg Capital, Baker Fentress and Adams Express.

Capital Southwest further states that the Plan will not unduly complicate Capital Southwest's structure because equity-based incentive compensation arrangements are widely used among corporations and commonly known to investors. Capital Southwest notes that the Plan is being submitted to shareholders for their approval. Capital Southwest further notes that the Plan will be disclosed to investors in accordance with the requirements for registration statements, and pursuant to the standards and guidelines adopted by the Financial Accounting Standards Board for operating companies. Capital Southwest concludes that the Plan will be adequately disclosed to investors and appropriately reflected in the market value of Capital Southwest's shares of Common Stock. In addition, Capital Southwest states that its shareholders will be further protected by the conditions to the requested order that assure continuing oversight of the operation of the Plan by Capital Southwest's Board.

#### **D. Standards for an Order Under Rule 17d-1**

Rule 17d-1 provides that the Commission may, by order upon application, grant relief 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.

##### **1. Consistency with the 1940 Act's Policies and Purposes**

The arguments as to why the Plan is consistent with the 1940 Act are almost identical to the standards for exemptions under Section 6(c) and have been set forth above. Additionally, Section 57(j)(1) expressly permits any director, officer, or employee of a BDC to acquire warrants, options, and rights to purchase voting securities of such BDC, and the securities issued upon the exercise or conversion thereof, pursuant to an executive compensation plan which meets the requirements of Section 61(a)(3)(B). Capital Southwest submits that the issuance of Awards pursuant to the Plan poses no greater risk to shareholders than the issuances currently permitted by Section 57(j)(1).



2. Differences in Participation

Capital Southwest's Plan provides no differences in participation between Non-Employee Directors and other employees and officers.

**IX. CAPITAL SOUTHWEST'S CONDITIONS**

Capital Southwest agrees that the Order granting the requested relief will be subject to the following condition:

1. The Plan will be authorized by Capital Southwest's shareholders.

**X. PROCEDURAL MATTERS**

**A. Communications**

Please address all communications concerning this Application and the Notice and Order to:

Gary L. Martin

Chief Executive Officer

Capital Southwest Corporation

12900 Preston Road, Suite 700  
Dallas, Texas 75230

Please address any questions concerning this Application and a copy of any communications, notice, or order to:

Gina Betts, Esq.

Locke Lord Bissell & Liddell LLP

2200 Ross Ave., Suite 2200

Dallas, Texas 75201

**B. Authorization**

The filing of Capital Southwest's Application for the Order sought hereby and the taking of all acts reasonably necessary to obtain the relief requested herein was authorized by the unanimous consent of the Board dated June 2, 2009. A copy of the resolution then adopted by the Board is attached as Exhibit B. Such authorization still remains in full force and effect.

**XI. EXHIBITS**

Exhibit A      Capital Southwest Corporation 2009 Stock Incentive Plan



Exhibit B