

## On the Record

**Samuel Flax**  
American Capital Strategies

Samuel Flax is executive vice president and general counsel of American Capital Strategies, based in Bethesda, Md.

### Can you talk about what the company does?

Our primary business has been as a publicly traded private equity fund. We invest in private middle-market companies, about half of which we control and about half we don't control. That half-and-half comes from the tax code provision we operate under, which limits us to not controlling a majority of the companies in which we've invested. We are taxed as a regulated investment company, a class that includes mutual funds, which means that we generally don't pay income taxes as long as we dividend out most of our earnings to our stockholders. Congress wanted to make sure that investment companies aren't conglomerates in disguise, so they said you can't control more than half of your companies.

Most of our companies are companies people haven't heard of. Among our better-known control companies are Piper Aircraft and the franchiser for Aamco Transmissions. Among our noncontrol investments, where we're primarily a lender, are Gibson Guitar and Evenflo baby products. They're typically niche-type, nonpublic companies. We are organized as a business development company, which means that we have to put 70 percent of our assets into domestic, nonpublic, or microcap companies. We have, at any given time, about 225 to 250 portfolio companies.

In recent years, we've been following an initiative to develop an asset management business, so, through affiliates, we're managing other investment companies as well as directly making investments at American Capital. Our first managed fund was a European fund called European Capital. We're also an investor in European Capital and took it public in London in May of this year. We've now done several other private funds, as well.

When we went public in 1997, we raised \$150 million, which seemed huge at the time. Now we have \$11 billion in



assets on the American Capital balance sheet and a total of about \$17 billion of assets under management.

### Do you have a long history with the company?

I go back with the company 19 years. I started working with them when I was an associate at Arnold & Porter in the late 1980s. The company was founded in 1986. So I was not there at the very beginning, but I was involved close to the beginning.

It was founded as a boutique investment banking firm, specializing in employee buyout transactions, which used employee stock ownership plans, or ESOPs. We would help employees, typically at unionized manufacturing plants, buy their companies. Malon Wilkus, our founder—who is still our very active president, CEO, and chairman—was a pioneer in the employee ownership area. And I was the lawyer on a number of those transactions.

But those deals are not happening that much now. One thing that happened was the decline in domestic manufacturing. Another was the huge growth in private equity, which provided a buyer for many businesses that might have otherwise been sold to the employees. The employee buyouts were complicated, and our greatest challenge in ESOPs was getting enough capital to do

the transaction. Malon really wanted a fund to be able to do that sort of work. Through a confluence of circumstances in 1997, Friedman Billings, the investment banking firm in Arlington [Va.], took the company public. It was a surprisingly smooth IPO, and it was a privilege to represent the company.

The sea change in my relationship with the company was going public in '97. From the IPO on, this was my primary client. In fact, I attended more board meetings while still a partner at Arnold & Porter than any board member!

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### **How large is your legal department?**

We now have 16 lawyers, but when we went public in 1997, we had an idea that, other than our core investment function, we were going to outsource much of the company's work. We had Riggs Bank doing our loan accounting, accounting firms doing our financial due diligence on investments, and I was doing most of the legal work at Arnold & Porter. Not long after our IPO, we started the process of reversing the focus on outsourcing, although the legal department was about the last significant function to be built in-house.

We hired our first in-house lawyer four years ago. I was already sitting out here, but I was still an A&P partner, so I was only a de facto general counsel. The first hire was one of the Arnold & Porter associates who had been spending most of her time on American Capital matters. Over the next year, I started hiring others.

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### **Meanwhile, you were still at Arnold & Porter?**

Yes, it was sort of an odd thing. I was hiring and supervising in-house lawyers, but I was technically working for them as outside counsel. Malon had been after me for a long time to join the company and eventually he gave me a "fish or cut bait" speech. I joined full-time at the beginning of 2005.

Of our 16 lawyers, two are in London and all the rest in Bethesda. We basically have four groups. One does our corporate and capital-raising work. As you can imagine, we've raised a lot of capital through the years. Cydonii Fairfax, who heads that group, was that first lawyer who came over from Arnold & Porter. The second group, which is headed by Ken Pollack, works with our investment committee supervising our outside investment counsel, and they also work with our restructuring group. The third group does a fair amount of our investment transaction work in-house. They operate in the same way as our outside counsel, and it's headed by Mike Messersmith. The fourth group, led by Heather French, does litigation and employment matters.

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### **What would you say are your big legal issues?**

A significant issue is the regulatory environment we

operate under as a business development company. We are in many ways a hybrid, being in certain aspects an investment company and in other aspects a regular operating business. This extends to our regulatory environment, where, instead of being registered under the Investment Company Act, we're registered under the 1934 [Securities Exchange] Act. This subjects us to a very different regulatory and reporting scheme than most of the other companies under the jurisdiction of the SEC's Division of Investment Management. While we're now the largest business development company, and the BDC sector has grown significantly in recent years, we're still a very small portion of the universe regulated by Investment Management. That's one major issue.

There are also a number of potential issues arising from the current uncertainty of the capital markets, which could have ramifications for us as we raise and invest capital. For instance, if a recession occurs, we will probably see an increase in our restructuring work. We're also implementing a major new accounting pronouncement about the valuation of investment assets, which is affecting our disclosure and reporting.

And then, there's staying up to speed on the parallel universe of European regulations, which are quite different. When we went over there with European Capital, we knew that the basic business we do would be very much the same. But American Capital is very much a creation of American securities laws, American accounting practices, American capital markets, and American tax law, all of which are a little different over there. To duplicate the American Capital corporate and economic structure over there has been a real challenge. A further complication is that even with all the great progress of the EU trying to operate as a single entity, it's still much more different moving from country to country over there than from state to state here.

We were quite proud to receive the [Washington Metropolitan Area Corporate Counsel Association award for] outstanding legal department this year, and in the award citation, they noted the department's work on the European Capital IPO. This reflected the complicated nature of our European operations.

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### **What would you say you most enjoy about the job?**

I think it's being involved much more in the business side than even when I was de facto general counsel. I'm sitting in on most investment committee meeting discussions. It's a different role. We have a very collective decision-making process.

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### **What outside firms do you use?**

We still use Arnold & Porter a great deal, primarily for capital raising and litigation work. For investment work, we

use Weil, Gotshal & Manges, and we also use O'Melveny & Myers, Kirkland & Ellis, and Patton Boggs in Dallas, among others.

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**Can you talk more about your background?**

I grew up in Silver Spring [Md.], and both of my parents were lawyers, so it wasn't much of a surprise that I'd end up in law school. I was an associate first at Morgan, Lewis [ & Bockius] and then went to Arnold & Porter as a midlevel. I stayed at A&P for 20 years, the last 15 as a partner in the corporate and securities group. I went to Morgan, Lewis after a 4th Circuit clerkship for Judge Emory Widener. He took senior status this summer at the age of 84 and, very sadly, died shortly thereafter. At the time he took senior status, he was the longest-serving active circuit court judge in the country. He just kept going. When I was there, he had already been on the 4th for 10 years, and that was 25 years ago. He never got a lot of press attention and never sought it out. He sat in Abingdon, Va., a very small town in far southwest Virginia. There were rumors that Nixon was looking at him for the Supreme Court, and he was one of Nixon's first

appointees to the federal bench. Judge Widener had a very practical way of approaching cases. It was a great experience to clerk for him.

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**Where would we find you when you're not in the office?**

Well, I have three kids, which is a major component of my life. They're 14, 12, and 8. We had our first high school back-to-school night this year, and we figured out that we would have them for 10 straight years.

I like to ski, and I'm also trying to learn how to play golf, which will probably ultimately be futile.

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**Read any good books lately?**

I find that most of my reading is magazines and newspapers, but I've also been reading Alan Greenspan's *The Age of Turbulence: Adventures in a New World*. It came out this fall. He loved Ford, but was not too warm on either Bush, particularly the current one. ■