Your letter dated February 2, 2007 requests our views under sections 206(1) and (2) of the Investment Advisers Act of 1940 (the “Advisers Act”) concerning “hedge clauses,” as described more fully below, that are used by Heitman Capital Management, LLC, Heitman Institutional Advisors, Heitman Endowment Advisors, L.P., Heitman Institutional Realty Advisors L.P., and Heitman Real Estate Securities LLC (each, a “Heitman Advisor”) in investment advisory agreements with certain current and future sophisticated clients and clients that are represented by certain sophisticated financial intermediaries (the “Clients”). In particular, you request our assurance that we would not recommend that the Securities and Exchange Commission (“Commission”) take any enforcement action under sections 206(1) and (2) of the Advisers Act against a Heitman Advisor, if it includes a hedge clause and related disclosure substantially in the form described below in its investment advisory agreements with such Clients.

BACKGROUND

You state the following: The Heitman Advisors provide investment advisory services predominantly to institutional investors. Each Heitman Advisor is registered with the Commission as an investment adviser under the Advisers Act. Each Heitman Advisor, historically, has included a “hedge clause” in investment advisory contracts entered into with Clients. The following is an example of the wording of the hedge clause presently included in the Heitman Advisors’ form of such investment advisory contracts:

CLIENT INDEMNIFICATION: Client shall indemnify and hold harmless Manager [a Heitman Advisor] and its affiliates and their respective directors, managers, officers, agents and employees, from and against any and all losses, claims, demands, actions, or liability of any nature, including but not limited to attorneys’ fees, expenses and court costs, arising out of or in connection with this Agreement, except to the extent based upon, arising out of or in connection with Manager’s grossly negligent, reckless, willfully improper or illegal conduct in its performance or failure to perform under this Agreement, actions outside the scope of Manager’s authority or other material breach under this Agreement, by Manager, its directors, managers, officers, employees and agents.

The Heitman Advisors’ form of such investment advisory contracts also includes a provision that states, in essence, that the Client may have legal rights against the Heitman Advisor regardless of the hedge clause (“non-waiver disclosure”). The non-waiver disclosure immediately follows the “Client Indemnification” section. The following is an example of the wording of the non-waiver disclosure presently included in the Heitman Advisors’ form of such investment advisory contracts:
Non-Waiver of Rights: Notwithstanding the foregoing, nothing contained in this paragraph or elsewhere in this Agreement shall constitute a waiver by Client of any of its legal rights under applicable U.S. federal securities laws or any other laws whose applicability is not permitted to be contractually waived

You represent that the Clients, listed below, are sophisticated persons that have the resources and experience to understand the investment advisory agreements with the applicable Heitman Advisor, and the bargaining power to negotiate, and in some cases even dictate, the terms of the investment advisory agreements:

I. Investment companies that are registered as such under the Investment Company Act of 1940 (“Company Act”);
II. Institutional investors who are “qualified institutional buyers” as defined in rule 144A under the Securities Act of 1933;
III. Natural persons or companies who are “qualified clients” as defined in rule 205-3 under the Advisers Act;
IV. Any person or entity who is a “qualified purchaser” as defined in section 2(a)(51) of the Company Act (“Qualified Purchasers”); and
V. Any commingled fund entity (“CFE”), such as a multiple owner trust, partnership or limited liability company, that has a reasonable expectation (based upon indications of interests from investors) that it will meet the definition of Qualified Purchaser within 120 days of the date that the CFE acquires its first investment.

You state that the Heitman Advisors’ other Clients include the following persons:

VI. Investors in wrap accounts (“Wrap Account Clients”) that are sponsored by registered investment advisers under the Advisers Act (“Wrap Account Sponsors”);
VII. Any CFE that is sponsored by an entity that is both unaffiliated with Heitman and a Qualified Purchaser (a “Qualified Sponsor”); and
VIII. Any entity all of the equity owners of which are entities or individuals of the types described in Categories I through VII above.

You represent that the Wrap Account Sponsors and the Qualified Sponsors are also sophisticated persons that have the resources and experience to understand the investment advisory agreements with the applicable Heitman Advisor, and the bargaining power to negotiate, and in some cases even dictate, the terms of the investment advisory agreements.\(^1\) You state that the Wrap Account Sponsors and the Qualified Sponsors act as intermediaries (the “Intermediaries”) between the appropriate Heitman Advisor and the Wrap Account Clients and the CFE (and its investors), respectively, and enter into investment advisory agreements with the appropriate Heitman Advisor on behalf of the

\(^1\) Telephone conversation among Kenneth C. Fang of the staff, and Jack W. Murphy and Christopher D. Christian of Dechert LLP, counsel to the Heitman Advisors, on February 12, 2007 (“February 12 Telephone Call”).
Wrap Account Clients and the CFE, respectively.\(^2\) You represent that the Intermediaries generally oversee the performance of the applicable Heitman Advisor under the relevant investment advisory contract. You represent further that an Intermediary could evaluate, and assist a Client in interpreting, the hedge clause and the non-waiver disclosure in the unlikely event that a Heitman Advisor’s conduct gave rise to a cause of action under the investment advisory agreement.\(^3\)

You seek our views on the use of a hedge clause and non-waiver disclosure, of the type described above, in the Heitman Advisors’ investment advisory agreements with the Clients because the Heitman Advisors’ use of the hedge clause may raise issues under sections 206(1) and (2) of the Advisers Act.

LEGAL ANALYSIS

Sections 206(1) and 206(2) of the Advisers Act make it unlawful for any investment adviser to employ any device, scheme, or artifice to defraud, or to engage in any transaction, practice, or course of business that operates as fraud or deceit on clients or prospective clients. Those antifraud provisions may be violated by the use of a hedge clause or other exculpatory provision in an investment advisory agreement which is likely to lead an investment advisory client to believe that he or she has waived non-waivable rights of action against the adviser that are provided by federal or state law.\(^4\) We have previously taken the position that hedge clauses that purport to limit an investment adviser’s liability to acts involving gross negligence or willful malfeasance are likely to mislead a client who is unsophisticated in the law into believing that he or she has waived

\(^2\) You represent that the Wrap Account Sponsors and, in many instances, the Qualified Sponsors are fiduciaries with respect to the wrap account clients and CFEs, respectively, and as such must act in their best interests.

\(^3\) See February 12 Telephone Call. You contend that investment advisory clients have very limited rights of action to proceed under federal law against an investment adviser for violations of the Advisers Act, citing Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979).

non-waivable rights,\textsuperscript{5} even if the hedge clause explicitly provides that rights under federal or state law cannot be relinquished.\textsuperscript{6}

You contend, however, that whether a hedge clause would mislead a client into believing that he or she has waived non-waivable rights in violation of section 206 of the Advisers Act depends on all of the surrounding facts and circumstances. You also request guidance concerning the application of sections 206(1) and 206(2) of the Advisers Act to the use of a hedge clause and non-waiver disclosure, of the type described above, in the Heitman Advisors’ investment advisory contracts.

We believe that whether an investment adviser that uses hedge clauses in investment advisory agreements that purport to limit that adviser’s liability to acts of gross negligence or willful malfeasance violates sections 206(1) and 206(2) of the Advisers Act would depend on all of the surrounding facts and circumstances. In making this determination, we would consider the form and content of the particular hedge clause (\textit{e.g.}, its accuracy), any oral or written communications between the investment adviser and the client about the hedge clause, and the particular circumstances of the client.\textsuperscript{7} For instance, when a hedge clause is in an investment advisory agreement with a client who is unsophisticated in the law, we would consider factors including, but not limited to, whether: (i) the hedge clause was written in plain English; (ii) the hedge clause was individually highlighted and explained during an in-person meeting with the client; and (iii) enhanced disclosure was provided to explain the instances in which such client may still have a right of action. In addition, we would consider the presence and sophistication of any intermediary assisting a client in his dealings with the investment adviser and the nature and extent of the intermediary’s assistance to the client.

\textsuperscript{5} See Auchinloss & Lawrence Incorporated, SEC Staff No-Action Letter (Feb. 8, 1974).


\textsuperscript{7} We note that a hedge clause may be “misleading in its overall effect even though it might be argued that when narrowly and literally read, no single statement of material fact was false.” See In the Matter of Spear & Staff, Inc., Investment Advisers Act Release No. 188 (March 25, 1965), \textit{citing} SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 185-195 (1963). Furthermore, we note that an investment adviser has an affirmative duty to explain a hedge clause if the investment adviser believes or has reason to believe that a particular client, in light of his or her unique circumstances, would be likely to be misled by it. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963) (defining an investment adviser’s fiduciary duty as “an affirmative duty of ‘utmost good faith, and full and fair disclosure of all material facts,’ as well as an affirmative obligation ‘to employ reasonable care to avoid misleading’ [his or her] clients”).
Consequently, we believe that the Heitman Advisors’ use of a hedge clause and non-waiver disclosure, of the type described above, would not per se violate sections 206(1) and 206(2) of the Advisers Act. We take no position, however, regarding whether the use of any specific hedge clause and non-waiver disclosure by a Heitman Advisor would mislead any particular Client because of the fact-intensive nature of the inquiry that would be necessary to discern the relationship and communications between a Heitman Advisor and each Client (and any Intermediary), in light of the form and content of the hedge clause, and the Client’s particular circumstances. As a matter of policy, we will not provide no-action or interpretive assurances under sections 206(1) or (2) of the Advisers Act regarding an investment adviser’s use of any particular hedge clause with its clients.

Kenneth C. Fang
Senior Counsel