Apollo Structured Credit Recovery Management III LLC
Form 40-APP/A
March 21, 2014

No. 812-13754

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 5 TO APPLICATION FOR AN ORDER PURSUANT TO SECTIONS 17(d) AND 57(i) OF THE INVESTMENT COMPANY ACT OF 1940 AND RULE 17d-1 UNDER THE ACT TO PERMIT CERTAIN JOINT TRANSACTIONS OTHERWISE PROHIBITED BY SECTIONS 17(d) AND 57(a)(4) OF THE ACT AND RULE 17d-1 UNDER THE ACT

Apollo Investment Corporation, Apollo Tactical Income Fund Inc., Apollo Investment Management, L.P., Apollo Management VII, L.P., Apollo Management VIII, L.P., Apollo Global Real Estate Management, L.P., Apollo Capital Management, L.P., Apollo SVF Management, L.P., Apollo Value Management, L.P., Apollo Europe Management, L.P., Apollo EPF Management, L.P., Apollo Credit Opportunity Management III LLC, Apollo Credit Management II, L.P., Apollo Credit Management (CLO), LLC, Apollo Credit Management II GP, LLC, Athene Asset Management, LLC, Apollo Credit Management, LLC, Apollo Palmetto Strategic Partnership, L.P., Apollo Special Opportunities Managed Account, L.P., Apollo Value Investment Master Fund, L.P., Apollo Investment Europe II, L.P., Apollo Credit Opportunity Fund III LP, Apollo Investment Fund VII, L.P., Apollo Investment Fund VIII, L.P., Apollo Commercial Real Estate Finance, Inc., ACREFI Management, LLC, Apollo Credit Senior Loan Fund, L.P., Apollo Senior Floating Rate Fund Inc., Apollo/Palmetto Loan Portfolio, L.P., ALM IV, Ltd., AGRE U.S. Real Estate Fund, L.P., ALM V, Ltd., Apollo Longevity, LLC, A-A European Senior Debt Fund, L.P., Apollo Management Singapore Pte. Ltd., Apollo European Strategic Management, L.P., Apollo European Strategic Investments (Holdings), L.P., Apollo Residential Mortgage, Inc., ARM Manager, LLC, AGRE Debt Fund I, L.P., AGRE CRE Debt Manager, LLC, Apollo Natural Resources Partners, L.P., Apollo Commodities Management, L.P., Financial Credit Investment I, L.P., Financial Credit Investment I Manager, LLC, Apollo European Senior Debt Management, LLC, Apollo/Palmetto Short-Maturity Loan Portfolio, L.P., Apollo Credit Management (Senior Loans), LLC, 2011 Stone Tower HY Cayman Fund Trust, AGRE NA Management, LLC, ALM X, Ltd., ALM VI, Ltd., ALM VII, Ltd., ALM VII (R), Ltd., ALM VII (R)-2, Ltd., ALM VIII, Ltd., Apollo AF Loan Trust 2012, Apollo Asia Private Credit Master Fund Pte., Ltd., Apollo Centre Street Management, LLC, Apollo Centre Street Partnership, L.P., Apollo Credit Management (Senior Loans) II, LLC, Apollo Credit Master Fund Ltd., Apollo Credit Strategies Master Fund Ltd., Apollo EPF II Partnership, Apollo EPF Management II, L.P., Apollo European Credit Management, L.P., Apollo European Credit Master Fund, L.P., Apollo SK Strategic Investments, L.P., Apollo SK Strategic Management, LLC, Apollo ST Debt Advisors LLC, Apollo ST Fund Management LLC, Apollo Structured Credit Recovery Master Fund II Ltd., Cornerstone CLO Ltd., Rampart

CLO 2006-I Ltd., Rampart CLO 2007 Ltd., Stone Tower CLO V Ltd., Stone Tower CLO VI Ltd., Stone Tower CLO VII Ltd., Stone Tower Loan Trust 2010, Stone Tower Loan Trust 2011, Merx Aviation Finance Holdings, LLC, ALME Loan Funding 2013-1 Limited, Apollo Capital Spectrum Fund, L.P., Apollo Capital Spectrum Management, LLC, Apollo Credit Opportunity Management III, LLC, Apollo Credit Short Opportunities Fund, L.P., Apollo Credit Short Opportunities Management, LLC, Apollo Franklin Management, LLC, Apollo Franklin Partnership, L.P., Apollo Structured Credit Recovery Management III LLC, Apollo Structured Credit Recovery Master Fund III L.P., Apollo Total Return Management LLC, Apollo Total Return Master Fund L.P., Apollo Zeus Strategic Management, LLC, Apollo Zeus Strategic Investments, L.P., Financial Credit Investment II, L.P., Financial Credit Investment II Manager, LLC

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I. INTRODUCTION

A. Requested Relief

Apollo Investment Corporation and a number of its related entities, including affiliated investment advisers, regulated funds and unregulated funds hereby request an order (the ***Order***) pursuant to Sections 17(d) and 57(i) of the Investment Company Act of 1940 (the ***Act***[1]) and Rule 17d-1 thereunder[2] authorizing certain joint transactions that otherwise may be prohibited by either or both of Sections 17(d) and 57(a)(4) as modified by the exemptive rules adopted by the U.S. Securities and Exchange Commission (the ***Commission***) under the Act.

B. Entities for Which Relief is Sought:

Apollo Investment Corporation (***AIC***);

Merx Aviation Finance Holdings, LLC (***Merx***), a special purpose vehicle, 100% of the equity of which is owned by AIC;

Apollo Investment Management, L.P., AIC s investment adviser (***AIM***);

Apollo Senior Floating Rate Fund Inc. (***ASFRF***), a closed-end investment company registered under the Act and managed by Apollo Credit Management, LLC (***ACM***);

Apollo Tactical Income Fund Inc. (***AIF***), a closed-end investment company registered under the Act and managed by ACM;

The investment advisers to the Existing Affiliated Funds (defined below) that are identified in Appendix A (***Existing Advisers to Affiliated Funds***), each of which is registered as an investment adviser under the Investment Advisers Act of 1940 (the ***Advisers Act***); and

The investment vehicles identified in Appendix A, each of which is a separate and distinct legal entity and would be an investment company but for Section 3(c)(1), 3(c)(5)(C) or 3(c)(7) of the Act (the ***Existing Affiliated Funds***; together with AIC, Merx, AIM, ASFRF, AIF, ACM and the Existing Advisers to Affiliated Funds, the ***Applicants***).

In particular, the relief requested in this application (the ***Application***) would allow one or more Regulated Funds (including one or more AIC Funds) and/or one or more Affiliated Funds to participate in the same investment opportunities where such participation would otherwise be prohibited under Section 17(d) or 57(a)(4) and the rules under the Act. All existing

[1] Unless otherwise indicated, all section references herein are to the Act.

[2] Unless otherwise indicated, all rule references herein are to rules under the Act.

entities that currently intend to rely on the Order have been named as Applicants and any existing or future entities that may rely on the Order in the future will comply with its terms and Conditions set forth in this application.

C. Defined Terms

Adviser means AIM, ACM and the Existing Advisers to Affiliated Funds together with any future investment adviser that controls, is controlled by or is under common control with AGM (defined below) and is registered as an investment adviser under the Advisers Act.

Advisers to Affiliated Funds means the Existing Advisers to Affiliated Funds and any other Adviser that, in the future, serves as investment adviser to one or more Affiliated Funds.

Advisers to Regulated Funds means AIM, ACM and any other Adviser that, in the future, serves as investment adviser to one or more Regulated Funds.

Affiliated Fund means any Existing Affiliated Fund or any entity (a) whose investment adviser is an Adviser, (b) that is not a Regulated Fund, and (c) that is not a BDC Downstream Affiliate. No Existing Affiliated Fund is a BDC Downstream Affiliate.

AIC Fund means AIC or any AIC Downstream Fund.

AIC Downstream Fund means a BDC Downstream Fund that AIC directly or indirectly controls. Currently, the only AIC Downstream Fund is Merx. Merx engages primarily in aircraft operating leasing and is thus excluded from investment company status under Section 3(a). Applicants believe that allowing the other Regulated Funds and the Affiliated Funds to co-invest with Merx does not raise any legal or policy concerns that are not otherwise raised by allowing the other Regulated Funds and the Affiliated Funds to co-invest with entities that rely on Section 3(c)(1) or 3(c)(7) for exclusion from the definition of investment company under the 1940 Act because, in terms of its operation and purpose, Merx differs from a private fund only in that it invests primarily in aircraft subject to leases instead of securities. Each BDC Downstream Fund that relies on Section 3(c)(1) or 3(c)(7) for exclusion from the definition of investment company under the 1940 Act is or will be controlled by AIC, and its investment adviser is or will be AIC, a person that AIC directly or indirectly controls or an Adviser. In the same way, Merx is controlled by AIC (as noted above, AIC owns 100% of the equity of Merx) and AIC is Merx s investment adviser.

BDC means a business development company under the Act.[3]

BDC Downstream Fund means, with respect to any Regulated Fund that is a BDC, an entity (a) that the BDC directly or indirectly controls, (b) that is not controlled by any person other than the BDC (except a person that indirectly controls the entity solely because it controls the BDC), (c) that either (i) would be an investment company but for section 3(c)(1) or 3(c)(7) of

[3] Section 2(a)(48) defines a BDC to be any closed-end investment company that operates for the purpose of making investments in securities described in Section 55(a)(1) through 55(a)(3) and makes available significant managerial assistance with respect to the issuers of such securities.

the Act or (ii) is Merx, as described in more detail in the definition of AIC Downstream Fund above, (d) whose investment adviser is the BDC, a person that the BDC directly or indirectly controls or an Adviser, and (e) whose investment adviser is registered under the Advisers Act.

Board means the board of directors or the equivalent of any relevant entity, including an Independent Party where applicable.

Co-Investment Transaction means any transaction in which a Regulated Fund participated together with one or more Affiliated Funds and/or one or more other Regulated Funds in reliance on the Order.

Follow-On Investment means an additional investment in the same issuer, including, but not limited to, through the exercise of warrants, conversion privileges or other rights to purchase securities of the issuer.

Future Regulated Fund means a closed-end management investment company (a) that will be registered under the Act or will elect to be regulated as a BDC (as defined below); and (b) whose investment adviser will be an Adviser to Regulated Funds.

Independent Director means a director or the equivalent of any relevant entity who is not an interested person as defined in Section 2(a)(19) of the Act.

Potential Co-Investment Transaction means any investment opportunity in which a Regulated Fund could not participate together with one or more Affiliated Funds and/or one or more other Regulated Funds without obtaining and relying on the Order.

Regulated Funds means AIC, ASFRF, AIF, the Future Regulated Funds and the BDC Downstream Funds.

II. APPLICANTS

Each applicant below may be deemed to be directly or indirectly controlled by Apollo Global Management, LLC (***AGM***), a publicly traded company. AGM owns controlling interests in the Advisers, and thus may be deemed to control the Regulated Funds and the Affiliated Funds. AGM, however, is a holding company and does not currently offer investment advisory services to any person and is not expected to do so in the future. Accordingly, AGM has not been included as an Applicant.

A. Apollo Investment Corporation and Merx Aviation Finance Holdings, LLC

AIC is a specialty finance company that is a closed-end, non-diversified management investment company incorporated in Maryland. AIC has elected to be regulated as a BDC under the Act, has qualified and elected to be treated as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986, as amended, and intends to continue to qualify as a regulated investment company in the future.

AIC s investment objective is to generate both current income and capital appreciation through debt and equity investments. AIC invests primarily in middle market companies, where

it believes the supply of primary capital is limited and investment opportunities are most attractive. AIC s primary investment mandate (as more fully described in AIC s disclosure documents, as may be amended or supplemented from time to time) is to focus on senior secured loans and subordinated and mezzanine investments and/or equity in private middle market companies, which may include an equity component such as warrants. AIC may also invest in the securities of public companies. In addition, AIC and its affiliated persons, as defined in Section 2(a)(3)(C) of the Act (***Affiliates***), together have the ability to provide one stop financing with the ability to hold larger investments than many of AIC s competitors. The ability to hold larger investments benefits AIC s stockholders by: (i) increasing flexibility, (ii) broadening market relationships and access to deal flow, (iii) allowing AIC to optimize its portfolio composition, (iv) allowing AIC to provide capital to middle market companies, which AIC believes currently have limited access to capital from traditional lending sources, and (v) potentially increasing the availability of more favorable investment terms and protections.

AIC s business and affairs are managed under the direction of a Board, which currently consists of eight members, six of whom are Independent Directors. AIC s Board has delegated daily management and investment authority to AIM pursuant to an investment advisory and management agreement (the ***Investment Advisory Agreement***). Apollo Investment Administration, LLC (***Apollo Administration***) serves as AIC s administrator pursuant to an administration agreement.

Merx, a vehicle owned by AIC to engage in aircraft leasing and related businesses, is a Delaware limited liability company. If applicants receive the requested Order, Merx may on occasion co-invest with other Regulated Funds and with Affiliated Funds.

B. Apollo Investment Management, L.P.

AIM, a Delaware limited partnership that is registered under the Advisers Act, serves as the investment adviser to AIC pursuant to the Investment Advisory Agreement. Subject to the overall supervision of AIC s Board, AIM manages the day-to-day operations of, and provides investment advisory and management services to, AIC. Under the terms of the Investment Advisory Agreement, AIM determines the composition of AIC s portfolio, the nature and timing of the changes to AIC s portfolio, and the manner of implementing such changes, identifies, evaluates, and negotiates the structure of the investments AIC makes (including performing due diligence on AIC s prospective portfolio companies); closes, monitors and, when and where applicable, restructures the investments AIC makes; and determines the investments and other assets that AIC purchases, retains or sells.

Pursuant to the administration agreement, Apollo Administration furnishes AIC with office facilities, equipment and clerical, bookkeeping and record-keeping services at such facilities. Under the administration agreement, Apollo Administration also performs, or oversees the performance of, AIC s required administrative services, which include, among other things, being responsible for the financial records that AIC is required to maintain and preparing reports to AIC s stockholders and reports filed with the Commission. In addition, Apollo Administration oversees AIC in determining and publishing AIC s net asset value, oversees the preparation and filing of AIC s tax returns and the printing and dissemination of reports to AIC s stockholders, and generally oversees the payment of AIC s expenses and the performance of administrative and professional services rendered to AIC by others.

Both AIM and Apollo Administration are indirect subsidiaries of AGM, Affiliates of which are or will be the investment advisers to the Affiliated Funds.

C. Apollo Senior Floating Rate Fund Inc. and Apollo Credit Management, LLC

ASFRF is a Maryland corporation and is registered with the Commission under the Act as a closed-end, non-diversified management investment company. ASFRF s investment objective is to seek current income and preservation of capital through debt investments. ASFRF invests primarily in senior, secured loans made to companies whose debt is rated below investment grade and investments with similar economic characteristics. ASFRF may also invest in subordinated loans and corporate bonds. Subordinated loans generally have the same characteristics as senior, secured loans except that such loans are subordinated in payment and/or lower in lien priority to first lien holders. In addition, ASFRF may invest in (i) loan interests that are not secured by any collateral of a borrower; (ii) other income producing securities (including, without limitation, U.S. Government debt securities and investment and non-investment grade, subordinated and unsubordinated corporate debt securities); (iii) rights, warrants and equity securities issued by a borrower or its affiliates as part of a package of investments in a borrower or its affiliates and (iv) structured products. ASFRF may also invest in other assets for, among other reasons, cash management, financing activities or hedging transactions.

ASFRF s business and affairs are managed under the direction of its Board. ASFRF s Board currently consists of six members, four of whom are Independent Directors. ASFRF s Board has delegated daily management and investment authority to ACM pursuant to an investment advisory and management agreement. ACM also serves as ASFRF s administrator pursuant to an administrative services and expense reimbursement agreement. BNY Mellon Investment Servicing (US) Inc., serves as administrator to AIF pursuant to an administration and accounting services agreement.

D. Apollo Tactical Income Fund Inc.

AIF is a Maryland corporation and is registered with the Commission under the Act as a closed-end, non-diversified management investment company. AIF s investment objective is to seek current income and preservation of capital through debt investments. AIF invests primarily in credit instruments that are rated below investment grade, including senior, secured loans and high yield corporate bonds, based on absolute and relative value considerations and its analysis of the credit markets.

AIF s business and affairs are managed under the direction of its Board. AIF s Board currently consists of six members, four of whom are Independent Directors. AIF s Board has delegated daily management and investment authority to ACM pursuant to an investment advisory and management agreement. BNY Mellon Investment Servicing (US) Inc., serves as administrator to AIF pursuant to an administration and accounting services agreement.

E. Existing Affiliated Funds

The Existing Advisers to Affiliated Funds are the investment advisers to the Existing Affiliated Funds. The Affiliated Funds are not BDCs or registered investment companies. A complete list of the Existing Affiliated Funds and the Existing Advisers to Affiliated Funds is included in Appendix A.

III. ORDER REQUESTED

The Applicants respectfully request an Order of the Commission under Sections 17(d) and 57(i) and Rule 17d-1 thereunder to permit, subject to the terms and conditions set forth below in this Application (the ***Conditions***), a Regulated Fund and one or more other Regulated Funds and/or one or more Affiliated Funds to enter into Co-Investment Transactions with each other.

The Regulated Funds and the Affiliated Funds seek relief to enter into Co-Investment Transactions because such Co-Investment Transactions would otherwise be prohibited by either or both of Section 17(d) or Section 57(a)(4) and the Rules under the Act. This Application seeks relief in order to (i) enable the Regulated Funds and Affiliated Funds to avoid, among other things, the practical commercial and/or economic difficulties of trying to structure, negotiate and persuade counterparties to enter into transactions while awaiting the granting of the relief requested in individual applications with respect to each Co-Investment Transaction that arises in the future and (ii) enable the Regulated Funds and the Affiliated Funds to avoid the significant legal and other expenses that would be incurred in preparing such individual applications.

A. Overview

Applicants include multiple advisers that are subsidiaries of AGM. The Advisers manage numerous private equity, credit and real estate funds and separate accounts with a wide variety of mandates and aggregate assets of $161.2 billion as of December 31, 2013. These clients currently include a BDC and registered investment companies that are regulated under the Act. Each Adviser manages the assets entrusted to it by its clients in accordance with its fiduciary duty to those clients and, in the case of the BDC and the registered investment companies, the Act.

The Advisers are presented with thousands of investment opportunities each year on behalf of their clients and must determine how to allocate those opportunities in a manner that, over time, is fair and equitable to all of their clients, and without violating the prohibitions on joint transactions included in Rule 17d-1 or Section 57(a)(4) of the Act. If terms other than price and quantity are negotiated, then such investment opportunities may be joint transactions such that the Advisers may not include a Regulated Fund in the allocation if any Affiliated Fund is participating. Once invested in a security, the Regulated Funds and Affiliated Funds often have the opportunity to either complete an additional investment in the same issuer or exit the investment in a transaction that may be a joint transaction. Currently, if a Regulated Fund and one or more Affiliated Funds are invested in an issuer such funds may not participate in a Follow-On Investment or exit the investment if the terms of the transaction are subject to negotiation other than price and quantity.

As a result, the Advisers clients are limited in the types of transactions in which they can participate with each other, and the Regulated Funds, which currently represent less than 5% of the Advisers assets under management, often must forego transactions that would be beneficial to investors in the Regulated Funds. Thus, Applicants are seeking the relief requested by the Application for certain initial investments, Follow-On Investments, and dispositions as described below.

The Advisers have established rigorous processes for allocating initial investment opportunities, Follow-On Investment opportunities and dispositions of securities holdings designed to treat all clients fairly and equitably. As discussed below, these processes will be extended and modified in a manner reasonably designed to ensure that the additional transactions permitted under the Order will both (i) be fair and equitable to all clients and (ii) comply with the conditions contained in the Order.

1. Initial Investments under the Order

The Advisers are organized and managed such that the individual portfolio managers, as well as the teams and committees of portfolio managers, analysts and senior management (***Investment Teams*** *and* ***Investment Committees*** [4]) responsible for evaluating opportunities and making investment decisions on behalf of clients timely learn of the opportunities.

(a) The Investment Process

The investment process consists of three stages: (i) the identification and consideration of investment opportunities; (ii) order placement and allocation; and (iii) consideration by each applicable Regulated Fund s Board when a Potential Co-Investment Transaction is being considered by one or more Regulated Funds, as provided by the Order.

(i) Identification and Consideration of Investment Opportunities

When an Adviser first identifies an investment opportunity, the opportunity is assigned to one or more analysts or portfolio managers at an Adviser for an initial, high-level review. If the opportunity is not recommended for investment approval by the analyst or portfolio managers at the initial review, but the analysts or portfolio managers nevertheless believe the opportunity has potential investment merit, the opportunity may be assigned to one or more analysts or portfolio managers for additional due diligence and research. During and upon conclusion of the initial review and (if applicable) the additional due diligence and research, the Adviser circulates information about the opportunity, including any relevant written materials, to the portfolio managers, Investment Teams and Investment Committees responsible for any clients for which the opportunity may be appropriate. Each investment opportunity recommended for investment approval as a result of the initial review and/or further due diligence process is considered by the applicable portfolio managers, Investment Teams and Investment Committees on behalf of each client for which the opportunity may be appropriate.

[4] Investment Teams and Investment Committees responsible for an area of investment may include portfolio managers, analysts and senior management from among one or many of the Advisers

Opportunities for Potential Co-Investment Transactions may arise when investment advisory personnel of an Adviser become aware of investment opportunities that may be appropriate for one or more Regulated Funds and one or more Affiliated Funds. If the requested Order is granted, the Advisers will establish and maintain policies and procedures reasonably designed to ensure that, when such opportunities arise, the Advisers to the relevant Regulated Funds are notified and receive the same information about the opportunity as any other Advisers considering the opportunity for their clients. In particular, consistent with Condition 1, if a Potential Co-Investment Transaction falls within the then-current Objectives and Strategies[5] and any Board-Established Criteria[6] of a Regulated Fund, the policies and procedures will require that the relevant portfolio managers, Investment Teams and/or Investment Committees responsible for that Regulated Fund receive sufficient information to allow the Regulated Fund s Adviser to make its independent determination and recommendations under Conditions 1 and 2(a).[7] After receiving notification of a Potential Co-Investment Transaction under Condition 1(a), the Adviser to each applicable Regulated Fund, working through the applicable portfolio manager, or in conjunction with any applicable Investment Team or Investment Committee, will then make an independent determination of the appropriateness of the investment for the Regulated Fund in light of the Regulated Fund s then-current circumstances.

Applicants represent that, if the requested Order is granted, the investment advisory personnel of the Advisers to the Regulated Funds will be charged with making sure they identify and participate in this process with respect to each investment opportunity that falls within the Objectives and Strategies and Board-Established Criteria of each Regulated Fund. Applicants

5 ***Objectives and Strategies*** means (i) with respect to AIC, ASFRF, AIF and any Future Regulated Fund, its investment objectives and strategies, as described in its most current registration statement on Form N-2, other current filings with the Commission under the Securities Act or under the Securities Exchange Act of 1934, as amended, and its most current report to stockholders, and (ii) with respect to any BDC Downstream Fund, those investment objectives and strategies described in its disclosure documents (including private placement memoranda and reports to equity holders) and organizational documents (including operating agreements).

6 ***Board-Established Criteria*** means criteria that the Board of a Regulated Fund may establish from time to time to describe the characteristics of Potential Co-Investment Transactions regarding which the Adviser to the Regulated Fund should be notified under Condition 1. If no Board-Established Criteria are in effect, then the Regulated Fund s Adviser will be notified of all Potential Co-Investment Transactions that fall within the Regulated Fund s then-current Objectives and Strategies. Board-Established Criteria will be objective and testable, meaning that they will be based on observable information, such as industry/sector of the issuer, minimum EBITDA of the issuer, asset class of the investment opportunity or required commitment size, and not on characteristics that involve a discretionary assessment. The Adviser to the Regulated Fund may from time to time recommend criteria for the Board s consideration, but Board-Established Criteria will only become effective if approved by a majority of the Independent Directors. The Independent Directors of a Regulated Fund may at any time rescind, suspend or qualify its approval of any Board-Established Criteria, though Applicants anticipate that, under normal circumstances, the Board would not modify these criteria more often than quarterly.

7 Representatives from each Adviser to a Regulated Fund are members of each Investment Team or Investment Committee, or are otherwise entitled to participate in each meeting of any Investment Team or Investment Committee, that is expected to approve or reject recommended investment opportunities falling within its Regulated Funds Objectives and Strategies and Board-Established Criteria. Accordingly, the policies and procedures may provide, for example, that the Adviser will receive the information required under Condition 1 in conjunction with its representatives participation in the relevant Investment Team or Investment Committee.

assert that the process described above is structured so that the relevant investment advisory personnel for each Regulated Fund will become aware of, and upon receipt of the Order can take appropriate action with respect to, all Potential Co-Investment Transactions that fall within the then-current Objectives and Strategies and Board-Established Criteria of such Regulated Fund.

(ii) Order Placement and Allocation

General. If the Adviser to a Regulated Fund deems the Regulated Fund s participation in any Potential Co-Investment Transaction to be appropriate, it will, working through the applicable portfolio manager or in conjunction with any applicable Investment Team or Investment Committee, formulate a recommendation regarding the proposed order amount for the Regulated Fund. In doing so, the Adviser and any applicable Investment Team or Investment Committee may consider such factors, among others, as investment guidelines, issuer, industry and geographical concentration, availability of cash and other opportunities for which cash is needed, tax considerations, leverage covenants, regulatory constraints (such as requirements under the Act), investment horizon, potential liquidity needs, and the Regulated Fund s risk concentration policies.

Allocation Procedure. For each Regulated Fund and Affiliated Fund for which it recommends participating in a Potential Co-Investment Transaction, the Adviser will submit a proposed order amount to the internal trading function, which is comprised of a group of individual traders who collect and execute trades. Prior to the External Submission (as defined below), each proposed order amount may be reviewed and adjusted, in accordance with the Advisers written allocation policies and procedures, by an allocation committee for the area in question (e.g., credit, private equity, real estate) on which senior management, legal and compliance personnel from that area participate or, in the case of issues involving multiple areas or AGM as a whole, an AGM-wide allocation committee on which senior management, legal and compliance personnel for AGM participate. The order of a Regulated Fund or Affiliated Fund resulting from this process is referred to as its ***Internal Order*** . The Internal Order will be submitted for approval by the Required Majority of any participating Regulated Funds in accordance with Condition 2.

If the aggregate approved Internal Orders for a Potential Co-Investment Transaction do not exceed the size of the investment opportunity immediately prior to the submission of the orders to the underwriter, broker, dealer or issuer, as applicable (the ***External Submission***), then each Internal Order will be fulfilled as placed. If, on the other hand, the aggregate Internal Orders for a Potential Co-Investment Transaction exceed the size of the investment opportunity immediately prior to the External Submission, then the allocation of the opportunity will be made pro rata on the basis of the size of the Internal Orders.[8] If, subsequent to such submission, the size of the opportunity is increased or decreased, or if the terms of such opportunity, or the

[8] The Advisers will maintain records of all proposed order amounts, Internal Orders and External Submissions in conjunction with Potential Co-Investment Transactions. Each applicable Adviser will provide the Eligible Directors with information concerning the Affiliated Funds and Regulated Funds order sizes to assist the Eligible Directors with their review of the applicable Regulated Fund s investments for compliance with the Conditions.

facts and circumstances applicable to the Regulated Funds or the Affiliated Funds consideration of the opportunity, change, the participants will be permitted to resize their Internal Orders in accordance with the Advisers written allocation policies and procedures; *provided* that, if the size of the opportunity is decreased such that the aggregate of the original Internal Orders would exceed the amount of the remaining investment opportunity, then upon submitting any resized order amount to the Board of a Regulated Fund for approval, the Adviser to the Regulated Fund will also notify the Board of the amount that the Regulated Fund would receive if the remaining investment opportunity were allocated pro rata on the basis of the size of the original Internal Orders.

Compliance. The Applicants represent that the Advisers allocation review process is a robust process designed as part of their overall compliance policies and procedures to ensure that every client is treated fairly and that the Advisers are following their allocation policies. The entire allocation process is monitored and reviewed by the compliance team, led by the Chief Compliance Officer, and approved by the Board of each Regulated Fund.

(iii) Approval of Potential Co-Investment Transactions

A Regulated Fund will enter into a Potential Co-Investment Transaction with one or more other Regulated Funds and/or Affiliated Funds only if, prior to the Regulated Fund s participation in the Potential Co-Investment Transaction, the Required Majority approves it in accordance with the Conditions of this Order.

For purposes of this Application, the participation of a Regulated Fund other than a BDC Downstream Fund may only be approved by a required majority, as defined in Section 57(o) (a ***Required Majority***), of the directors of the Board (or Independent Party, where applicable) eligible to vote on that Potential Co-Investment Transaction under Section 57(o) (the ***Eligible Directors***[9]).

The participation of a BDC Downstream Fund may only be approved (i) if the BDC Downstream Fund has a Board, by the Required Majority of that Board[10] or (ii) if the BDC Downstream Fund does not have a Board, by a Required Majority of a transaction committee or advisory committee of the BDC Downstream Fund[11] (clause (i) or (ii), as applicable, the ***Independent Party***). In the case of an Independent Party consisting of a transaction committee or advisory committee, the individuals on the committee would possess experience and training comparable to that of the directors of the parent Regulated Fund and sufficient to permit them to make informed decisions on behalf of the applicable BDC Downstream Fund. The use of

9 In the case of a Regulated Fund that is a registered closed-end fund, the Board members that make up the Required Majority will be determined as if the Regulated Fund were a BDC subject to Section 57(o).

10 In the case of a BDC Downstream Fund, the Board members that make up the Required Majority will be determined as if the BDC Downstream Fund were a BDC subject to Section 57(o).

11 In the case of a BDC Downstream Fund with such a committee, the committee members that make up the Required Majority will be determined as if the BDC Downstream Fund were a BDC subject to Section 57(o) and as if the committee members were directors of the fund.

Independent Parties for BDC Downstream Funds results in a standard of approval that Applicants believe is equally as stringent as the standard of approval that a board of directors would apply. Most importantly, Applicants represent that the Independent Parties of the BDC Downstream Funds would be bound (by law or by contract) by fiduciary duties comparable to those applicable to the directors of the parent Regulated Fund, including a duty to act in the best interests of their respective funds when approving transactions. These duties would apply in the case of all Potential Co-Investment Transactions, including transactions that could present a conflict of interest.

Further, Applicants believe that the existence of differing routes of approval between the BDC Downstream Funds and other Regulated Funds would not result in Applicants investing through the BDC Downstream Funds in order to avoid obtaining the approval of a Regulated Fund s Board. Each Regulated Fund and BDC Downstream Fund has its own Objectives and Strategies and may have its own Board-Established Criteria, the implementation of which depends on the specific circumstances of the entity s portfolio at the time an investment opportunity is presented**.** As noted above, consistent with its duty to its BDC Downstream Funds, the Independent Party must reach a conclusion that the investment is in the best interest of its relevant BDC Downstream Funds. An investment made solely to avoid an approval requirement at the Regulated Fund level should not be viewed as in the best interest of the entity in question and, thus, would not be approved by the Independent Party.

The use of Independent Parties has been common practice in institutional funds for many years and sophisticated investors, including global institutional investors, have relied on their presence in fund structures to ensure equitable treatment. Moreover, although a traditional board of directors would not be required to approve Co-Investment Transactions for a BDC Downstream Fund, a Board of a Regulated Fund would be required, as part of the overall duty of care that it owes to that Regulated Fund and its shareholders, to monitor the Co-investment Transaction activity of the Regulated Fund s respective BDC Downstream Funds to ensure that no pattern of abuse was extant.

(b) Delayed Settlement

All Regulated Funds and Affiliated Funds participating in a Co-Investment Transaction will invest at the same time, for the same price and with the same terms, conditions, class, registration rights and any other rights, so that none of them receives terms more favorable than any other. However, the settlement date for an Affiliated Fund in a Co-Investment Transaction may occur up to ten business days after the settlement date for the Regulated Fund, and vice versa, for one of two reasons. First, this may occur when the Affiliated Fund or Regulated Fund is not yet fully funded because, when the Affiliated Fund or Regulated Fund desires to make an investment, it must call capital from its investors to obtain the financing to make the investment, and in these instances, the notice requirement to call capital could be as much as ten business days. Accordingly, if a fund has called committed capital from its investors but the investors have not yet funded the capital calls, it may need to delay settlement during the notice period. Second, delayed settlement may also occur where, for tax or regulatory reasons, an Affiliated Fund or Regulated Fund does not purchase new issuances immediately upon issuance but only after a short seasoning period of up to ten business days. Nevertheless, in all cases, (i) the date on which the commitment of the Affiliated Funds and Regulated Funds is made will be the same

even where the settlement date is not and (ii) the earliest settlement date and the latest settlement date of any Affiliated Fund or Regulated Fund participating in the transaction will occur within ten business days of each other. Delayed settlement may occur in connection with a Co-Investment Transaction and in connection with a Follow-On Investment.

Applicants believe that an earlier or later settlement date does not create any additional risk for the Regulated Funds. As described above, the date of commitment will be the same and all other terms, including price, will be the same. Further, the investments by the Regulated Funds and the Affiliated Funds will be independent from each other, and a Regulated Fund would never take on the risk of holding more of a given security than it would prefer to hold in the event that an Affiliate Fund or another Regulated Fund did not settle as expected.

2. Follow-On Investments

From time to time the Advisers may have opportunities to make Follow-On Investments in the securities of issuers in which one or more Regulated Fund or one or more Affiliated Funds previously have invested. If the Order is granted, Follow-On Investments will be made in a manner that, over time, is fair and equitable to all of the Regulated Funds and Affiliated Funds and in accordance with the proposed procedures discussed above and with the Conditions of the Order.

One or more Regulated Funds and/or one or more Affiliated Funds may be invested in the same issuer for several reasons. First, they may have acquired a security in a Co-Investment Transaction subject to approval by a Required Majority of the relevant Regulated Funds under the Conditions of the Order. Second, they may have acquired securities of an issuer in a transaction or multiple transactions that did not implicate Rule 17d-1 or Section 57(a)(4), as applicable, for a variety of reasons and thus were not Potential Co-Investment Transactions subject to the Conditions of the Order.[12] As discussed below, and consistent with the Conditions of the Order, additional procedures are required to make a Follow-On Investment that is a Potential Co-Investment Transaction if the acquisition of any of the issuer s securities owned by the Regulated Funds or the Affiliated Funds has not been approved by the Required Majority of the applicable Regulated Funds in accordance with the Conditions of the Order.

Each Regulated Fund and each Affiliated Fund will bear its own expenses in connection with any Follow-On Investments approved by a Required Majority (including Pro Rata Follow-On Investments conducted pursuant to blanket authorization) in accordance with the conditions of the Order.

[12] For example, the transactions may have been (i) completed separate in time and therefore were not joint, (ii) made in reliance on certain exemptions included under the Act, such as Rule 17d-1(d)(5), or (iii) completed in reliance on no-action letters or other interpretive advice from the Commission staff, including SMC Capital, Inc., SEC No-Action Letter, September 5, 1995 (***SMC***) and Massachusetts Mutual Life Insurance Company, SEC No-Action Letter, June 7, 2000 (***MassMutual***).

(a) Follow-On Investments Subject to Approval by a Required Majority

(i) Transactions Subject to Standard Approval

If one or more Regulated Funds and one or more Affiliated Funds own securities of an issuer and the participation of the Regulated Funds in the acquisition of the securities has been approved by the Required Majority of the applicable Regulated Funds because either:

the securities were all purchased in one or more Co-Investment Transactions approved by the Required Majority of the participating Regulated Funds under Condition 2 and in Pro Rata Follow-On Investments (as defined below) under Condition 8(b)(i)(A); or

any prior acquisitions of securities of the issuer that did not implicate Rule 17d-1 or Section 57(a)(4), as applicable, were followed by a Co-Investment Transaction approved by the Required Majority of the participating Regulated Funds under Conditions 8(c) and (d) (which require the Required Majority not only to approve the Follow-On Investment before them but to make the findings required by Conditions 8(c) and (d) with respect to any prior transactions that did not implicate Rule 17d-1 or Section 57(a)(4), as applicable) and in any Pro Rata Follow-On Investments;

(collectively ***Reviewed Transactions***), then any subsequent purchases of securities of the issuer that are subject to Rule 17d-1 or Section 57(a)(4), as applicable, will either be made without Board approval under Condition 8(b) or with the approval of the Required Majority of the applicable Regulated Funds using the standard procedures required under Condition 8(c) (which refers to Condition 2 covering initial purchases of securities under the Order).

The standard procedures, among other things, require that if any Regulated Fund or Affiliated Fund desires to make such a Follow-On Investment, the Adviser to each such Regulated Fund or Affiliated Fund will:

notify each Regulated Fund that participated in any of the Reviewed Transactions of the proposed new investment at the earliest practical time; and

provide its written recommendation as to each Regulated Fund s participation in the proposed new investment, including the amount of the proposed new investment, to the Eligible Directors of each such Regulated Fund.

A Regulated Fund will participate in such Follow-On Investment at the same price and on the same terms and conditions as the other participating Regulated Funds and Affiliated Funds, but only to the extent that a Required Majority determines that it is in the Regulated Fund s best interests.

In order for a Regulated Fund to participate in such a Follow-On Investment, all Regulated Funds and Affiliated Funds that hold securities of the issuer immediately before the time of completion of the Follow-On Investment must hold the same security or securities of the issuer. For the purpose of determining whether the Regulated Funds and Affiliated Funds hold the same security or securities, they will disregard any security held by some but not all of them

if, prior to relying on the Order, the Required Majority is presented with all information necessary to make a finding, and finds, that: (i) any Affiliated Fund s holding of different securities (including for this purpose a security with a different maturity date) is immaterial in amount, including immaterial relative to the size of the issuer;[13] and (ii) the Board records the basis for any such finding in its minutes. In addition, securities that differ only in respect of issuance date, currency, or denominations may be treated as the same security.

(ii) Transactions Subject to Enhanced Approval by a Required Majority

In some cases, one or more Regulated Funds and/or one or more Affiliated Funds may have the opportunity to make a Follow-On Investment that is a Potential Co-Investment Transaction that is not covered under Section III.A.2.a.i above. For example, the securities may have been acquired in Qualified Transactions (as defined below) without a Co-Investment Transaction ever having arisen. Or, a Co-Investment Transaction may have occurred, after which one or more Qualified Transactions occurred which have not yet been approved by the Required Majority of the applicable Regulated Funds in connection with a Follow-On Investment submitted to such Boards pursuant to Conditions 8(c) and (d). To make a Follow-On Investment that is a Potential Co-Investment Transaction in these cases:

The issuer s securities must have been acquired only in Co-Investment Transactions (including prior Follow-On Investments that received approval by a Required Majority under Section III.A.2.a.i or this Section III.A.2.a.ii), Qualified Transactions or a combination of such transactions.

All Regulated Funds and Affiliated Funds that hold securities of the issuer immediately before the time of completion of the Follow-On Investment hold the same security or securities of the issuer. For the purpose of determining whether the Regulated Funds and Affiliated Funds hold the same security or securities, they will disregard any security held by some but not all of them if, prior to relying on the Order, the Required Majority is presented with all information necessary to make a finding, and finds, that: (x) any Affiliated Fund s holding of a different class of securities (including for this purpose a security with a different maturity date) is immaterial in amount, including immaterial relative to the size of the issuer; and (y)

[13] In determining whether a holding is immaterial for purposes of the Order, the Required Majority will consider whether the nature and extent of the interest in the transaction is sufficiently small that a reasonable person would not believe that the interest affected the determination of whether to enter into the transaction or arrangement or the terms of the transaction or arrangement. *Cf.* Rule 17a-6(b)(1)(i)(H) and *Final Rule: Transactions of Investment Companies with Portfolio and Subadvisory Affiliates*, Release No. IC-25888 (Feb. 24, 2003), at Section I.A.2 (discussing materiality of financial interests). Situations of this type where holdings by some funds of different securities of the same issuer may be immaterial may include, for example, where an Affiliated Fund or Regulated Fund that did not acquire securities in an initial Co-Investment Transaction (such as because it had not yet been formed or had an industry concentration or other factor that precluded or made inadvisable its participation in the investment) acquired different securities in a Follow-On Investment requiring approval by a Required Majority and now wishes to participate in a subsequent Follow-On Investment requiring approval by a Required Majority even though it does not hold any of the securities acquired by other Regulated Funds or Affiliated Funds in the initial Co-Investment Transaction.

the Board records the basis for any such finding in its minutes. In addition, securities that differ only in respect of issuance date, currency, or denominations may be treated as the same security.

The Affiliated Funds (individually or in the aggregate) do not control the issuer of the securities.

Such Follow-On Investments will be acquired pursuant to the same procedures applicable to an original Co-Investment Transaction under Condition 2, except that the exceptions for certain Pro Rata Investments will not apply. The procedures, among other things, will require that if any Regulated Fund or Affiliated Fund desires to make a Follow-On Investment in a portfolio company whose securities were acquired in one or more Qualified Transactions that are not Reviewed Transactions, the Adviser to each such Regulated Fund or Affiliated Fund will: (x) notify each Regulated Fund that holds the security at the earliest practical time; (y) formulate a recommendation as to the proposed participation, including the amount of the proposed investment, by such Regulated Fund; and (z) provide the Eligible Directors with all applicable information relating to the existing investments. The procedures will also require that (I) the Required Majority find that the making and holding of the original investments are not prohibited under Section 57 (as modified by Rule 57b-1) or Rule 17d-1, as applicable, and (II) independent counsel to the Board advises that the making and holding of the investments in the Qualified Transactions were not prohibited by Section 57 (as modified by Rule 57b-1) or Rule 17d-1, as applicable.

Before a Regulated Fund may complete such a Follow-On Investment under the Order, the Eligible Directors of each Regulated Fund participating in the investment must review the proposed Follow-On Investment both on a stand-alone basis and together with the Qualified Transactions in relation to the total economic exposure and other terms and the Required Majority of such Regulated Funds must approve the Follow-On Investment as if it were an original Co-Investment Transaction under Condition 2, including that (x) the terms of the transaction are reasonable and fair and do not involve overreaching, and (y) the transaction is in the best interest of the Regulated Fund and consistent with its investment objectives and policies to hold the total amount of securities of each issuer the Regulated Fund would hold if the Follow-On Investment is completed as proposed.

(b) Follow-On Investments Not Subject to Approval of a Required Majority

A Follow-On Investment may be made without the approval of the Required Majority if it is (i) a ***Pro Rata Follow-On Investment***, or (ii) a ***Qualified Transaction***, in each case as defined below. An Adviser to a Regulated Fund that participates in these types of Follow-On Investments will present to the Boards of the Regulated Funds that own securities of the issuer no less frequently than quarterly a record of all Follow-On Investments by each Affiliated Fund in securities of the issuer. These transactions do not present a significant opportunity for overreaching on the part of any Adviser and thus do not warrant the time or the attention of the Board.

(i) Pro Rata Follow-On Investments

A ***Pro Rata Follow-On Investment*** is a Follow-On Investment that is a Potential Co-Investment Transaction and that is (i) acquired and allocated among each Affiliated Fund and each Regulated Fund in proportion to its investments in the issuer or security, as appropriate,[14] immediately preceding the Follow-On Investment, and (ii) in the case of a Regulated Fund, the Required Majority has approved the Regulated Fund s participation in Pro Rata Follow-On Investments as being in the best interests of the Regulated Fund. The Regulated Fund s Required Majority may refuse to approve, or at any time rescind, suspend or qualify, its approval of Pro Rata Follow-On Investments in which case all subsequent Follow-On Investments that are Potential Co-Investment Transactions will be submitted to the Regulated Fund s Eligible Directors.

(ii) Qualified Transactions

A ***Qualified Transaction*** is any transaction in which a Regulated Fund participates together with one or more Affiliated Funds and/or one or more other Regulated Funds in which (i) the only terms negotiated on their behalf are price and quantity terms, (ii) the securities involved in the transaction are allocated among the Advisers clients in accordance with allocation policies that, in the case of the Regulated Funds, have been reviewed and approved pursuant to Rule 38a-1 and are consistent with the principals set forth by the staff of the Commission in *SMC* and *MassMutual*, and (iii) the securities were acquired in contemporaneous secondary market transactions or in an offering by the issuer, or, in the case of acquisitions occurring prior to an initial Co-Investment Transaction (and dispositions of securities so acquired) but not in the case of acquisitions occurring after an initial Co-Investment Transaction, were acquired or disposed of in transactions occurring at least 90 days apart and without coordination between the Regulated Fund and any Affiliated Fund.

3. Dispositions

The Regulated Funds and Affiliated Funds may be presented with opportunities to sell, exchange or otherwise dispose of securities in a transaction that implicates Rule 17d-1 or Section 57(a)(4), as applicable. If the Order is granted, such dispositions will be made in a manner that, over time, is fair and equitable to all of the Regulated and Affiliated Funds and in accordance with procedures set forth in the proposed Conditions to the Order and discussed below.

Similar to a situation in which securities are held by a Regulated Fund that is considering a Follow-On Investment, one or more Regulated Funds and/or one or more Affiliated Funds may

[14] To the extent that a Follow-On Investment opportunity is in a security or arises in respect of a security held by the participating Regulated Funds and Affiliated Funds, proportionality will be measured by each participating Regulated Fund s and Affiliated Fund s outstanding investment in the security in question immediately preceding the Follow-On Investment using the most recent available valuation thereof. To the extent that a Follow-On Investment opportunity relates to an opportunity to invest in a security that is not in respect of any security held by any of the participating Regulated Funds or Affiliated Funds, proportionality will be measured by each participating Regulated Fund s and Affiliated Fund s outstanding investment in the issuer immediately preceding the Follow-On Investment using the most recent available valuation thereof.

be invested in the same issuer for several reasons. First, they may have acquired a security in a Co-Investment Transaction approved by the Required Majority of the relevant Regulated Funds under the Conditions of the Order. Second, they may have acquired securities of an issuer in one or more transactions that did not implicate Rule 17d-1 or Section 57(a)(4), as applicable, for a variety of reasons and thus were not subject to the Conditions of the Order and wish to dispose of those securities in a manner that would be prohibited by Rule 17d-1 and, if applicable, Section 57(a)(4) in the absence of the Order.

Each Regulated Fund and each Affiliated Fund will bear its own expenses in connection with any such disposition approved by a Required Majority (including Pro Rata Follow-On Investments conducted pursuant to blanket authorization) in accordance with the Conditions of the Order.

(a) Dispositions of Securities Subject to Approval by a Required Majority

(i) Dispositions Subject to Standard Approval

If all of the securities of an issuer owned by one or more Regulated Funds and one or more Affiliated were acquired in Reviewed Transactions, then any dispositions of those securities by the applicable Regulated Funds may be made either without Board approval under Condition 7(c) or with standard Board approval under Condition 7(d).

The standard procedures require the Adviser to each such Regulated Fund or Affiliated Fund that elects to sell, exchange or otherwise dispose of an interest in a security that was acquired in a Co-Investment Transaction to:

notify each Regulated Fund that participated in any of the Co-Investment Transactions of the proposed disposition at the earliest practical time; and

provide its written recommendation as to each Regulated Fund s participation in the proposed disposition, including the amount of securities to be disposed, to the Eligible Directors of each such Regulated Fund.

A Regulated Fund will participate in such disposition at the same price and on the same terms and conditions as those applicable to the participating Regulated Funds and participating Affiliated Funds, but only to the extent that a Required Majority determines that it is in the Regulated Fund s best interests.

(ii) Dispositions Subject to Enhanced Approval

In some cases, one or more Regulated Funds and one or more Affiliated Funds may have the opportunity to make a disposition that is not covered under Section III.A.3.a.i above but that would be prohibited by Rule 17d-1 and, if applicable, Section 57(a)(4) in the absence of the Order. For example, even though the securities may have been acquired outside of the Order in Qualified Transactions without a Co-Investment Transaction ever having arisen or after approval of a Co-Investment Transaction by the Required Majority of the applicable Regulated Funds, the Regulated Funds and Affiliated Funds may wish to sell such securities in a transaction when terms other than price or quantity are negotiated, such as a voting agreement. To make a disposition in these cases:

The securities will be disposed of pursuant to the same procedures required to approve a disposition under paragraphs (a), (b) and (c) of Condition 7, except that the exceptions for certain Pro Rata Dispositions will not apply. These procedures, among other things, will require that if any Regulated Fund or Affiliated Fund elects to sell, exchange or otherwise dispose of securities of an issuer that were acquired in one or more Qualified Transactions that are not Reviewed Transactions, the Adviser to each such Regulated Fund or Affiliated Fund will (x) notify each Regulated Fund that holds the class of the security of the proposed disposition at the earliest practical time; (y) formulate a recommendation as to participation by such Regulated Fund in the disposition and (z) provide the Eligible Directors with all applicable information relating to the existing investments. The procedures will also require that (I) the Required Majority find that the making and holding of the original investments are not prohibited under Section 57 (as modified by Rule 57b-1) or Rule 17d-1, as applicable, and (II) independent counsel to the Board advises that the making and holding of the investments in the Qualified Transactions were not prohibited by Section 57 (as modified by Rule 57b-1) or Rule 17d-1, as applicable.

Before a Regulated Fund may complete such a disposition under the Order, the Required Majority of each Regulated Fund participating in the disposition must approve its participation in the disposition based on findings that (i) the terms of the transaction are reasonable and fair and do not involve overreaching, and (ii) the disposition is in the best interest of the Regulated Fund and it is consistent with the Regulated Fund s Objectives and Strategies and Board-Established Criteria to hold the total amount of securities of each issuer the Regulated Fund would hold if the disposal is completed as proposed.

(b) Dispositions of Securities Not Subject to Approval by a Required Majority

A disposition of securities acquired in a Co-Investment Transaction (including in a Follow-On Investment approved by a Required Majority under Conditions 8(c) or 8(d) and 8(e)) may be made without the approval of the Required Majority if (i) the disposition is a ***Pro Rata Disposition***; or (ii) the securities are ***Tradable Securities***, in each case as defined below. In each case, however, an Adviser to a Regulated Fund participating in a disposition not subject to the approval of the Required Majority will present to the Board of such Regulated Fund no less frequently than quarterly a record of all dispositions by Regulated Funds and Affiliated Funds of securities of any issuer in which the respective Regulated Fund holds an interest. Dispositions of securities not acquired in a Co-Investment Transaction are not subject to approval by a Required Majority. These transactions do not present a significant opportunity for overreaching on the part of any Adviser and thus do not warrant the time or the attention of the Board.

(i) Pro Rata Dispositions

A ***Pro Rata Disposition*** is a disposition where (i) the participation of each Affiliated Fund and Regulated Fund in the disposition is proportionate to its investment in the security

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subject to disposition immediately preceding the disposition; and (ii) in the case of a Regulated Fund, the Required Majority has approved the Regulated Fund s participation in Pro Rata Dispositions as being in the best interests of the Regulated Fund. The Regulated Fund s Required Majority may refuse to approve, or at any time rescind, suspend or qualify, its approval of Pro Rata Dispositions in which case all subsequent Pro Rata Dispositions will be submitted to the Regulated Fund s Eligible Directors.

(ii) Dispositions of Tradable Securities

A ***Tradable Security*** is a security acquired in a Co-Investment Transaction (including in a Follow-On Investment approved by a Required Majority under Conditions 8(c) or 8(d) and 8(e)) that meets the following criteria:

at the time of disposition it trades on a national securities exchange or designated offshore securities market as defined in rule 902(b) under the Securities Act of 1933;

it is not subject to restrictive agreements with the issuer or other security holders;

it trades with sufficient volume (findings as to which are documented by the adviser and retained for the life of the Regulated Fund) to allow each Regulated Fund to dispose of its entire position remaining after the proposed disposition within a short period of time at the market price of the security;

the disposition is not to the issuer or any affiliated person of the issuer; and

the security is sold for cash in a transaction where the only terms of the security negotiated are price and quantity.

B. Applicable Law

1. Section 17(d) and Section 57(a)(4)

Section 17(d) of the 1940 Act generally prohibits an affiliated person (as defined in Section 2(a)(3) of the 1940 Act), or an affiliated person of such affiliated person, of a registered investment company acting as principal, from effecting any transaction in which the registered investment company is a joint or a joint and several participant, in contravention of such rules as the Commission may prescribe for the purpose of limiting or preventing participation by the registered investment company on a basis different from or less advantageous than that of such other participant.

Similarly, with regard to BDCs, Section 57(a)(4) prohibits certain persons specified in Section 57(b) from participating in a joint transaction with the BDC, or a company controlled by the BDC, in contravention of rules as prescribed by the Commission. In particular, Section 57(a)(4) applies to:

Any director, officer, employee, or member of an advisory board of a BDC or any person (other than the BDC itself) who is an affiliated person of the forgoing pursuant to Section 2(a)(3)(C); or

Any investment adviser or promoter of, general partner in, principal underwriter for, or person directly or indirectly either controlling, controlled by, or under common control with, a BDC (except the BDC itself and any person who, if it were not directly or indirectly controlled by the BDC, would not be directly or indirectly under the control of a person who controls the BDC);[15] or any person who is an affiliated person of any of the forgoing within the meaning of Section 2(a)(3)(C) or (D).

[15] Also excluded from this category by Rule 57b-1, is any person who would otherwise be included (a) solely because that person is directly or indirectly controlled by a business development company, or (b) solely because that person is, within the meaning of Section 2(a)(3)(C) or (D), an affiliated person of a person described in (a) above.

Pursuant to the foregoing application of Section 57(a)(4), BDC Downstream Funds on the one hand and other Regulated Funds and Affiliated Funds on the other, may not co-invest absent an exemptive order because the BDC Downstream Funds are controlled by a BDC and the Affiliated Funds and other Regulated Funds are included in Section 57(b).

Section 2(a)(3)(C) defines an affiliated person of another person to include any person directly or indirectly controlling, controlled by, or under common control with, such other person. Section 2(a)(3)(D) defines any officer, director, partner, copartner, or employee of an affiliated person as an affiliated person. Section 2(a)(9) defines control as the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with that company. Under Section 2(a)(9) a person who beneficially owns, either directly or through one or more controlled companies, more than 25% of the voting securities of a company is presumed to control such company. The Commission and its staff have indicated on a number of occasions their belief that an investment adviser that provides discretionary investment management services to a fund and that sponsored, selected the initial directors, and provides administrative or other non-advisory services to the fund, controls such fund, absent compelling evidence to the contrary.[16]

2. Rule 17d-1

Rule 17d-1 generally prohibits an affiliated person (as defined in Section 2(a)(3)), or an affiliated person of such affiliated person, of a registered investment company acting as principal, from effecting any transaction in which the registered investment company, or a company controlled by such registered company, is a joint or a joint and several participant, in contravention of such rules as the Commission may prescribe for the purpose of limiting or preventing participation by the registered investment company on a basis different from or less advantageous than that of such first or second tier affiliate. Rule 17d-1 generally prohibits participation by a registered investment company and an affiliated person (as defined in Section 2(a)(3))

[16] See, e.g., SEC Rel. No. IC-4697 (Sept. 8, 1966) (For purposes of Section 2(a)(3)(C), affiliation based upon control would depend on the facts of the given situation, including such factors as extensive interlocks of officers, directors or key personnel, common investment advisers or underwriters, etc.); Lazard Freres Asset Management (pub. Avail January 10, 1997) (While, in some circumstances, the nature of an advisory relationship may give an adviser control over its client s management or policies, whether an investment company and another entity are under common control is a factual question).

or principal underwriter for that investment company, or an affiliated person of such affiliated person or principal underwriter, in any joint enterprise or other joint arrangement or profit-sharing plan, as defined in the rule, without prior approval by the Commission by order upon application.

Rule 17d-1 was promulgated by the Commission pursuant to Section 17(d) and made applicable to persons subject to Sections 57(a) and (d) by Section 57(i) to the extent specified therein. Section 57(i) provides that, until the Commission prescribes rules under Sections 57(a) and (d), the Commission s rules under Section 17(d) applicable to registered closed-end investment companies will be deemed to apply to persons subject to the prohibitions of Section 57(a) or (d). Because the Commission has not adopted any rules under Section 57(a) or (d), Rule 17d-1 applies to persons subject to the prohibitions of Section 57(a) or (d).

Applicants seek relief pursuant to Rule 17d-1, which permits the Commission to authorize joint transactions upon application. In passing upon applications filed pursuant to Rule 17d-1, the Commission is directed by Rule 17d-1(b) to consider whether the participation of a registered investment company or controlled company thereof in the joint enterprise or joint arrangement under scrutiny is consistent with provisions, policies and purposes of the 1940 Act and the extent to which such participation is on a basis different from or less advantageous than that of other participants.

The Commission has stated that Section 17(d), upon which Rule 17d-1 is based, and upon which Section 57(a)(4) was modeled, was designed to protect investment companies from self-dealing and overreaching by insiders. The Commission has also taken notice that there may be transactions subject to these prohibitions that do not present the dangers of overreaching.[17] The Court of Appeals for the Second Circuit has enunciated a like rationale for the purpose behind Section 17(d): The objective of [Section] 17(d) is to prevent injuring the interest of stockholders of registered investment companies by causing the company to participate on a basis different from or less advantageous than that of such other participants.[18] Furthermore, Congress acknowledged that the protective system established by the enactment of Section 57 is similar to that applicable to registered investment companies under Section 17, and rules thereunder, but is modified to address concerns relating to unique characteristics presented by business development companies.[19]

Applicants believe that the Conditions would ensure that the conflicts of interest that Section 17(d) and Section 57(a)(4) were designed to prevent would be addressed and the standards for an order under Rule 17d-1 and Section 57(i) would be met.

17 See Protecting Investors: A Half-Century of Investment Company Regulation, 1504 Fed. Sec. L. Rep., Extra Edition (May 29, 1992) at 488 *et seq.*

18 Securities and Exchange Commission v. Talley Industries, Inc., 399 F.2d 396, 405 (2d Cir. 1968), cert. denied, 393 U.S. 1015 (1969).

19 H.Rep. No. 96-1341, 96th Cong., 2d Sess. 45 (1980) *reprinted in* 1980 U.S.C.C.A.N. 4827.

C. Need for Relief

Co-Investment Transactions are prohibited by either or both of Rule 17d-1 and Section 57(a)(4) without a prior exemptive order of the Commission to the extent that the Affiliated Funds and the Regulated Funds participating in such transactions fall within the category of persons described by Rule 17d-1 and/or Section 57(b), as modified by Rule 57b-1 thereunder, as applicable, vis-à-vis each participating Regulated Fund.

Each of the participating Regulated Funds and Affiliated Funds may be deemed to be affiliated persons vis-à-vis a Regulated Fund within the meaning of Section 2(a)(3) by reason of common control because (i) controlled Affiliates of AGM manage each of the Affiliated Funds and ASFRF and AIF and may be deemed to control any future Regulated Fund, (ii) AGM controls AIM, which manages AIC pursuant to the Investment Advisory Agreement, and (iii) AIC Downstream Funds, are, and, in the future will be, deemed to be controlled by AIM, AIC or certain of AIC s subsidiaries. Thus, each of the Affiliated Funds could be deemed to be a person related to the AIC Funds in a manner described by Section 57(b) and related to the other Regulated Funds in a manner described by Rule 17d-1; and therefore the prohibitions of Rule 17d-1 and Section 57(a)(4) would apply respectively to prohibit the Affiliated Funds from participating in Co-Investment Transactions with the Regulated Funds.

D. Precedents

The Commission has issued numerous exemptive orders under the Act permitting registered investment companies and BDCs to co-invest with affiliated persons.[20] Although the various precedents involved somewhat different formulae, the Commission has accepted, as a basis for relief from the prohibitions on joint transactions, use of allocation and approval procedures to protect the interests of investors in the BDCs and registered investment companies. Applicants submit that the allocation procedures set forth in the conditions for relief are consistent with and expand the range of investor protections found in the orders we cite.

While Applicants have sought to conform substantial portions of this Application and the conditions herein to recent precedent, most of the recent orders involving joint transactions have involved one or two managers that advise a small number of BDCs or regulated funds, on the one hand, and a small number of private funds, on the other hand. As discussed above,

[20] See, e.g., Prospect Capital Corporation, et. al (File No. 812-14199) Release No. IC-30909 (Feb. 10, 2014) (order), Release No. IC-30855 (Jan. 13, 2014) (notice); Medley Capital Corporation, et. al. (File No. 812-14020) Release No. IC-30807 (Nov. 25, 2013) (order), Release No. IC-30769 (Oct. 28, 2013) (notice); Stellus Capital Investment Corporation, et. al. (File No. 812-14061) Release No. IC-30754 (Oct. 23, 2013) (order), Release No. IC-30739 (Sept. 30, 2013) (notice); FS Investment Corporation, et al. (File No. 812-13665), Release No. IC-30548 (June 4, 2013) (order), Release No. IC-30511 (May 9, 2013) (notice); Corporate Capital Trust, Inc., et al. (File No. 812-13844), Release No. IC 30526 (May 21, 2013) (order), Release No. IC-30494 (April 25, 2013) (notice); Gladstone Capital Corp., et al (File No. 812-13878), Release No. IC-30154 (July 26, 2012) (order), Release No. IC-30125 (June 29, 2012) (notice); Medley Capital Corp., et al (File No. 812- 13787), Release No. IC- 30009, (March 26, 2012) (order), Release No. IC-29968 (Feb. 26, 2012) (notice); NGP Capital Resources Company, et al. (File No. 812-13695), Release No. IC-29860 (Nov. 10, 2011) (order), Release No. IC-29831(Oct. 7, 2011) (notice); Ridgewood Capital Energy Growth Fund, LLC, et. al. (File No. 812-13569), Release No. IC-28982 (Oct. 21, 2009) (order), Release No. IC-28931 (Sept. 25, 2009) (notice).

Applicants have multiple advisers with several regulated funds and numerous private funds, which have similar, but not identical investment objectives and policies. Due to the size and complexity of Applicants operations, an order based on existing precedents would not provide sufficient flexibility for the Regulated Funds to participate in attractive and appropriate investment opportunities that would be beneficial to their security holders.[21] Thus, for example, Applicants propose to limit the Potential Co-Investment Transactions of which each Adviser would be notified of to those investments that would be consistent with each fund s then-current Objectives and Strategies and Board-Established Criteria**,** thus reducing unnecessary burdens that would otherwise be imposed on Applicants. In addition, Applicants seek to extend existing precedents to obtain exemptive relief to permit co-investments by downstream affiliates of Regulated Funds that are not wholly owned subsidiaries of the Regulated Funds, subject to appropriate safeguards built into proposed conditions.

An order based solely on existing precedents also would not permit Applicants to participate in negotiated Follow-On Investments or negotiated dispositions unless the affiliates had completed the initial investment under the order, would require board approval for every transaction following a Co-Investment Transaction (except for certain pro rata follow-on investments and dispositions), and would prohibit co-investment under the order if any fund already held securities of the issuer or different funds held even insignificant amounts of different classes of securities.

Applicants began with the Application on the co-investment protocol followed by Gladstone Capital Corporation and its affiliates, for which an order was granted on July 26, 2012 (the ***Gladstone Order***);[22] however, Applicants are requesting that such protocol be expanded to allow for the additional requests included in this Application based on new conditions designed to protect the Regulated Funds. Although departing from existing precedent, Applicants believe that the relief requested herein is consistent with the policy underlying the Gladstone Order as well as co-investment relief granted by the Commission to other BDCs and to registered closed-end funds.

IV. STATEMENT IN SUPPORT OF RELIEF REQUESTED

In accordance with Rule 17d-1 (made applicable to transactions subject to Section 57(a) by Section 57(i)), the Commission may grant the requested relief as to any particular joint transaction if it finds that the participation of the Regulated Funds in the joint transaction is consistent with the provisions, policies and purposes of the Act and is not on a basis different from or less advantageous than that of other participants. Applicants submit that allowing the Co-Investment Transactions described in this Application is justified on the basis of (i) the potential benefits to the Regulated Funds and the shareholders thereof and (ii) the protections found in the Conditions.

21 For example, the Gladstone Order (as defined below) includes one adviser, three Regulated Funds and one existing fund that are prohibited from completing joint transactions , whereas in the Apollo platform there are over 30 Existing Advisers to Affiliated Funds and over 50 Existing Affiliated Funds.

22 *See* note 21, *supra*.

As required by Rule 17d-1(b), the Conditions ensure that the terms on which Co-Investment Transactions may be made will be consistent with the participation of the Regulated Funds being on a basis that it is neither different from nor less advantageous than other participants, thus protecting the equity holders of any participant from being disadvantaged. The Conditions ensure that all Co-Investment Transactions are reasonable and fair to the Regulated Funds and their shareholders and do not involve overreaching by any person concerned, including the Advisers.

A. Potential Benefits

In the absence of the relief sought hereby, in many circumstances the Regulated Funds would be limited in their ability to participate in attractive and appropriate investment opportunities. Section 17(d), Section 57(a)(4) and Rule 17d-1 should not prevent BDCs and registered closed-end investment companies from making investments that are in the best interests of their shareholders.

Each Regulated Fund and its shareholders will benefit from the ability to participate in Co-Investment Transactions. The Board, including the Required Majority, of each Regulated Fund has determined that it is in the best interests of the Regulated Fund to participate in Co-Investment Transactions because, among other matters, (i) the Regulated Fund should be able to participate in a larger number and greater variety of transactions; (ii) the Regulated Fund should be able to participate in larger transactions; (iii) the Regulated Fund should be able to participate in all opportunities approved by a Required Majority or otherwise permissible under the Order rather than risk underperformance through rotational allocation of opportunities among the Regulated Funds; (iv) the Regulated Fund and any other Regulated Funds participating in the proposed investment should have greater bargaining power, more control over the investment and less need to bring in other external investors or structure investments to satisfy the different needs of external investors; (v) the Regulated Fund should be able to obtain greater attention and better deal flow from investment bankers and others who act as sources of investments; and (vi) the Conditions are fair to the Regulated Funds and their shareholders.

B. Protective Representations And Conditions

The Conditions ensure that the proposed Co-Investment Transactions are consistent with the protection of each Regulated Fund s shareholders and with the purposes intended by the policies and provisions of the Act. Specifically, the Conditions incorporate the following critical protections: (i) all Regulated Funds participating in the Co-Investment Transactions will invest at the same time (except that the settlement date for an Affiliated Fund in a Co-Investment Transaction may occur up to ten business days after the settlement date for the Regulated Fund, and vice versa), for the same price and with the same terms, conditions, class, registration rights and any other rights, so that none of them receives terms more favorable than any other; (ii) a Required Majority of each Regulated Fund must approve various investment decisions (not including transactions completed on a pro rata basis pursuant to Conditions 7 and 8 or otherwise not requiring Board approval) with respect to such Regulated Fund in accordance with the Conditions; and (iii) the Regulated Funds are required to retain and maintain certain records.

Applicants believe that participation by the Regulated Funds in Pro Rata Follow-On Investments and Pro Rata Dispositions, as provided in Conditions 7 and 8, is consistent with the provisions, policies and purposes of the Act and will not be made on a basis different from or less advantageous than that of other participants. A formulaic approach, such as pro rata investment or disposition eliminates the possibility for overreaching and unnecessary prior review by the Board. Applicants note that the Commission has adopted a similar pro rata approach in the context of Rule 23c-2, which relates to the redemption by a closed-end investment company of less than all of a class of its securities, indicating the general fairness and lack of overreaching that such approach provides.

Applicants also believe that the participation by the Regulated Funds in Qualified Transactions and in dispositions of Tradable Securities without the approval of a Required Majority is consistent with the provisions, policies and purposes of the Act as there is no opportunity for overreaching by affiliates.

In sum, the Applicants believe that the Conditions would ensure that each Regulated Fund that participates in any type of Co-Investment Transaction does not participate on a basis different from, or less advantageous than, that of such other participants for purposes of Section 17(d) or Section 57(a)(4) and the Rules under the Act. As a result, Applicants believe that the participation of the Regulated Funds in Co-Investment Transactions in accordance with the Conditions would be consistent with the provisions, policies, and purposes of the Act, and would be done in a manner that was not different from, or less advantageous than, the other participants.

V. CONDITIONS

Applicants agree that any Order granting the requested relief shall be subject to the following Conditions:

1. Duties of the Advisers

(a) The Advisers will maintain policies and procedures reasonably designed to ensure that each Adviser is notified of all Potential Co-Investment Transactions that fall within the then-current Objectives and Strategies and Board-Established Criteria of any Regulated Fund the Adviser manages.

(b) When an Adviser to a Regulated Fund is notified of a Potential Co-Investment Transaction under Condition 1(a), the Adviser will make an independent determination of the appropriateness of the investment for the Regulated Fund in light of the Regulated Fund s then-current circumstances.

2. Board Approvals of Co-Investment Transactions

(a) If the Adviser deems a Regulated Fund s participation in any Potential Co-Investment Transaction to be appropriate for the Regulated Fund, it will then determine an appropriate level of investment for the Regulated Fund.

(b) If the aggregate amount recommended by the Advisers to be invested in the Potential Co-Investment Transaction by the participating Regulated Funds and any participating Affiliated Funds, collectively, exceeds the amount of the investment opportunity, the investment opportunity will be allocated among them pro rata based on the size of the Internal Orders, as described in section III.A.1.a.ii above. Each Adviser to a participating Regulated Fund will provide the Eligible Directors with information concerning the Affiliated Funds and Regulated Funds order sizes to assist the Eligible Directors with their review of the applicable Regulated Fund s investments for compliance with these Conditions.

(c) After making the determinations required in Conditions 1 above, each Adviser to a participating Regulated Fund will distribute written information concerning the Potential Co-Investment Transaction (including the amount proposed to be invested by each participating Regulated Fund and each participating Affiliated Fund) to the Eligible Directors of its participating Regulated Fund(s) for their consideration. A Regulated Fund will enter into a Co-Investment Transaction with one or more other Regulated Funds or Affiliated Funds only if, prior to the Regulated Fund s participation in the Potential Co-Investment Transaction, a Required Majority concludes that:

(i) the terms of the transaction, including the consideration to be paid, are reasonable and fair to the Regulated Fund and its equity holders and do not involve overreaching in respect of the Regulated Fund or its equity holders on the part of any person concerned;

(ii) the transaction is consistent with:

(A) the interests of the Regulated Fund s equity holders; and

(B) the Regulated Fund s then-current Objectives and Strategies;

(iii) the investment by any other Regulated Fund(s) or Affiliated Fund(s) would not disadvantage the Regulated Fund, and participation by the Regulated Fund would not be on a basis different from, or less advantageous than, that of any other Regulated Fund(s) or Affiliated Fund(s) participating in the transaction; provided that the Required Majority shall not be prohibited from reaching the conclusions required by this Condition 2(c)(iii) if:

(A) the settlement date for another Regulated Fund or an Affiliated Fund in a Co-Investment Transaction is later than the settlement date for the Regulated Fund by no more than ten business days or earlier than the settlement date for the Regulated Fund by no more than ten business days, in either case, so long as: (x) the date on which the commitment of the Affiliated Funds and Regulated Funds is made is the same; and (y) the earliest settlement date and the latest settlement date of any Affiliated Fund or Regulated Fund participating in the transaction will occur within ten business days of each other; or

(B) any other Regulated Fund or Affiliated Fund, but not the Regulated Fund itself, gains the right to nominate a director for election to a portfolio company s board of directors, the right to have a board observer or any similar right to participate in

the governance or management of the portfolio company so long as: (x) the Eligible Directors will have the right to ratify the selection of such director or board observer, if any; (y) the Adviser agrees to, and does, provide periodic reports to the Regulated Fund s Board with respect to the actions of such director or the information received by such board observer or obtained through the exercise of any similar right to participate in the governance or management of the portfolio company; and (z) any fees or other compensation that any other Regulated Fund or Affiliated Fund or any affiliated person of any other Regulated Fund or Affiliated Fund receives in connection with the right of one or more Regulated Funds or Affiliated Funds to nominate a director or appoint a board observer or otherwise to participate in the governance or management of the portfolio company will be shared proportionately among any participating Affiliated Funds (who may, in turn, share their portion with their affiliated persons) and any participating Regulated Fund(s) in accordance with the amount of each such party s investment; and

(iv) the proposed investment by the Regulated Fund will not involve compensation, remuneration or a similar direct or indirect[23] financial benefit to the Advisers, any other Regulated Fund, the Affiliated Funds or any affiliated person of any of them (other than the parties to the Co-Investment Transaction), except (A) to the extent permitted by Condition 13, (B) to the extent permitted by Section 17(e) or 57(k), as applicable, (C) indirectly, as a result of an interest in the securities issued by one of the parties to the Co-Investment Transaction, or (D) in the case of fees or other compensation described in Condition 2(c)(iii)(B)(z).

3. Right to Decline. Each Regulated Fund has the right to decline to participate in any Potential Co-Investment Transaction or to invest less than the amount proposed.

4. Board Reporting. Each Adviser to a Regulated Fund will present to the Board of each Regulated Fund, on a quarterly basis, (i) a record of all investments in Potential Co-Investment Transactions made by any of the other Regulated Funds or any of the Affiliated Funds during the preceding quarter that fell within the Regulated Fund s then-current Objectives and Strategies and Board-Established Criteria that were not made available to the Regulated Fund, and an explanation of why such investment opportunities were not made available to the Regulated Fund; and (ii) a record of all Follow-On Investments in and dispositions of securities by any Affiliated Fund or other Regulated Fund during the prior quarter that are held by the Regulated Fund. All information presented to the Regulated Fund s Board pursuant to this Condition will be kept for the life of the Regulated Fund and at least two years thereafter, and will be subject to examination by the Commission and its staff.

[23] For example, procuring the Regulated Fund s investment in a Potential Co-Investment Transaction to permit an affiliate to complete or obtain better terms in a separate transaction would constitute an indirect financial benefit.

5. General Limitation. Except for Follow-On Investments made in accordance with Condition 8 below, a Regulated Fund will not invest in reliance on the Order in any issuer in which a Related Party[24] has an investment.

6. Same Terms and Conditions. A Regulated Fund will not participate in any Potential Co-Investment Transaction unless (i) the terms, conditions, price, class of securities to be purchased, date on which the commitment is entered into and registration rights (if any) will be the same for each participating Regulated Fund and Affiliated Fund and (ii) the earliest settlement date and the latest settlement date of any participating Regulated Fund or Affiliated Fund will occur as close in time as practicable and in no event more than ten business days apart. The grant to one or more Regulated Funds or Affiliated Funds, but not the respective Regulated Fund, of the right to nominate a director for election to a portfolio company s board of directors, the right to have an observer on the board of directors or similar rights to participate in the governance or management of the portfolio company will not be interpreted so as to violate this Condition 6, if Condition 2(c)(iii)(B) is met.

7. Dispositions.

(a) *General*. If any Regulated Fund or Affiliated Fund elects to sell, exchange or otherwise dispose of an interest in a security that was acquired in a Co-Investment Transaction that has been approved by the Required Majority of any participating Regulated Fund in accordance with Condition 2, Condition 8(c) or Conditions 8(d) and (e), the Adviser to such Regulated Fund or Affiliated Fund will:

(i) notify each Regulated Fund that participated in the Co-Investment Transaction of the proposed disposition at the earliest practical time; and

(ii) formulate a recommendation as to participation by such Regulated Fund in the disposition.

(b) *Same Terms and Conditions*. Each Regulated Fund will have the right to participate in such disposition on a proportionate basis, at the same price and on the same terms and conditions as those applicable to the Affiliated Funds and any other Regulated Fund.

[24] For this purpose, ***Related Party*** means (i) any Close Affiliate (as defined below) and (ii) in respect of matters as to which any Adviser has knowledge, any Remote Affiliate (as defined below). ***Close Affiliate*** means the Advisers, the Regulated Funds, the Affiliated Funds and any other person described in Section 57(b) (after giving effect to Rule 57b-1) in respect of any Regulated Fund (treating any registered investment company or series thereof as a BDC for this purpose) except for limited partners included solely by reason of the reference in Section 57(b) to Section 2(a)(3)(D). ***Remote Affiliate*** means any person described in Section 57(e) in respect of any Regulated Fund (treating any registered investment company or series thereof as a BDC for this purpose) and any limited partner holding 5% or more of the limited partner interests that would be a Close Affiliate but for the exclusion in that definition.

(c) *No Board Approval*. A Regulated Fund may participate in a disposition described in Condition 7(a) without obtaining prior approval of the Required Majority if:

(i) (A) the participation of each Regulated Fund and Affiliated Fund in such disposition is proportionate to its then-current holding of the security (or securities) of the issuer that is (or are) the subject of the disposition; (B) the Board of the Regulated Fund has approved as being in the best interests of the Regulated Fund the ability to participate in such dispositions on a pro rata basis (as described in greater detail in the Application); (C) the security (or securities) were not acquired in a Follow-On Investment subject to Condition 8(d); and (D) the Board of the Regulated Fund is provided on a quarterly basis with a list of all dispositions made in accordance with this Condition; or

(ii) the security (or securities) is a Tradable Security.

(d) *Standard Board Approval*. In all other cases, the Adviser will provide its written recommendation as to the Regulated Fund s participation to the Eligible Directors and the Regulated Fund will participate in such disposition solely to the extent that a Required Majority determines that it is in the Regulated Fund s best interests.

(e) *Enhanced Board Approval*. If any Regulated Fund that owns a security that was acquired in one or more Qualified Transactions that have not been followed by a Follow-On Investment described in Condition 8(a) elects to sell, exchange or otherwise dispose of an interest in such security in a transaction in which it could not participate with one or more Affiliated Funds and/or one or more other Regulated Funds without relying on the Order, the Adviser to such Regulated Fund or Affiliated Fund will:

(i) notify each Regulated Fund that holds such security at the earliest practical time;

(ii) formulate a recommendation as to participation by such Regulated Fund in the disposition; and

(iii) provide to the Board of each such Regulated Fund all information relating to the existing investments, including the terms of such investments and how they were made, that is necessary for the Required Majority to make the findings required by Condition 7(e) and (f).

(f) *Requirements for Enhanced Board Approval*. A Regulated Fund may participate in a disposition described in Condition 7(e) only if:

(i) a Required Majority finds that the making and holding of the investments in the Qualified Transactions were not prohibited by Section 57 (as modified by Rule 57b-1) or Rule 17d-1, as applicable, and records the basis for such finding in its minutes;

(ii) independent counsel to the Board advises that the making and holding of the investments in the Qualified Transactions were not prohibited by Section 57 (as modified by Rule 57b-1) or Rule 17d-1, as applicable; and

(iii) a Required Majority determines that (A) the terms of the transaction are reasonable and fair and do not involve overreaching, and (B) the disposition is in the best interest of the Regulated Fund and it is consistent with the Regulated Fund s Objectives and Strategies to hold the total amount of securities of the issuer that the Regulated Fund would hold if the disposal is completed as proposed.

(g) *Multiple Classes of Securities*. If, with respect to any disposition subject to Condition 7(c) or Conditions 7(d) and (e), if any Affiliated Fund or other Regulated Fund holds securities of any class of the issuer that are not held by the Regulated Fund, the Regulated Fund will participate in such Follow-On Investment only if a Required Majority finds that any other Regulated Fund or Affiliated Fund s holding of such other securities is immaterial in amount, including immaterial relative to the size of the issuer; and records the basis for such finding in its minutes.

(h) *Expenses*. Each Regulated Fund and each Affiliated Fund will bear its own expenses in connection with any such disposition.

8. Follow-On Investments.

(a) *General*. If any Regulated Fund or Affiliated Fund desires to make a Follow-On Investment that is not a Qualified Transaction in a portfolio company whose securities were acquired in a Co-Investment Transaction that has been approved by the Required Majority of any participating Regulated Fund under Condition 2, Condition 8(c) or Conditions 8(d) and (e), the Adviser to each such Regulated Fund or Affiliated Fund will:

(i) notify each Regulated Fund with Investment Objectives and Strategies and Board-Established Criteria that would permit an investment in such securities of the proposed transaction at the earliest practical time; and

(ii) formulate a recommendation as to the proposed participation, including the amount of the proposed investment, by such Regulated Fund.

(b) No Board Approval. A Regulated Fund may participate in a Follow-On Investment described in Condition 8(a) without obtaining prior approval of the Required Majority if:

(i) (A) the proposed participation of each Regulated Fund and each Affiliated Fund in such investment is proportionate to its outstanding investments in the issuer or the security at issue, as appropriate,[25] immediately preceding the Follow-On Investment; and (B) the Board of the Regulated Fund has approved as being in the best interests of the Regulated Fund the ability to participate in Follow-On Investments on a pro rata basis (as described in greater detail in this Application); or

(ii) it is a Qualified Transaction.

[25] To the extent that a Follow-On Investment opportunity is in a security or arises in respect of a security held by the participating Regulated Funds and Affiliated Funds, proportionality will be measured by each participating Regulated Fund s and Affiliated Fund s outstanding investment in the security in question immediately preceding the Follow-On Investment using the most recent available valuation thereof. To the extent that a Follow-On Investment opportunity relates to an opportunity to invest in a security that is not in respect of any security held by any of the participating Regulated Funds or Affiliated Funds, proportionality will be measured by each participating Regulated Fund s and Affiliated Fund s outstanding investment in the issuer immediately preceding the Follow-On Investment using the most recent available valuation thereof.

(c) Standard Board Approval. In all other cases, the Adviser will provide its written recommendation as to the Regulated Fund s participation to the Eligible Directors and the Regulated Fund will participate in such Follow-On Investment only if a Required Majority makes the determinations set forth in Condition 2(c).

(d) Enhanced Board Approval. If any Regulated Fund or Affiliated Fund desires to make a Follow-On Investment that would be a Potential Co-Investment Transaction and is in securities of an issuer which were acquired in one or more Qualified Transactions that have not been followed by a Follow-On Investment described in Condition 8(a), the Adviser to each such Regulated Fund or Affiliated Fund will:

(i) notify each Regulated Fund that holds the security or that desires to participate in such Follow-On Investment of the proposed transaction at the earliest practical time;

(ii) formulate a recommendation as to the proposed participation, including the amount of the proposed investment, by such Regulated Fund.

(iii) provide to the Eligible Directors of each such Regulated Fund all information relating to the existing investments, including the terms of such investments and how they were made, that is necessary for the Required Majority to make the findings required by Conditions 8(e), 8(f)(ii) and 8(g).

(e) Requirements for Enhanced Board Approval. A Regulated Fund may participate in a Follow-On Investment described in Condition 8(d) only if:

(i) a Required Majority finds that the making and holding of the investments in the Qualified Transactions were not prohibited by Section 57 (as modified by Rule 57b-1) or Rule 17d-1, as applicable, and records the basis for such finding in its minutes;

(ii) independent counsel to the Board advises that the making and holding of the investments in the Qualified Transactions were not prohibited by Section 57 (as modified by Rule 57b-1) or Rule 17d-1, as applicable; and

(iii) a Required Majority after reviewing such proposed Follow-On Investment both on a stand-alone basis and together with the Qualified Transactions in relation to the total economic exposure and other terms, makes the determinations set forth in Condition 2(c).

(f) Multiple Classes of Securities. If, with respect to any Follow-On Investment subject to Condition 8(c) or Condition 8(d):

(i) both (A) the amount of the opportunity proposed to be made available to any Regulated Fund is not based on the Regulated Funds and the Affiliated Funds outstanding investments in the issuer or the security at issue, as appropriate, immediately preceding the Follow-On Investment; and (B) the aggregate amount recommended by the Advisers to be invested in the Follow-On Investment by the participating Regulated Funds and any participating Affiliated Funds, collectively, exceeds the amount of the investment opportunity, then the Follow-On Investment opportunity will be allocated among them pro rata based on the size of the Internal Orders, as described in section III.A.1.a.ii above; and (ii) any Affiliated Fund or other Regulated Fund holds securities of any class of the issuer that are not held by the Regulated Fund, the Regulated Fund will participate in such Follow-On Investment only if a Required Majority finds that any other Regulated Fund or Affiliated Fund s holding of such other securities is immaterial in amount, including immaterial relative to the size of the issuer; and records the basis for such finding in its minutes.

(g) Other Conditions. Except as set forth in Condition 8(b)(ii), the making of a Follow-On Investment subject to this Condition will be considered a Co-Investment Transaction for all purposes and subject to the other applicable Conditions set forth in this application.

9. Board Reporting, Compliance and Annual Re-Approval

(a) The Independent Directors of each Regulated Fund will be provided quarterly for review all information concerning Potential Co-Investment Transactions and Co-Investment Transactions, including investments made by other Regulated Funds or Affiliated Funds that the Regulated Fund considered but declined to participate in, so that the Independent Directors or Independent Party, as applicable, may determine whether all investments made in Potential Co-Investment Transactions and Co-Investment Transactions during the preceding quarter, including those investments that the Regulated Fund considered but declined to participate in, comply with the Conditions.

(b) Each Regulated Fund s chief compliance officer, as defined in rule 38a-1(a)(4), shall prepare an annual report for its Board each year that evaluates the Regulated Fund s compliance with the terms and conditions of the application and the procedures established to achieve such compliance. In the case of a BDC Downstream Fund that does not have a chief compliance officer, the chief compliance officer of the BDC to which the BDC Downstream Fund pertains will prepare such report for the relevant Independent Party.

(c) The Independent Directors and each Independent Party will consider at least annually whether continued participation in new and existing Co-Investment Transactions is in the Regulated Fund s best interests.

10. Record Keeping. Each Regulated Fund will maintain the records required by Section 57(f)(3) of the Act as if each of the Regulated Funds were a BDC and each of the investments permitted under these Conditions were approved by the Required Majority under Section 57(f).

11. Director Independence. No Independent Director or Independent Party of a Regulated Fund will also be a director, general partner, managing member or principal, or otherwise be an affiliated person (as defined in the Act) of any Affiliated Fund.

12. Expenses. The expenses, if any, associated with acquiring, holding or disposing of any securities acquired in a Co-Investment Transaction (including, without limitation, the expenses of the distribution of any such securities registered for sale under the Securities Act) will, to the extent not payable by the Advisers under their respective advisory agreements with the Regulated Funds and the Affiliated Funds, be shared by the Regulated Funds and the participating Affiliated Funds in proportion to the relative amounts of the securities held or being acquired or disposed of, as the case may be.

13. Transaction Fees. Any transaction fee (including break-up, structuring, monitoring or commitment fees but excluding brokerage or underwriting compensation permitted by Section 17(e) or 57(k)) received in connection with any Co-Investment Transaction will be distributed to the participants on a pro rata basis based on the amounts they invested or committed, as the case may be, in such Co-Investment Transaction. If any transaction fee is to be held by an Adviser pending consummation of the transaction, the fee will be deposited into an account maintained by the Adviser at a bank or banks having the qualifications prescribed in Section 26(a)(1), and the account will earn a competitive rate of interest that will also be divided pro rata among the participants based on the amount they invest in such Co-Investment Transaction. None of the Advisers, the Affiliated Funds, the other Regulated Funds or any affiliated person of the Affiliated Funds or the Regulated Funds will receive any additional compensation or remuneration of any kind as a result of or in connection with a Co-Investment Transaction (other than (i) in the case of the Regulated Funds and the Affiliated Funds), the pro rata transaction fees described above and fees or other compensation described in Condition 2(c)(iii)(B)(z), (ii) brokerage or underwriting compensation permitted by Section 17(e) or 57(k), or (iii) in the case of the Advisers and their service-provider affiliates (such as, affiliated administrators and loan servicers), investment advisory, administrative[26], loan-servicing and other service compensation permitted by Section 17(c) or 57(g) and paid in accordance with a written agreement between the applicable Regulated Fund(s) or Affiliated Fund(s) or portfolio company and its Adviser or an affiliated person thereof.

[26] Administrative compensation refers to the administrative and operational services compensation paid pursuant to agreements by and between the applicable Regulated Fund(s) or Affiliated Fund(s) and its Adviser or an affiliated person thereof for services provided by such Adviser or affiliated person.

VI. PROCEDURAL MATTERS

A. Communications

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

James C. Zelter

Chief Executive Officer

Apollo Investment Corporation

9 West 57th Street

New York, NY 10019

(212) 515-3450

and

John J. Suydam

Chief Legal Officer and Vice President

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and

Joseph D. Glatt

Secretary and Vice-President

Apollo Investment Corporation

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New York, NY 10019

(212) 515-3450

Please address any questions, and a copy of any communications, concerning this Application, the Notice and Order to:

Steven B. Boehm

Sutherland Asbill & Brennan LLP

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Washington, D.C. 20001

(202) 383-0176

and

Richard Prins, Esq.

Michael K. Hoffman, Esq.

Skadden, Arps, Slate, Meagher & Flom LLP

Four Times Square

New York, New York 10036

(212) 735-2790

B. Authorization

All requirements for the execution and filing of this Application in the name and on behalf of each Applicant by the undersigned have been complied with and the undersigned is fully authorized to do so and has duly executed this Application as of this 21st day of March, 2014.

APOLLO INVESTMENT CORPORATION

By /s/ Joseph D. Glatt
Name: Joseph D. Glatt
Title: Secretary and Vice President

APOLLO TACTICAL INCOME FUND INC.

APOLLO SENIOR FLOATING RATE FUND INC.

MERX AVIATION FINANCE HOLDINGS, LLC

APOLLO INVESTMENT MANAGEMENT, L.P.

APOLLO GLOBAL REAL ESTATE MANAGEMENT, L.P.

APOLLO CAPITAL MANAGEMENT, L.P.

APOLLO SVF MANAGEMENT, L.P.

APOLLO VALUE MANAGEMENT, L.P.

APOLLO EUROPE MANAGEMENT, L.P.

APOLLO EPF MANAGEMENT, L.P.

APOLLO CREDIT OPPORTUNITY MANAGEMENT III, LLC

APOLLO CREDIT MANAGEMENT II, L.P.

APOLLO CREDIT MANAGEMENT (CLO), LLC

APOLLO CREDIT MANAGEMENT II GP, LLC

APOLLO CREDIT MANAGEMENT, LLC

APOLLO PALMETTO STRATEGIC PARTNERSHIP, L.P.

APOLLO SPECIAL OPPORTUNITIES MANAGED ACCOUNT, L.P.

APOLLO VALUE INVESTMENT MASTER FUND, L.P.

APOLLO INVESTMENT EUROPE II, L.P.

APOLLO CREDIT OPPORTUNITY FUND III L.P.

ACREFI MANAGEMENT, LLC

APOLLO CREDIT SENIOR LOAN FUND, L.P.

APOLLO/PALMETTO LOAN PORTFOLIO, L.P.

ALM IV, LTD.

AGRE U.S. REAL ESTATE FUND, L.P.

ALM V, LTD.

APOLLO LONGEVITY, LLC

A-A EUROPEAN SENIOR DEBT FUND, L.P.

APOLLO EUROPEAN STRATEGIC MANAGEMENT, L.P.

APOLLO EUROPEAN STRATEGIC INVESTMENTS (HOLDINGS), L.P.

ARM MANAGER, LLC

AGRE DEBT FUND I, L.P.

AGRE CRE DEBT MANAGER, LLC

APOLLO NATURAL RESOURCES PARTNERS, L.P.

APOLLO COMMODITIES MANAGEMENT, L.P.

FINANCIAL CREDIT INVESTMENT I, L.P.

FINANCIAL CREDIT INVESTMENT I MANAGER, LLC

APOLLO EUROPEAN SENIOR DEBT MANAGEMENT, LLC

APOLLO/PALMETTO SHORT-MATURITY LOAN PORTFOLIO, L.P.

APOLLO CREDIT MANAGEMENT (SENIOR LOANS), LLC

2011 STONE TOWER HY CAYMAN FUND TRUST

AGRE NA MANAGEMENT, LLC

ALM X, LTD.

ALM VI, LTD.

ALM VII, LTD.

ALM VII (R), LTD.

ALM VII (R)-2, LTD.

ALM VIII, LTD.

APOLLO AF LOAN TRUST 2012

APOLLO CENTRE STREET MANAGEMENT, LLC

APOLLO CENTRE STREET PARTNERSHIP, L.P.

APOLLO CREDIT MANAGEMENT (SENIOR LOANS) II, LLC

APOLLO CREDIT MASTER FUND LTD.

APOLLO CREDIT STRATEGIES MASTER FUND LTD.

APOLLO EPF II PARTNERSHIP

APOLLO EPF MANAGEMENT II, L.P.

APOLLO EUROPEAN CREDIT MANAGEMENT, L.P.

APOLLO EUROPEAN CREDIT MASTER FUND, L.P.

APOLLO SK STRATEGIC INVESTMENTS, L.P.

APOLLO SK STRATEGIC MANAGEMENT, LLC

APOLLO ST DEBT ADVISORS LLC

APOLLO ST FUND MANAGEMENT LLC

APOLLO STRUCTURED CREDIT RECOVERY MASTER FUND II LTD.

CORNERSTONE CLO LTD.

RAMPART CLO 2006-I LTD.

RAMPART CLO 2007 LTD.

STONE TOWER CLO V LTD.

STONE TOWER CLO VI LTD.

STONE TOWER CLO VII LTD.

STONE TOWER LOAN TRUST 2010

STONE TOWER LOAN TRUST 2011

ALME LOAN FUNDING 2013-1 LIMITED

APOLLO CAPITAL SPECTRUM FUND, L.P.

APOLLO CAPITAL SPECTRUM MANAGEMENT, LLC

APOLLO CREDIT OPPORTUNITY MANAGEMENT III, LLC

APOLLO CREDIT SHORT OPPORTUNITIES FUND, L.P.

APOLLO CREDIT SHORT OPPORTUNITIES MANAGEMENT, LLC

APOLLO FRANKLIN MANAGEMENT, LLC

APOLLO FRANKLIN PARTNERSHIP, L.P.

APOLLO STRUCTURED CREDIT RECOVERY MANAGEMENT III LLC

APOLLO STRUCTURED CREDIT RECOVERY MASTER FUND III L.P.

APOLLO TOTAL RETURN MANAGEMENT LLC

APOLLO TOTAL RETURN MASTER FUND L.P.

APOLLO ZEUS STRATEGIC MANAGEMENT, LLC

APOLLO ZEUS STRATEGIC INVESTMENTS, L.P.

FINANCIAL CREDIT INVESTMENT II, L.P.

FINANCIAL CREDIT INVESTMENT II MANAGER, LLC

By: /s/ Joseph Glatt
Name: Joseph Glatt
Title: Authorized Person

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APOLLO MANAGEMENT VII, L.P.

APOLLO MANAGEMENT VIII, L.P.

APOLLO INVESTMENT FUND VII, L.P.

APOLLO INVESTMENT FUND VIII, L.P.

APOLLO MANAGEMENT SINGAPORE PTE. LTD.

APOLLO RESIDENTIAL MORTGAGE, INC.

APOLLO ASIA PRIVATE CREDIT MASTER FUND PTE., LTD.

By: /s/ John J. Suydam
Name: John J. Suydam
Title: Authorized Person

APOLLO COMMERCIAL REAL ESTATE FINANCE, INC.

By: /s/ Stuart A. Rothstein
Name: Stuart A. Rothstein
Title: Chief Financial Officer

ATHENE ASSET MANAGEMENT, LLC

By: /s/ James R. Belardi
Name: James R. Belardi
Title: Chief Executive Officer

STATE OF NEW YORK)
)
COUNTY OF NEW YORK)

The undersigned states that he has duly executed the attached application dated as of March 21, 2014 for and on behalf of Apollo Investment Corporation; that he is the Secretary and Vice President of such company; and that all action by officers, directors, and other bodies necessary to authorize the undersigned to execute and file such instrument has been taken. The undersigned further states that he is familiar with such instrument, and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

APOLLO INVESTMENT CORPORATION

By: /s/ Joseph D. Glatt
Name: Joseph D. Glatt
Title: Secretary and Vice President

STATE OF NEW YORK)
)
COUNTY OF NEW YORK)

The undersigned states that he has duly executed the attached application dated as of March 21, 2014 for and on behalf of those of the entities indicated by his signature hereto: Apollo Investment Corporation, Apollo Investment Management, L.P., Apollo Management VII, L.P., Apollo Management VIII, L.P., Apollo Global Real Estate Management, L.P., Apollo Capital Management, L.P., Apollo SVF Management, L.P., Apollo Value Management, L.P., Apollo Europe Management, L.P., Apollo EPF Management, L.P., Apollo Credit Opportunity Management III, LLC, Apollo Credit Management II, L.P., Apollo Credit Management (CLO), LLC, Apollo Credit Management II GP, LLC, Athene Asset Management, LLC, Apollo Credit Management, LLC, Apollo Palmetto Strategic Partnership, L.P., Apollo Special Opportunities Managed Account, L.P., Apollo Value Investment Master Fund, L.P., Apollo Investment Europe II, L.P., Apollo Credit Opportunity Fund III L.P., Apollo Investment Fund VII, L.P., Apollo Investment Fund VIII, L.P., Apollo Commercial Real Estate Finance, Inc., ACREFI Management, LLC, Apollo Credit Senior Loan Fund, L.P., Apollo Senior Floating Rate Fund Inc., Apollo/Palmetto Loan Portfolio, L.P., ALM IV, Ltd., AGRE U.S. Real Estate Fund, L.P., ALM V, Ltd., Apollo Longevity, LLC, A-A European Senior Debt Fund, L.P., Apollo Management Singapore Pte. Ltd., Apollo European Strategic Management, L.P., Apollo European Strategic Investments (Holdings), L.P., Apollo Residential Mortgage, Inc., ARM Manager, LLC, AGRE Debt Fund I, L.P., AGRE CRE Debt Manager, LLC, Apollo Natural Resources Partners, L.P., Apollo Commodities Management, L.P., Financial Credit Investment I, L.P., Financial Credit Investment I Manager, LLC, Apollo European Senior Debt Management, LLC, Apollo/Palmetto Short-Maturity Loan Portfolio, L.P., Apollo Credit Management (Senior Loans), LLC, 2011 Stone Tower HY Cayman Fund Trust, AGRE NA Management, LLC, ALM IX, Ltd., ALM VI, Ltd., ALM VII, Ltd., ALM VII (R), Ltd., ALM VII (R)-2, Ltd., ALM VIII, Ltd., Apollo AF Loan Trust 2012, Apollo Asia Private Credit Master Fund Pte., Ltd., Apollo Centre Street Management, LLC, Apollo Centre Street Partnership, L.P., Apollo Credit Management (Senior Loans) II, LLC, Apollo Credit Master Fund Ltd., Apollo Credit Strategies Master Fund Ltd., Apollo EPF II Partnership, Apollo EPF Management II, L.P., Apollo European Credit Management, L.P., Apollo European Credit Master Fund, L.P., Apollo SK Strategic Investments, L.P., Apollo SK Strategic Management, LLC, Apollo ST Debt Advisors LLC, Apollo ST Fund Management LLC, Apollo Structured Credit Recovery Master Fund II Ltd., Cornerstone CLO Ltd., Rampart CLO 2006-I Ltd., Rampart CLO 2007 Ltd., Stone Tower CLO V Ltd., Stone Tower CLO VI Ltd., Stone Tower CLO VII Ltd., Stone Tower Loan Trust 2010, Stone Tower Loan Trust 2011, Merx Aviation Finance Holdings, LLC, ALME Loan Funding 2013-1 Limited, Apollo Capital Spectrum Fund, L.P., Apollo Capital Spectrum Management, LLC, Apollo Credit Opportunity Management III, LLC, Apollo Credit Short Opportunities Fund, L.P., Apollo Credit Short Opportunities Management, LLC, Apollo Franklin Management, LLC, Apollo Franklin Partnership, L.P., Apollo Structured Credit Recovery Management III LLC, Apollo Structured Credit Recovery Master Fund III L.P., Apollo Total Return Management LLC, Apollo Total Return Master Fund L.P., Apollo Zeus Strategic Management, LLC, Apollo Zeus Strategic Investments, L.P., Financial Credit Investment II, L.P., Financial Credit Investment II Manager, LLC that he is authorized to execute this statement of each entity; and that all action by officers, directors, and other bodies necessary to authorize

the undersigned to execute and file such instrument has been taken. The undersigned further states that he is familiar with such instrument, and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

As to all of the entities listed above

other than those listed for the signatures below

By: /s/ Joseph Glatt
Name: Joseph Glatt
Title: Authorized Person

As to APOLLO ASIA PRIVATE CREDIT MASTER FUND PTE., LTD.

APOLLO RESIDENTIAL MORTGAGE, INC.

APOLLO MANAGEMENT SINGAPORE PTE. LTD.

APOLLO INVESTMENT FUND VIII, L.P.

APOLLO INVESTMENT FUND VII, L.P.

APOLLO MANAGEMENT VII, L.P.

APOLLO MANAGEMENT VIII, L.P.

By: /s/ John J. Suydam
Name: John J. Suydam
Title: Authorized Person

As to APOLLO COMMERCIAL REAL ESTATE FINANCE, INC.

By: /s/ Stuart A. Rothstein
Name: Stuart A. Rothstein
Title: Chief Financial Officer

As to ATHENE ASSET MANAGEMENT, LLC

By: /s/ James R. Belardi
Name: James R. Belardi
Title: Chief Executive Officer

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APPENDIX A

The Existing Affiliated Funds are comprised of the following groups, and all Existing Affiliated Funds are managed by Advisers to Affiliated Funds:

1. Private Equity: The private equity group s primary investment focus is global private equity, traditional buyout and distress for control investing. The private equity group includes, among other entities that are currently in existence but that are not currently expected to participate in Co-Investment Transactions, the following Existing Affiliated Funds:

(a) Apollo Investment Fund VII, L.P. This fund is managed by Apollo Management VII, L.P.

(b) Apollo Investment Fund VIII, L.P. This fund is managed by Apollo Management VIII, L.P.

2. Credit: The credit group was established to complement the private equity group s business. The credit group includes the following Existing Affiliated Funds:

(a) Apollo Investment Europe II, L.P., which is managed by Apollo Europe Management, L.P.

(b) Apollo Special Opportunities Managed Account, L.P., which is managed by Apollo SVF Management, L.P.

(c) Apollo EPF II Partnership, which is managed by Apollo EPF Management II, L.P.

(d) Apollo Credit Senior Loan Fund, L.P., which is managed by Apollo Credit Management II GP, LLC.

(e) Apollo/Palmetto Loan Portfolio, L.P., which is managed by Apollo Credit Management II, L.P.

(f) ALM IV, Ltd., which is managed by Apollo Credit Management (CLO), LLC.

(g) ALM V, Ltd., which is managed by COF II CLO II, LLC.

(h) Apollo Longevity, LLC, which is managed by Apollo Capital Management, L.P.

(i) ALM VI, Ltd., which is managed by Apollo Credit Management (CLO), LLC.

(j) ALM VII, Ltd., which is managed by Apollo Credit Management (CLO), LLC.

(k) ALM VII (R), Ltd., which is managed by Apollo Credit Management (CLO), LLC.

(l) ALM VII (R)-2, Ltd., which is managed by Apollo Credit Management (CLO), LLC.

(m) ALM VIII, Ltd., which is managed by Apollo Credit Management (CLO), LLC.

(n) ALM X, Ltd., which is managed by Apollo Credit Management (CLO), LLC.

(o) A-A European Senior Debt Fund, L.P., which is managed by Apollo European Senior Debt Management, LLC.

(p) Apollo European Strategic Investments (Holdings), L.P., which is managed by Apollo European Strategic Management, L.P.

(q) Apollo/Palmetto Short-Maturity Loan Portfolio, L.P., which is managed by Apollo Credit Management (Senior Loans), LLC.

(r) Apollo Asia Private Credit Master Fund Pte. Ltd., which is managed by Apollo Management Singapore Pte. Ltd.

(s) Apollo European Credit Master Fund, L.P., which is managed by Apollo European Credit Management, L.P.

(t) Apollo Centre Street Partnership, L.P., which is managed by Apollo Centre Street Management, LLC.

(u) Apollo SK Strategic Investments, L.P., which is managed by Apollo SK Strategic Management, LLC.

(v) Apollo AF Loan Trust 2012, which is managed by Apollo Credit Management (Senior Loans) II, LLC.

(w) Apollo Credit Master Fund Ltd., which is managed by Apollo ST Fund Management LLC.

(x) Apollo Credit Strategies Master Fund Ltd., which is managed by Apollo ST Fund Management LLC.

(y) Apollo Structured Credit Recovery Master Fund II Ltd., which is managed by Apollo ST Fund Management LLC.

(z) Stone Tower Loan Trust 2010, which is managed by Apollo ST Fund Management LLC.

(aa) Stone Tower Loan Trust 2011, which is managed by Apollo ST Fund Management LLC.

(bb) 2011 Stone Tower HY Cayman Fund Trust, which is managed by Apollo ST Fund Management LLC.

(cc) Cornerstone CLO Ltd., which is managed by Apollo ST Debt Advisors LLC.

(dd) Rampart CLO 2006-I Ltd., which is managed by Apollo ST Debt Advisors LLC.

(ee) Rampart CLO 2007 Ltd., which is managed by Apollo ST Debt Advisors LLC.

(ff) Stone Tower CLO V Ltd., which is managed by Apollo ST Debt Advisors LLC.

(gg) Stone Tower CLO VI Ltd., which is managed by Apollo ST Debt Advisors LLC.

(hh) Stone Tower CLO VII Ltd., which is managed by Apollo ST Debt Advisors LLC.

(ii) Apollo Value Investment Master Fund, L.P., which is managed by Apollo Value Management, L.P.

(jj) Apollo Credit Opportunity Fund III L.P., which is managed by Apollo Credit Opportunity Management III LLC.

(kk) Apollo Palmetto Strategic Partnership, L.P., which is managed by Apollo Credit Management, L.P.

(ll) ALME Loan Funding 2013-1 Limited, which is managed by Apollo Credit Management CLO LLC

(mm) Apollo Capital Spectrum Fund, L.P., which is managed by Apollo Capital Spectrum Management, LLC

(nn) Apollo Credit Short Opportunities Fund, L.P., which is managed by Apollo Credit Short Opportunities Management, LLC

(oo) Apollo Franklin Partnership, L.P., which is managed by Apollo Franklin Management, LLC

(pp) Apollo Structured Credit Recovery Master Fund III L.P., which is managed by Apollo Structured Credit Recovery Management III LLC

(qq) Apollo Total Return Master Fund L.P., which is managed by Apollo Total Return Management LLC

(rr) Apollo Zeus Strategic Investments, L.P., which is managed by Apollo Zeus Strategic Management, LLC

3. Real Estate: The real estate group primarily invests in legacy commercial mortgage-backed securities, commercial first mortgage loans, mezzanine investments and other commercial real estate-related debt investments. Additionally, the real estate group includes real estate funds that focus on opportunistic investments in distressed debt and equity recapitalization transactions. The real estate group includes, among other entities that are currently in existence but that are not currently expected to participate in Co-Investment Transactions, the following Existing Affiliated Funds:

(a) Apollo Commercial Real Estate Finance, Inc. (*ACREFI*), which is managed by ACREFI Management, LLC.

(b) AGRE U.S. Real Estate Fund, L.P., which is managed by AGRE NA Management, LLC.

(c) AGRE Debt Fund I, L.P., which is managed by AGRE CRE Debt Manager, LLC.

(d) Apollo Residential Mortgage, Inc., which is managed by ARM Manager, LLC.

4. Natural Resources:

(a) Apollo Natural Resources Partners, L.P., which is managed by Apollo Commodities Management, L.P. with respect to Series I, is a fund established to capitalize on private equity investment opportunities in the natural resources industry, principally in the metals and mining, energy and select other natural resources sectors.

5. Life Settlements:

(a) Financial Credit Investment I, L.P., which is managed by Financial Credit Investment I Manager, LLC is a fund formed for the purpose of acquiring and managing portfolios of life insurance policies and other related instruments.

(b) Financial Credit Investment II, L.P., which is managed by Financial Credit Investment II Manager, LLC

Each of the above Existing Affiliated Funds is a separate and distinct legal entity and each relies on the exemption from registration as an investment company under the Act provided by Section 3(c)(1), 3(c)(5)(C) or 3(c)(7).

In addition, each of the Existing Affiliated Funds is a Delaware limited partnership, Delaware corporation or managed account except as follows:

Maryland corporations:

Apollo Commercial Real Estate Finance, Inc.

Cayman Island limited partnerships and limited companies:

Apollo Value Investment Master Fund, L.P.;

Apollo Investment Europe II, L.P.;

Apollo European Principal Finance Fund, L.P.;

Apollo European Strategic Investments (Holdings), L.P.;

AGRE Debt Fund I, L.P.; and

Financial Credit Investment I, L.P.

ALM IV, Ltd.

ALM V, Ltd.

ALM VI, Ltd.

ALM VII, Ltd.

ALM VII (R), Ltd.

ALM VII (R)-2, Ltd.

ALM VIII, Ltd.

ALM X, Ltd.

Apollo European Credit Master Fund, L.P.

Apollo SK Strategic Investments, L.P.

Apollo Credit Master Fund Ltd.

Apollo Credit Strategies Master Fund Ltd.

Apollo Structured Credit Recovery Master Fund II Ltd.

Stone Tower Loan Trust 2010

Stone Tower Loan Trust 2011

2011 Stone Tower HY Cayman Fund Trust

Cornerstone CLO Ltd.

Rampart CLO 2006-I Ltd.

Rampart CLO 2007 Ltd.

Stone Tower CLO V Ltd.

Stone Tower CLO VI Ltd.,

Stone Tower CLO VII Ltd.

Marshall Islands partnership:

Apollo EPF II Partnership

Singapore limited company:

Apollo Asia Private Credit Master Fund Pte. Ltd.

Any of the Affiliated Funds could be deemed to be persons identified in Section 57(b), thus requiring exemptive relief to co-invest with the AIC Funds or BDC Downstream Funds by virtue of the fact that the AIC Funds , the BDC Downstream Funds and the Affiliated Funds respective investment advisers/managers are under common control.

APPENDIX B

Resolutions of the Board of Directors of

Apollo Investment Corporation

NOW, THEREFORE, BE IT RESOLVED, that the officers (the Officers) of Apollo Investment Corporation (the Corporation) be, and they hereby are, authorized, empowered and directed, in the name and on behalf of the Corporation, to cause to be prepared, executed, delivered and filed with the Securities and Exchange Commission (the Commission) an application for an order pursuant to Section 57(i) of the Investment Company Act and Rule 17d-l promulgated under the Investment Company Act of 1940 (an Application), to authorize the entering into of certain joint transactions and co-investments by the Corporation with certain entities which may be deemed to be affiliates of the Corporation pursuant to the provisions of the Investment Company Act of 1940, which such joint transactions and co-investments would otherwise be prohibited by Section 57(a)(4) of the Investment Company Act of 1940, all as more fully set forth in the draft Application that has been presented to the Board, and to do such other acts or things and execute such other documents, including amendments to the Application, as they deem necessary or desirable to cause the Application to conform to comments received from the staff of the Commission and otherwise to comply with the Investment Company Act of 1940 and the rules and regulations promulgated thereunder, in such form and accompanied by such exhibits and other documents, as the Officer or Officers preparing the same shall approve, such approval to be conclusively evidenced by the filing of the Application;

RESOLVED FURTHER, that a Policy on Transactions with Affiliates statement substantially in a form restating the conditions set forth in Section II of the Application as finally approved by the Commission is hereby approved and will be adopted, upon final approval of the Application by the Commission, in all respects as a policy of the Corporation and the Officers be, and they hereby are, authorized, empowered and directed, in the name and on behalf of the Corporation, to take such action as they shall deem necessary or desirable to formalize such policies and streamline the approval process for co-investment transactions with affiliates of the Corporation, in such form as the Officer or Officers preparing the same shall approve, such approval to be conclusively evidenced by the taking of any such action; and

RESOLVED FURTHER, that the Officers be, and each of them hereby is, authorized, empowered and directed, in the name and on behalf of the Corporation, to perform all of the agreements and obligations of the Corporation in connection with the foregoing resolutions and to consummate the transactions contemplated thereby, to take or cause to be taken any and all further actions, to execute and deliver, or cause to be executed and delivered, all other documents, instruments, agreements, undertakings, and certificates of any kind and nature whatsoever, to incur and pay all fees and expenses and to engage such persons as the Officer or Officers may determine to be necessary, advisable or appropriate to effectuate or carry out the purposes and intent of the foregoing resolutions, and the execution by the Officer or Officers of any such documents, instruments, agreements, undertakings and certificates, the payment of any fees and expenses or the engagement of such persons or the taking by them of any action in connection with the foregoing matters shall conclusively establish the Officer s or Officers authority thereof and the authorization, acceptance, adoption, ratification, approval and confirmation by the Corporation thereof.

APPENDIX C

Resolutions of the Board of Directors of

Apollo Senior Floating Rate Fund, Inc.

Apollo Tactical Income Fund Inc.

NOW, THEREFORE, BE IT RESOLVED, that the officers (the Officers) of each of Apollo Senior Floating Rate Fund, Inc. and Apollo Tactical Income Fund Inc. (each the Corporation) be, and they hereby are, authorized, empowered and directed, in the name and on behalf of the Corporation, to cause to be prepared, executed, delivered and filed with the Securities and Exchange Commission (the Commission) an application for an order pursuant to Section 57(i) of the Investment Company Act and Rule 17d-l promulgated under the Investment Company Act of 1940 (an Application), to authorize the entering into of certain joint transactions and co-investments by the Corporp; Historically, between one-half and two-thirds of our total sales have been made to distributors pursuant to agreements that allow certain rights of return on our products held by these distributors. As a result of these rights, we defer the recognition of revenue and the costs of revenues derived from sales to distributors until such distributors resell our products to their customers. We determine the amounts to defer based on the level of actual inventory on hand at our distributors as well as inventory that is in transit to them. The gross profit that is deferred as a result of this policy is reflected as deferred income on sales to distributors in the accompanying condensed consolidated balance sheets.

Stock-based compensation

Effective January 1, 2006, we adopted SFAS 123R, which requires the measurement and recognition of compensation expense for share-based payment awards. We estimate the fair value of employee stock options and employee stock purchase rights under our Employee Stock Purchase Plan (ESPP shares) on the date of grant using the Black-Scholes option-pricing model. The Black-Scholes model requires us to estimate the expected terms of awards, expected stock price volatility, dividend rate, and the risk-free interest rate. These estimates, some of which are highly subjective, greatly affect the fair value of each employee stock option and ESPP share. We calculate our estimate of expected volatility for both stock options and ESPP shares using a weighted average of our historical stock price volatility and the implied volatility of our shares. Effective January 1, 2008, we have developed a model which uses historical exercise, cancelled and outstanding option data to calculate the expected life of stock option grants. We will continue to monitor the assumptions used to compute the fair value of our stock-based awards, and we will revise our assumptions as appropriate. In the event that we later determine that assumptions used to compute the fair value of our stock-based awards are inaccurate or if we change our assumptions significantly in future periods, stock-based compensation expense and, therefore, our results of operations, could be materially impacted.

Estimating sales returns and allowances

Net revenues consist primarily of product revenues reduced by estimated sales returns and allowances. To estimate sales returns and allowances, we analyze, both when we initially establish the reserve and then each quarter when we review the adequacy of the reserve, the following factors: historical returns, current economic trends, levels of inventories of our products held by our distributors, and changes in customer demand and acceptance of our products. This reserve represents the gross profit on estimated future returns and is reflected as a reduction to accounts receivable in the accompanying condensed consolidated balance sheets. Increases to the reserve are recorded as a reduction to net revenues equal to the expected customer credit memo, and a corresponding credit is made to cost of revenues equal to the estimated cost of the product to be returned. The net difference, or gross margin, is recorded as an addition to the reserve. Because the reserve for sales returns and allowances is based on our judgments and estimates, particularly as to future customer demand and level of acceptance of our products, our reserves may not be adequate to cover actual sales returns and other allowances. If our reserves are not adequate, our future net revenues and cost of revenues could be adversely affected.

Estimating distributor pricing credits

Historically, between one-half and two-thirds of our total sales have been made to distributors. Frequently, distributors need a cost lower than our standard sales price in order to win business. After the distributor ships product to its customer, the distributor submits a ship and debit claim to us in order to adjust its cost from the standard price to the approved lower price. After verification by us, a credit memo is issued to the distributor to adjust the sell-in price from

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the standard distribution price to the pre-approved lower price. We maintain a reserve for these credits that appears as a reduction to accounts receivable in our condensed consolidated balance sheets. Any increase in the reserve results in a corresponding reduction in our net revenues. To establish the adequacy of our reserves, we analyze historical ship and debit amounts and levels of inventory in the distributor channels. If our reserves are not adequate, our net revenues could be adversely affected.

From time to time we reduce our distribution list prices. We give our distributors protection against these price declines in the form of credits on products they hold in inventory. These credits are referred to as price protection. Since we do not recognize revenue until the distributor sells the product to its customers, we generally do not need to provide reserves for price protection. However, in rare instances we must consider price protection in the analysis of reserve requirements, as there may be a timing gap between a price decline and the issuance of price protection credits. If a price protection reserve is required, we will maintain a reserve for these credits that appears as a reduction to accounts receivable in our condensed consolidated balance sheets. Any increase in the reserve results in a corresponding reduction in our net revenues. We analyze distribution price declines and levels of inventory in the distributor channels in determining the reserve levels required. If our reserves are not adequate, our net revenues could be adversely affected.

Estimating allowance for doubtful accounts

We maintain an allowance for losses we may incur as a result of our customers inability to make required payments. Any increase in the allowance for doubtful accounts results in a corresponding increase in our general and administrative expenses. In establishing this allowance, and in evaluating the adequacy of the allowance for doubtful accounts each quarter, we analyze historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms. If the financial condition of one or more of our customers deteriorates, resulting in their inability to make payments, or if we otherwise underestimate the losses we incur as a result of our customers inability to pay us, we could be required to increase our allowance for doubtful accounts, which could in turn adversely affect our operating results.

Estimating write-downs for excess and obsolete inventory

When evaluating the adequacy of our valuation adjustments for excess and obsolete inventory, we identify excess and obsolete products and also analyze historical usage, forecasted production based on demand forecasts, current economic trends, and historical write-offs**.** This write-down is reflected as a reduction to inventory in the condensed consolidated balance sheets, and an increase in cost of revenues. If actual market conditions are less favorable than our assumptions, we may be required to take additional write-downs, which could adversely impact our cost of revenues and operating results.

Income taxes

We follow the liability method of accounting for income taxes which requires recognition of deferred tax liabilities and assets for the expected future tax consequence of temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities. We recognize valuation allowances to reduce any deferred tax assets to the amount that we estimate will be more likely than not realized based on available evidence and management s judgment. We limit the deferred tax assets recognized related to certain of our officers compensation to amounts that we estimate will be deductible in future periods based upon Internal Revenue Code Section 162(m). In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our results of operations and financial position.

On January 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). Under FIN 48, the impact of an uncertain income tax position on income tax expense must be recognized at the amount that is more-likely-than-not of being sustained under the two step approached prescribed by FIN 48. Tax positions that fail to qualify for initial recognition are recognized in the first subsequent interim period that they meet the more likely than not standard. The tax laws and regulations are subject to legal and factual interpretation, judgment and uncertainty. Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, evolution of regulations and court rulings. Therefore, the actual liability for U.S. or foreign taxes may be materially different from our estimates, which would result in the need to record additional tax

liabilities or potentially to reverse previously recorded liabilities.

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California Assembly Bill 1452. On September 30, 2008, California enacted Assembly Bill 1452 which among other provisions, suspends net operating loss deductions for 2008 and 2009 and extends the carryforward period of any net operating losses not utilized due to such suspension; adopts the federal 20-year net operating loss carryforward period; phases-in the federal two-year net operating loss carryback periods beginning in 2011 and limits the utilization of tax credits to 50 percent of a taxpayer s taxable income. We do not expect a significant impact to our effective tax rate or tax provision in the fourth quarter as the result of this law.

Emergency Economic Stabilization Act of 2008. The Emergency Economic Stabilization Act of 2008, which contains the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 , was signed into law on October 3, 2008. Under the Act, the research credit was retroactively extended for amounts paid or incurred after December 31, 2007 and before January 1, 2010. The effects of the change in the tax law will be recognized in our fourth quarter, which is the quarter in which the law was enacted. We are currently in the process of analyzing the impact of the new law.

Goodwill and intangible assets

As of December 31, 2007 we recorded goodwill in the amount of $1.8 million as a result of our acquisition of Potentia Semiconductor Corporation. For details on this acquisition refer to Note 8 of our Annual Report on Form 10-K for the year ended December 31, 2007. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, we will evaluate goodwill for impairment on an annual basis, or as other indicators of impairment emerge. The provisions of SFAS No. 142 require that we perform a two-step impairment test. In the first step, we will compare the implied fair value of our single reporting unit to its carrying value, including goodwill. If the fair value of our reporting unit exceeds the carrying amount no impairment adjustment is required. If the carrying amount of our reporting unit exceeds the fair value, step two will be completed to measure the amount of goodwill impairment loss, if any exists. If the carrying value of our single reporting unit s goodwill exceeds its implied fair value, then we record an impairment loss equal to the difference, but not in excess of the carrying amount of the goodwill.

SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives, and reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. We review long-lived assets, such as acquired intangibles and property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We measure recoverability of assets to be held and used by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, we recognize an impairment charge by the amount by which the carrying amount of the asset exceeds the fair value of the asset. We would present assets to be disposed of separately in the balance sheet and would report the assets at the lower of the carrying amount or fair value less costs to sell, and would no longer depreciate the assets and liabilities of a disposed group classified as held for sale. Currently, we have no impairment of long-lived assets nor any assets held for disposal.

Results of Operations

The following table sets forth certain operating data as a percentage of total net revenues for the periods indicated:

	Percentage of Total Net Revenues for Three Months Ended September 30,		Percentage of Total Net Revenues for Nine Months Ended September 30,	
	2008	2007	2008	2007
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	45.8	47.0	46.0	45.5
Gross profit	54.2	53.0	54.0	54.5

Operating expenses:				
Research and development	13.1	13.4	14.3	13.3
Sales and marketing	13.1	14.0	14.0	14.1
General and administrative	11.9	13.0	11.3	13.3
Total operating expenses	38.1	40.4	39.6	40.7
Income from operations	16.1	12.6	14.4	13.8
Total other income	3.0	3.9	3.7	4.3
Income before provision for income taxes	19.1	16.5	18.1	18.1
Provision for income taxes	4.9	2.9	4.0	3.6
Net income	14.2%	13.6%	14.1%	14.5%

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Comparison of the Three Months and Nine Months Ended September 30, 2008 and 2007

Net revenues. Net revenues for the three months ended September 30, 2008 were $53.8 million compared with $49.8 million for the three months ended September 30, 2007, an increase of $4.0 million, or 8%. The increase was driven primarily by further penetration of our products into the consumer, communications and industrial markets, including applications such as appliances, external adapters, flat-panel TVs, videogame consoles, cordless phones, tools and LED lighting. The increase in net revenues was driven largely by sales of our LinkSwitch products, which are targeted primarily at replacing linear power supplies. The growth in LinkSwitch sales was partially offset by lower sales of our TinySwitch products, primarily reflecting the loss of a major end customer in the communications market in 2007. We have since regained a substantial portion of this lost business with one of our LinkSwitch products.

Net revenues for the nine months ended September 30, 2008 were $159.3 million compared with $138.4 million for the comparable period of 2007, an increase of $20.9 million or 15%. The increase was driven primarily by penetration gains across all of our major end markets.

Revenue mix by product family was as follows:

	Three Months Ended		Nine Months Ended	
Product Family	**September 30, 2008**	**September 30, 2007**	**September 30, 2008**	**September 30, 2007**
TinySwitch	44%	51%	45%	54%
LinkSwitch	28%	21%	27%	15%
TOPSwitch	26%	26%	26%	29%
DPA-Switch	2%	2%	2%	2%

Approximate revenue mix by end market was as follows:

	Three Months Ended		Nine Months Ended	
End Market	**September 30, 2008**	**September 30, 2007**	**September 30, 2008**	**September 30, 2007**
Consumer	31%	29%	31%	30%
Communications	26%	26%	27%	27%
Computer	21%	23%	21%	21%
Industrial	15%	15%	15%	15%
Other	7%	7%	6%	7%

International sales, which consist of sales outside of the Americas based on ship to customer locations, were $51.2 million in the third quarter of 2008 compared to $47.6 million for the same period in 2007, an increase of $3.6 million, or 8%. International sales represented 95% of net revenues compared to 96% in the three months ended September 30, 2008 and 2007, respectively. International sales were $152.1 million for the nine months ended September 30, 2008 compared to $131.3 million for the same period in 2007, an increase of $20.8 million, or 16%. International sales represented 96% and 95% of net revenues for the nine months ended September 30, 2008 and 2007, respectively.

Distributors accounted for 65% of our net product sales for the three months ended September 30, 2008, while 35% of revenues were from direct sales to end customers. For the nine months ended September 30, 2008, distributors accounted for 63% of net product sales while direct sales accounted for 37%. These percentages did not change significantly compared to the same periods in 2007.

The following customers accounted for 10% or more of total net revenues:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Customer	**2008**	**2007**	**2008**	**2007**

A	18%	25%	16%	24%
B	11%	*	*	*

* less than 10%

Customers A and B are distributors of our products. No other customers accounted for 10% or more of our net revenues in those periods.

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Customer demand for our products can change quickly and unexpectedly. Our customers perceive that our products are readily available and typically order only for their short-term needs. Our revenue levels are highly dependent on the amount of new orders that are received for which product can be delivered by us within the same period. Orders that are booked and shipped within the same period are called turns business. Because of the uncertainty of customer demand, and the short lead-time environment and high level of turns business, it is difficult to predict future levels of revenues and profitability.

Cost of revenues; Gross profit. Gross profit is equal to net revenues less cost of revenues. Our cost of revenues consists primarily of the purchase of wafers from our foundries, assembly, packaging and testing of our products by sub-contractors, and internal labor and overhead costs associated with the testing of wafers and packaged components. The table below compares gross profit for the three and nine months ended September 30, 2008 and 2007 (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net revenues	$ 53.8	$ 49.8	$159.3	$138.4
Gross profit	$ 29.2	$ 26.4	$ 86.1	$ 75.5
Gross profit as a % of net revenue	54.2%	53.0%	54.0%	54.5%

The increase in the gross profit margin for the three-month period was driven primarily by an increase in the percentage of revenue coming from smaller, higher-margin customers, as well as reduced manufacturing costs and unit-cost benefits associated with increased production volumes. The decrease in the gross profit margin for the nine months ended September 30, 2008 was driven primarily by an increase in higher-volume, lower margin business, in addition to a product mix consisting of a higher volume of lower margin products compared to the prior year.

Research and development expenses. Research and development (R&D) expenses consist primarily of employee-related expenses (including stock-based compensation), expensed engineering material and facility costs associated with the development of new processes and new products. We also expense prototype wafers and mask sets related to new products as research and development costs until new products are released to production. The table below compares R&D expenses for the three and nine months ended September 30, 2008 and 2007 (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net revenues	$ 53.8	$ 49.8	$159.3	$138.4
R&D expenses	$ 7.0	$ 6.7	$ 22.8	$ 18.5
R&D expenses as a % of net revenue	13.1%	13.4%	14.3%	13.3%

The increase in R&D expenses of $0.3 million in the third quarter ended September 30, 2008 versus the comparable period in 2007 was due primarily to increased stock based compensation expense of $0.3 million and increased salaries and related expenses of $0.6 million, partially offset by reduced bonus expenses of $0.6 million. The increase of $4.3 million in the nine month period ended September 30, 2008 versus the comparable period in 2007 was driven primarily by increased payroll and related expenses of $2.1 million, outside services of $0.3 million and stock-based compensation expenses of $1.4 million, partially offset by reduced bonus expenses of $0.3 million. The increase in R&D expenses for the three and nine month periods were driven primarily by increased headcount related to our acquisition of Potentia Semiconductor in December 2007, and the decreased bonus expense was due to a reduction in the bonus accrual resulting from a forecast reduction. We expect R&D expenses to increase gradually in absolute dollars in future periods primarily as a result of our ongoing development of new products and manufacturing technologies, as well as regular salary increases, but these expenses may fluctuate as a percentage of our net revenues.

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Sales and marketing expenses. Sales and marketing expenses consist primarily of employee-related expenses (including stock-based compensation), commissions to sales representatives, facilities expenses including expenses associated with our regional sales offices and support offices, and field application engineering costs. The table below compares sales and marketing expenses for the three and nine months ended September 30, 2008 and 2007 (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net revenues	$ 53.8	$ 49.8	$159.3	$138.4
Sales and marketing expenses	$ 7.1	$ 7.0	$ 22.3	$ 19.5
Sales and marketing expenses as a % of net revenue	13.1%	14.0%	14.0%	14.1%

The increase of $2.8 million for the nine-month period was driven primarily by an increase in salaries, benefits and payroll taxes of $1.2 million, consultant expenses of $0.3 million and an increase in stock-based compensation expenses of $0.6 million. These increases were associated with growth in headcount, primarily in our sales organization, resulting from overall growth of our sales and application-support staff, in addition to our acquisition of Potentia Semiconductor in December 2007. We expect sales and marketing expenses to increase in absolute dollars in future periods because of increased investment in sales and marketing but these expenses may fluctuate as a percentage of our net revenues.

General and administrative expenses. General and administrative (G&A) expenses consist primarily of employee-related expenses (including stock-based compensation) for administration, finance, human resources and general management, as well as consulting fees, outside services, legal fees and fees for audit and tax services. The table below compares G&A expenses for the three and nine months ended September 30, 2008 and 2007 (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net revenues	$ 53.8	$ 49.8	$159.3	$138.4
G&A expenses	$ 6.4	$ 6.5	$ 18.1	$ 18.4
G&A expenses as a % of net revenue	11.9%	13.0%	11.3%	13.3%

For both the three- and nine-month periods ending September 30, 2008, we incurred a decrease in expenses for professional services of $1.0 million and $2.4 million, respectively, compared to the same periods in 2007. The decrease reflected the conclusion of a financial restatement and related matters in August 2007. These reductions were partially offset by bad debt expense of $1.3 million in the third quarter of 2008 associated with the receivable from a distributor who was terminated by us in December 2007 (see note 11 in our notes to condensed consolidated financial statements). For the nine-month period, reduced professional-services fees were further offset by expenses associated with our recent chief financial officer transition, and increased payroll taxes resulting from employee stock option exercises. We expect G&A expenses to continue to fluctuate in both absolute dollars and as a percentage of our revenues in future periods, due largely to fluctuations in expenses related to patent litigation in 2008. Our ongoing patent litigation is explained in Part II, Item 1 (Legal Proceedings) of this Form 10-Q.

Other income, net. Other income, net consists primarily of interest income earned on cash and short-term investments. Other income, net, for the three and nine months ended September 30, 2008 was $1.6 million and $5.2 million, respectively, compared with $1.9 million and $5.2 million for the three and nine months ended

September 30, 2007, respectively. The decrease primarily reflects lower interest rates earned on cash and short-term investments, partially offset by an increase in our cash balance year over year which resulted in more interest earned.

Provision for income taxes. Provision for income taxes represents federal, state and foreign taxes. The provision for income taxes was $2.6 million and $1.4 million for the quarters ended September 30, 2008 and 2007, respectively. The provision for income taxes was $6.4 million for the nine months ended September 30, 2008 compared to $5.0 million in the same period in 2007. Our estimated effective tax rate was approximately 26% and 22% for the three and nine months ended September 30, 2008, respectively, compared to 18% and 20% for the same periods in 2007. The difference between the statutory rate of 35% and our effective tax rate for the third quarter of 2008 was due primarily to the geographic distribution of our earnings, which resulted in lower tax rates in foreign jurisdictions. The difference

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between the statutory rate of 35% and our effective tax rate for the nine months ended September 30, 2008 was due primarily to the geographic distribution of earnings as well as the settlement of certain issues related to the IRS audits of our 2002 and 2003 tax years. The difference between the statutory rate of 35% and our effective tax rates for the three and nine months ended September 30, 2007 was due primarily to international sales which are subject to lower tax rates, and the favorable effects of research and development tax credits, partially offset by permanent differences related to SFAS 123R stock option expense for foreign employees.

Liquidity and Capital Resources

As of September 30, 2008, we had $225.5 million in cash, cash equivalents and short-term investments (including $0.3 million of restricted cash), an increase of approximately $20.0 million from December 31, 2007. We had working capital, defined as current assets less current liabilities, of $249.0 million, an increase of $34.0 million from December 31, 2007.

We generated $32.1 million in cash from operating activities in the nine months ended September 30, 2008. This cash flow was primarily the result of net income in the amount of $22.5 million, which was reduced by non-cash expenses for stock-based compensation and depreciation and amortization, totaling $12.1 million and $7.3 million, respectively. An increase in accounts payable of $3.7 million, due primarily to the timing of payments to our inventory suppliers, also contributed to the increase in cash flows from operating activities. These increases were partially offset by uses of cash including: an increase in inventories of $6.8 million largely as a result of lower-than-expected sales in the first three quarters of 2008; a $5.0 million increase in prepaid expense and other current assets related to a prepayment to one of our wafer suppliers to secure production material and prepaid income taxes: and an increase in accounts receivable of $4.1 million primarily reflecting seasonally lower sales in December 2007 as compared to September 2008, as well as year-end collections activity in December 2007.

In the nine months ended September 30, 2007 our operating activities generated $44.4 million in cash. This cash flow from operations was primarily the result of our net income of $20.0 million, which was reduced by non-cash expenses for stock-based compensation and depreciation and amortization, totaling $9.8 million and $6.0 million, respectively. In addition, inventories decreased by $8.3 million over the nine-month period, driven primarily by strong product sales in the third quarter. The positive cash impact of the decrease in inventories was partially offset by higher accounts receivable, which increased by $4.1 million primarily reflecting growth in our sales.

Net cash provided by investing activities in the nine months ended September 30, 2008 was $73.5 million. Our investing activities consisted of net proceeds of $79.6 million of held-to-maturity investments and the release of restricted cash of $1.1 million, offset by purchases of property and equipment of $7.2 million. Net cash used in investing activities in the nine months ended September 30, 2007 was $14.8 million. Our investing activities consisted of net purchases of $7.8 million of held-to-maturity investments and purchases of property and equipment of $7.0 million.

Net cash used in financing activities for the nine months ended September 30, 2008 was $5.6 million, consisting primarily of the use of $29.2 million for the repurchase of common stock, partially offset by proceeds of $22.8 million from the issuance of common stock through the exercise of stock options and the purchase of shares through our employee stock purchase program. Our net cash provided by financing activities for the nine months ended September 30, 2007 was $7.8 million consisting primarily of net proceeds of $7.7 million from the issuance of common stock through the exercise of stock options.

In February 2008, we announced that our board of directors had authorized the use of up to $50 million for the repurchase of our common stock. During the three and nine months ended September 30, 2008, we purchased 788,400 and 1,099,565 shares of our common stock, respectively, for approximately $20.2 million and $29.2 million, respectively. This repurchase program concluded on October 31, 2008, and utilized the remaining $20.8 million to repurchase our common stock.

In October 2008, the board of directors authorized the use of an additional $50 million to repurchase our common stock. Repurchase activity related to the authorization is expected to commence in November 2008, after the conclusion of the above-mentioned repurchase plan. There is currently no expiration date for this stock repurchase plan.

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On October 21, 2008, our board of directors declared a quarterly cash dividend of $0.025 cents per share, to be paid to holders of record as of the dividend record date. We intend to pay dividends on a quarterly basis beginning in the fourth quarter of 2008, and continuing through the end of 2009. The first quarterly dividend will be payable on December 31, 2008 to shareholders of record as of November 28, 2008.

Our contractual obligation related to income tax, as of September 30, 2008, consisted primarily of unrecognized tax benefits of approximately $19.1 million, and was classified as deferred tax assets and long-term income taxes payable in our condensed consolidated balance sheet. The settlement period for our income tax liabilities cannot be determined; however it is not expected to be due within the next twelve months.

There were no material changes outside of the ordinary course of business in the contractual commitments reported in our Annual Report on Form 10-K for the year ended December 31, 2007.

In the first quarter of 2008, we entered into a security agreement with the Union Bank of California, whereby we agreed to maintain $0.4 million in an interest-bearing certificate of deposit with the bank. This balance was classified as restricted cash on our condensed consolidated balance sheet. The purpose of this agreement is to secure commercial letters of credit which we provide to our workers compensation insurance carrier as part of our insurance program. The CD was renewed on July 28, 2008, and again on October 27, 2008, and per the agreement with the bank, the amount was decreased to $0.3 million. This agreement remains in effect until the cancellation of our letters of credit. As of September 30, 2008, there were outstanding letters of credit totaling approximately $0.2 million.

Our cash, cash equivalents and short term investments are subject to market interest rate risk and will vary in value as market interest rates fluctuate. To minimize market risk, most of our investments subject to market risk mature in less than one year, and therefore if market interest rates were to increase or decrease by 10% from interest rates as of September 30, 2008 and December 31, 2007, the increase or decrease in the fair market value of our portfolio on these dates would not have been material.

During the first nine months of 2008, a significant portion of our cash flow was generated by our operations. If our operating results were to deteriorate as a result of a decrease in customer demand for our products, severe pricing pressures from our customers or our competitors, or for other reasons, our ability to generate positive cash flow from operations may be jeopardized. In that case, we may be forced to use our cash, cash equivalents and short-term investments or seek financing from third parties to fund our operations. We believe that cash generated from operations, together with existing sources of liquidity, will satisfy our projected working capital and other cash requirements for at least the next 12 months.

Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133 (SFAS No. 161)* . This standard amends FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* by requiring expanded disclosure about an entity s derivative instruments and hedging activities, but does not change the scope or accounting for Statement No. 133. SFAS No. 161 requires qualitative, quantitative and credit-risk disclosures. Required qualitative disclosures include 1) how and why an entity is using derivative instruments or hedging activity, 2) how an entity is accounting for its derivative instruments and hedging items under SFAS No. 133, and 3) how the instruments affect an entity s financial position, financial performance and cash flow. The qualitative disclosure should include information about the fair value of the derivative instruments, including gains and losses. Credit-risk disclosures should include information about the existence and nature of credit risk related contingent features included in derivative instruments. SFAS No. 161 also amends SFAS No. 107, *Disclosures about Fair Value of Financial Assets,* to clarify that derivative instruments are subject to SFAS No. 107 s concentration-of-credit-risk disclosures. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, and will be adopted by us in the first quarter of 2009. We are currently evaluating the impact SFAS No. 161 will have on our consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with

generally accepted accounting principles (the GAAP hierarchy). SFAS No. 162 will become effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. We do not expect the adoption of SFAS No. 162 to have a material effect on our consolidated financial statements.

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In May 2008, the FASB issued Staff Position (FSP) Accounting Principles Board (APB) 14-1 *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1). FSP APB 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer s non-convertible debt borrowing rate. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008 on a retroactive basis and will be adopted us in the first quarter of 2009. We do not expect the adoption of FSP APB 14-1 to have a material effect on our consolidated financial statements.

On January 1, 2008, we adopted the following accounting pronouncements:

In June 2007, the FASB ratified Emerging Issues Task Force (EITF) 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* (EITF 06-11). EITF 06-11 requires that the tax benefits of dividends on unvested share-based payments be recognized in equity and be reclassified from additional paid-in capital to the income statement when the related award is forfeited or no longer expected to vest. There was no material impact to our financial statements related to EITF 06-11.

In June 2007, the FASB ratified EITF 07-3, *Accounting for Non-Refundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* (EITF 07-3). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. The adoption of EITF 07-3 had no material impact to our financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB granted a one year deferral for non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis, at least annually, to comply with SFAS No. 157. However, the effective date for financial assets and liabilities remains intact. There was no material impact to our financial statements as a result of the adoption of SFAS No. 157. See note 14 to our condensed consolidated financial statements for the disclosures required by SFAS No. 157. We are currently evaluating the financial statement impact, if any, of adopting this standard, related to non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. We do not believe the postponed portion of this standard will have a significant impact on our financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value; we did not elect to value any of our financial assets or liabilities in accordance with SFAS No. 159.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

There has not been a material change in our exposure to interest rate and foreign currency risks from that described in our 2007 Annual Report on Form 10-K.

Interest Rate Risk. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We consider cash invested in highly liquid financial instruments with a remaining maturity of three months or less at date of purchase to be cash equivalents. Investments in highly liquid financial instruments with maturities greater than three months but not longer than twelve months from the balance sheet date are classified as short-term investments. Investments in highly liquid financial instruments with maturities greater than twelve months from the balance sheet date are classified as long-term investments. We do not use derivative financial instruments in our investment portfolio to manage our interest rate risk, foreign currency risk, or for any other purpose. We invest in high-credit quality issuers and, by policy, limit the amount of credit exposure to any one issuer. As stated in our policy, we seek to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in safe and high-credit quality securities and by constantly positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer, guarantor or depository. The portfolio includes only marketable securities with active secondary or resale markets to facilitate portfolio liquidity. We do not hold any instruments for trading purposes. At September 30, 2008 and December 31, 2007, we held primarily cash equivalents and short-term investments with fixed interest rates and with maturity dates of less than twelve months.

These securities are subject to market interest rate risk and will vary in value as market interest rates fluctuate. To minimize market risk, most of our investments subject to market risk mature in less than one year, and therefore if market interest rates were to increase or decrease by 10% from interest rates as of September 30, 2008 and December 31, 2007, the increase or decrease in the fair market value of our portfolio on these dates would not have been material.

Foreign Currency Exchange Risk. We transact business in various foreign countries. Our primary foreign currency cash flows are in Asia and Western Europe and involve contracts with two of our suppliers (Matsushita and OKI). Currently, we do not employ a foreign currency hedge program utilizing foreign currency forward exchange contracts; however, the contract prices to purchase wafers from Matsushita and OKI are denominated in Japanese yen and both agreements allow for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar. It has been and currently is our practice to maintain a Japanese yen account with a U.S. bank in an amount that generally approximates expected payments to our wafer suppliers in Japan. This practice acts to minimize the impact of changes in the yen. One of our other major suppliers, Epson, contracts prices to purchase wafers in U.S. dollars, however, the agreement with Epson also allows for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar. Nevertheless, changes in the exchange rate between the U.S. dollar and the Japanese yen could subject our gross profit and operating results to the potential for material fluctuations. All else being equal, a 10% change in the value of the U.S. dollar compared to the Japanese yen would result in a corresponding change in our gross margin of approximately one percentage point.

ITEM 4. CONTROLS AND PROCEDURES.

Limitation on Effectiveness of Controls

Any control system, no matter how well designed and operated, can provide only reasonable assurance as to the tested objectives. The design of any control system is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. The inherent limitations in any control system include the realities that judgments related to decision-making can be faulty, and that reduced effectiveness in controls can occur because of simple errors or mistakes. Due to the inherent limitations in a cost-effective control system, misstatements due to error may occur and may not be detected.

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of

1934, as amended (the Exchange Act), as of the end of the period covered by this report (the Evaluation Date). Based on this evaluation, our principal executive officer and principal financial officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective to provide reasonable assurance that the information relating to us, including our consolidated subsidiaries, required to be disclosed in our SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

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Changes in Internal Control over Financial Reporting

There has not been any change in our internal control over financial reporting during the quarter ended September 30, 2008, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 20, 2004, we filed a complaint against Fairchild Semiconductor International, Inc. and Fairchild Semiconductor Corporation (referred to collectively as Fairchild) in the United States District Court for the District of Delaware. In the complaint, we alleged that Fairchild has and is infringing of four Power Integrations patents pertaining to PWM integrated circuit devices. Fairchild denied infringement and asked for a declaration from the court that it does not infringe any Power Integration patent and that the patents are invalid. The Court held a claim construction hearing on February 2, 2006 and issued a claim construction order on March 31, 2006 which was favorable to us. The Court set a first trial on the issues of infringement, willfulness and damages for October 2, 2006. At the close of the first trial, on October 10, 2006, the jury returned a verdict in favor of us finding all asserted claims of all four patents-in-suit to be willfully infringed by Fairchild and awarding $33,981,781 in damages. Although the jury awarded damages, and we requested that the damages be enhanced in view of the jury s finding on willfulness, at this stage of the proceedings we cannot state the amount, if any, which might ultimately be recovered by the Company from Fairchild, and no benefits have been recorded in our consolidated financial statements as a result of the damages award. Fairchild also raised defenses contending that the asserted patents are invalid or unenforceable, and the court held a second trial on these issues beginning on September 17, 2007. On September 21, 2007, the jury returned a verdict in our favor, affirming the validity of the asserted claims of all four patents-in-suit. Fairchild submitted further materials on the issue of enforceability along with various other post-trial motions, and we filed post-trial motions seeking increased damages and attorneys fees, an accounting and interest on the damages award, and a permanent injunction. On September 24, 2008, the Court denied Fairchild s motion regarding enforceability and ruled that all four patents are enforceable. The Court will address the remaining post-trial motions in the coming months.

On June 28, 2004, we filed a complaint for patent infringement in the U.S. District Court, Northern District of California, against System General Corporation (System General), a Taiwanese company, and its U.S. subsidiary. Our complaint alleged that certain integrated circuits produced by System General infringed and continue to infringe certain of our patents. We sought, among other things, an order enjoining System General from infringing our patents and an award for damages resulting from the alleged infringement. On June 10, 2005, in response to the initiation of the U.S. International Trade Commission (ITC) investigation (discussed below), the District Court stayed all proceedings. Subsequent to the completion of the ITC proceedings, the District Court temporarily lifted the stay. On December 6, 2006, System General filed a notice of appeal of the ITC decision as discussed below. In response, and by agreement of the parties, the District Court renewed the stay of proceedings pending the outcome of the Federal Circuit appeal of the ITC determination. On November 19, 2007, the Federal Circuit affirmed the ITC s findings in all respects, and System General did not file a petition for review, so the ITC decision is now final. The parties subsequently filed a motion to dismiss the District Court case without prejudice, and the case is closed.

On May 9, 2005, we filed a Complaint with the ITC under section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. section 1337. We filed a supplement to the complaint on May 24, 2005. We alleged infringement of our patents pertaining to pulse width modulation (PWM) integrated circuit devices produced by System General, which are used in power conversion applications such as power supplies for computer monitors. The Commission instituted an investigation on June 8, 2005 in response to our complaint. System General Corporation filed a response to the ITC complaint asserting that the patents-in-suit were invalid and not infringed. We subsequently and voluntarily narrowed the number of patents and claims in suit, which proceeded to a hearing. The hearing on the investigation was held before the Administrative Law Judge (ALJ) from January 18 to January 24, 2006. Post-hearing briefs were submitted and briefing concluded February 24, 2006. The ALJ s initial determination was issued on May 15, 2006. The ALJ found all remaining asserted claims valid and infringed, and recommended the exclusion of the infringing products as well as certain downstream products that contain the infringing products. After further briefing, on June 30, 2006 the Commission decided not to review the initial determination on liability, but did invite briefs on remedy, bonding and

the public interest. On August 11, 2006 the Commission issued an order excluding from entry into the United States the infringing System General PWM chips, and any LCD computer monitors, AC printer adapters and sample/demonstration circuit boards containing an infringing System

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General chip. The U.S. Customs Service is authorized to enforce the exclusion order. On October 11, 2006, the presidential review period expired without any action form the President, and the ITC exclusion order is now in full effect. On December 6, 2006, System General filed a notice of appeal of the ITC decision. Briefing was completed on July 23, 2007, and the U.S. Court of Appeals heard oral argument for the Federal Circuit on November 9, 2007. On November 19, 2007, the Federal Circuit affirmed the ITC s findings in all respects, and the ITC s decision is now final. On October 27, 2008, System General filed a petition to modify the exclusion order in view of a recent Federal Circuit opinion in an unrelated case. We have not yet responded to System General s petition.

On June 14, 2007, we filed a complaint for patent infringement in the U.S. District Court, Northern District of California, against Shanghai SIM-BCD Semiconductor Manufacturing Limited, a Chinese company, and its U.S. sister corporation, BCD Semiconductor Corporation (referred to collectively as BCD). Power Integrations complaint alleged that certain integrated circuits produced by BCD infringe certain of our patents, seeking, among other things, an order enjoining BCD from infringing on our patents and an award for damages resulting from the alleged infringement. We voluntarily dismissed the California case against BCD on October 15, 2007 and filed a substantially identical complaint against BCD in the United States District Court for the District of Delaware on October 15, 2007. On January 21, 2008, BCD moved to dismiss the Delaware action for lack of personal jurisdiction in favor of a declaratory judgment action it filed against Power Integrations on the same patents in the U.S. District Court, Northern District of California, discussed in further detail below. On January 25, 2008, we moved for a preliminary injunction against further sales of the accused BCD products based on infringement of one of the patents in suit. On September 9, 2008, the Court denied BCD s motion to dismiss, and BCD answered our complaint on September 19, 2008, denying infringement and asking for a declaration from the Court that it does not infringe any of our patents and that the patents are invalid and unenforceable. The Court held a hearing on our motion for preliminary injunction on October 3, 2008, and on November 4, 2008, the magistrate issued a report recommending that the Court deny the motion for preliminary injunction. Trial is set for September 2009.

On January 18, 2008, BCD filed a complaint in the U.S. District Court, Northern District of California seeking a declaratory judgment of non-infringement and invalidity with respect to the three patents that we originally asserted against BCD in the Delaware action discussed above. BCD dismissed the California case on August 21, 2008 after the Delaware court denied its motion to dismiss.

On March 23, 2008, we filed a complaint against Fairchild Semiconductor International, Inc., Fairchild Semiconductor Corporation, and Fairchild s wholly-owned subsidiary System General Corporation (referred to collectively as Fairchild) in the United States District Court for the District of Delaware. In our complaint, we alleged that Fairchild has and is infringing three patents pertaining to power supply controller integrated circuit devices. Fairchild filed a motion for a more definite statement or to dismiss the complaint in lieu of filing an answer, but the Court denied that motion on October 21, 2008. Fairchild has not yet answered the Company s complaint.

On October 14, 2008, Fairchild Semiconductor Corporation and Fairchild s wholly-owned subsidiary, System General Corporation (referred to collectively as Fairchild), filed a complaint against us in the United States District Court for the District of Delaware. In its complaint, Fairchild alleged that we have and are infringing three patents pertaining to primary side power conversion integrated circuit devices. We have not yet answered Fairchild s complaint.

On April 25, 2006, Kimberly Quaco, an alleged shareholder, filed a derivative complaint in the United States District Court for the Northern District of California, purportedly on behalf of Power Integrations, against certain of our current and former executives and members of our board of directors relating to our historical stock option granting practices. On August 1, 2006, Kathryn L. Champlin, another alleged shareholder, filed a similar derivative complaint in the United States District Court for the Northern District of California purportedly on behalf of Power Integrations. On September 21, 2006, Christopher Deboskey, another alleged shareholder, filed a similar derivative suit in the United States District Court for the Northern District of California purportedly on behalf of Power Integrations. On November 30, 2006, Ms. Champlin voluntarily dismissed her suit. On December 18, 2006, the Court appointed Ms. Quaco s counsel as lead counsel and ordered that another purported shareholder, Mr. Geoffrey Wren, be substituted in as lead plaintiff. On January 17, 2007, the plaintiffs filed their consolidated complaint. On August 3, 2007, plaintiffs filed an amended consolidated complaint. The amended consolidated complaint alleges, among other

things, that the defendants breached their fiduciary duties by improperly backdating stock option grants in violation of our shareholder approved stock option plans, improperly recording and accounting for the backdated options, improperly taking tax deductions based on the backdated options, and disseminating false financial statements that improperly recorded the backdated option grants. The amended consolidated complaint asserts claims for, among other things, breach of fiduciary duty, unjust enrichment,

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and violations of Section 10(b) of the Securities Exchange Act of 1934. On January 30, 2008, the parties agreed to settle the dispute. The settlement is subject to court approval. On February 1, 2008, plaintiffs filed a motion for preliminary approval of the settlement. On May 1, 2008, the Court granted plaintiffs motion for preliminary approval of the settlement. On July 10, 2008, the Court held a final approval hearing. On July 18, 2008, the Court issued an order and final judgment approving the settlement.

On May 26, 2006, Stanley Banko, an alleged shareholder, filed a derivative complaint in the Superior Court of California, Santa Clara County, purportedly on behalf of Power Integrations, against certain of our current and former executives and members of our board of directors relating to our historical stock option granting practices. On May 30, 2006, Joan Campbell, also an alleged shareholder, filed a derivative suit in the Superior Court of California, Santa Clara County, making the identical allegations asserted in the Banko lawsuit. On June 30, 2006, pursuant to a stipulation by the parties, the Court consolidated the two cases into a single proceeding and required plaintiffs to file an amended, consolidated complaint. Plaintiffs filed their consolidated complaint on August 14, 2006, in which plaintiffs named additional officers and former officers and KPMG LLP, Power Integrations former auditor, as new defendants. The consolidated complaint alleges, among other things, that the defendants caused or allowed Power Integrations executives to manipulate their stock option grant dates that defendants improperly backdated stock option grants, and that costs associated with the stock option grants that we did not properly recorded in its financial statements. The complaint asserts claims for, among other things, insider trading, breach of fiduciary duty, gross mismanagement and unjust enrichment. On January 30, 2008, the parties agreed to settle the dispute. On March 3, 2008, pursuant to a stipulation by the parties, the Court stayed the action pending the final order approving the settlement and entry of the order and final judgment in the Quaco Action. On July 25, 2008, following the entry of the order and final judgment in the Quaco Action and pursuant to the settlement agreement, the parties submitted a stipulation to the Court requesting that the Court dismiss the action with prejudice. On July 29, 2008, the Court entered the order granting the stipulation and dismissing the action with prejudice.

The Internal Revenue Service (IRS) recently completed its audit of our 2002 and 2003 tax returns. The Company and the IRS were unable to reach an agreement on certain adjustments proposed by the IRS for those years with respect to our research and development cost sharing arrangement. We agreed to rollover the disputed issues into the audit of the Company s tax returns for 2004 through 2006 which is now in progress, in order to allow the IRS to further evaluate multiple year data related thereto.

On July 4, 2008 Azzurri Technology GmbH (in the following referred to as Azzurri) filed a complaint in the amount of EUR 1,247,832.07 plus interest against us in the Regional Court Munich I (Germany). We received this complaint on or about September 16, 2008. In its complaint, Azzurri, a former distributor and agent of our products in Germany and Austria, alleged that pursuant to mandatory European law it is entitled to a compensation claim in said amount following the termination of the distributor agreement by us even though the distribution agreement did not provide for such payment. We will deny such claims.

On November 5, 2008, we filed a demand for arbitration in San Francisco, California, against Azzurri for breach of its distribution agreement with us. We are seeking in excess of $1.25 million dollars from Azzurri that is due as a result of Azzurri s failure to pay for goods delivered to it by us.

The legal proceedings above have also been described in our Annual Report on Form 10-K for our fiscal year ended December 31, 2007. There can be no assurance that we will prevail in the litigation with Fairchild, Azzurri or BCD. This litigation, whether or not determined in our favor or settled, will be costly and will divert the efforts and attention of our management and technical personnel from normal business operations, potentially causing a material adverse effect on the business, financial condition and operating results. In addition, we are unable to predict the outcome of the other legal proceedings and matters described above. Adverse determinations in litigation could result in monetary losses, the loss of proprietary rights, subject us to significant liabilities, require us to seek licenses from third parties or prevent us from licensing the technology, any of which could have a material adverse effect on our business, financial condition and operating results.

ITEM 1A. RISK FACTORS

In addition to the other information in this report, the following factors should be considered carefully in evaluating our business before purchasing shares of our stock. These risk factors have not changed substantively from

those discussed in our Annual Report on Form 10-K for the year ended December 31, 2007, except for those risk factors below designated by an asterisk (*).

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**Our quarterly operating results are volatile and difficult to predict. If we fail to meet the expectations of public market analysts or investors, the market price of our common stock may decrease significantly*. Our net revenues and operating results have varied significantly in the past, are difficult to forecast, are subject to numerous factors both within and outside of our control, and may fluctuate significantly in the future. As a result, our quarterly operating results could fall below the expectations of public market analysts or investors. If that occurs, the price of our stock may decline.

Some of the factors that could affect our operating results include the following:

the volume and timing of orders received from customers;

competitive pressures on selling prices;

we are being audited by the Internal Revenue Service, which is asserting that we owe additional taxes relating to a number of items;

the demand for our products declining in the major end markets we serve, which may occur due to competitive factors or to the economic environment, including the current economic downturn and the credit crisis (which we expect to cause our revenues to decrease);

the inability to adequately protect or enforce our intellectual property rights;

the volume and timing of orders placed by us with our wafer foundries and assembly subcontractors;

continued impact of changes in securities laws and regulations, including potential risks resulting from our evaluation of internal controls under the Sarbanes-Oxley Act of 2002;

expenses we incur related to stock-based compensation may increase if we are required to change our assumptions used in the Black-Scholes model;

expenses we are required to incur (or choose to incur) in connection with our litigation against Fairchild Semiconductor and BCD;

fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen;

the licensing of our intellectual property to one of our wafer foundries;

the lengthy timing of our sales cycle;

undetected defects and failures in meeting the exact specifications required by our products;

reliance on international sales activities for a substantial portion of our net revenues;

our ability to develop and bring to market new products and technologies on a timely basis;

the ability of our products to penetrate additional markets;

attraction and retention of qualified personnel in a competitive market;

changes in environmental laws and regulations; and

earthquakes, terrorists acts or other disasters.

For example, we believe that the current economic climate is the principal reason why our revenues ceased to grow from the second to the third quarter of 2008, and will cause our revenues to decline in the fourth quarter of 2008 compared to the third quarter of 2008.

**We do not have long-term contracts with any of our customers and if they fail to place, or if they cancel or reschedule orders for our products, our operating results and our business may suffer.* Our business is characterized by

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short-term customer orders and shipment schedules. Our customer base is highly concentrated, and a relatively small number of distributors, OEMs and merchant power supply manufacturers account for a significant portion of our revenues. Our top ten customers, including distributors, accounted for 62%, of our net revenues for the nine months ended September 30, 2008. The ordering patterns of some of our existing large customers have been unpredictable in the past and we expect that customer-ordering patterns will continue to be unpredictable in the future. Not only does the volume of units ordered by particular customers vary substantially from period to period, but also purchase orders received from particular customers often vary substantially from early oral estimates provided by those customers for planning purposes. In addition, customer orders can be canceled or rescheduled without significant penalty to the customer. In the past we have experienced customer cancellations of substantial orders for reasons beyond our control, and significant cancellations could occur again at any time.

**Intense competition in the high-voltage power supply industry may lead to a decrease in our average selling price and reduced sales volume of our products.* The high-voltage power supply industry is intensely competitive and characterized by significant price sensitivity. Our products face competition from alternative technologies, such as linear transformers, discrete switcher power supplies, and other integrated and hybrid solutions. If the price of competing solutions decreases significantly, the cost effectiveness of our products will be adversely affected. If power requirements for applications in which our products are currently utilized go outside the cost-effective range of our products, some of these alternative technologies can be used more cost effectively. In addition, as our patents expire, our competitors could legally begin using the technology covered by the expired patents in their products, potentially increasing the performance of their products and/or decreasing the cost of their products, which may enable our competitors to compete more effectively. Our current patents may or may not inhibit our competitors from getting any benefit from an expired patent. One of our patents recently expired, and our remaining U.S. patents have expiration dates ranging from 2009 to 2027. We cannot assure that our products will continue to compete favorably or that we will be successful in the face of increasing competition from new products and enhancements introduced by existing competitors or new companies entering this market. We believe our failure to compete successfully in the high-voltage power supply business, including our ability to introduce new products with higher average selling prices, would materially harm our operating results.

We are being audited by the Internal Revenue Service which is asserting that we owe additional taxes relating to a number of items, and if we are not successful in defending our position we may be obligated to pay additional taxes, as well as penalties and interest, and may also have a higher effective income tax rate in the future. Our operations are subject to income and transaction taxes in the United States and in multiple foreign jurisdictions and to review or audit by the IRS and state, local and foreign tax authorities. In connection with an IRS audit of our United States Federal income tax returns for fiscal years 2002 and 2003, the IRS is asserting that we owe additional taxes relating to a number of items, the most significant of which is our research and development cost sharing arrangements with one of our subsidiaries. We disagree with the IRS s position; however, if we are not successful in defending our position, we could be required to pay additional taxes, penalties and interest for 2002 and 2003. In the first quarter of 2008, we were formally informed by the Internal Revenue Service of their planned audit for years 2004 2006 and received Information Document Requests for information for those years. We are in the process of compiling the data requested for the additional years. Resolution of this matter could take considerable time, possibly years.

We believe the IRS s position with respect to certain items for which it has proposed adjustments for fiscal years 2002 and 2003 are inconsistent with applicable tax laws, and that we have meritorious defenses to our position with respect to these proposed adjustments. Accordingly, we intend to continue to challenge the IRS s position on these matters vigorously. While we believe the IRS s asserted position on these matters is not supported by applicable law, we may be required to make additional payments in order to resolve these matters. If the IRS determines that we owe additional taxes for these matters, our results of operations and financial condition could be materially and adversely affected.

**If demand for our products declines in our major end markets, our net revenues will decrease.* A limited number of applications of our products, such as cellphone chargers, standby power supplies for PCs, and power supplies for home appliances comprise a significant percentage of our net revenues. We expect that a significant level of our net revenues and operating results will continue to be dependent upon these applications in the near term. The demand for

these products has been highly cyclical and has been impacted by economic downturns in the past. Any economic slowdown in the end markets that we serve could cause a slowdown in demand for our ICs; for example, the current economic/credit crisis will have such an effect. We believe that the current economic climate is the principal reason why our revenues ceased to grow from the second quarter to the third quarter in 2008, and will cause our revenues to decline in the fourth quarter of 2008 compared to the third quarter of 2008. When our customers are not successful in maintaining high levels of demand for their products, their demand for our ICs decreases, which adversely affects our operating results. Any significant downturn in demand in these markets would cause our net revenues to decline and could cause the price of our stock to fall.

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If we are unable to adequately protect or enforce our intellectual property rights, we could lose market share, incur costly litigation expenses, suffer incremental price erosion or lose valuable assets, any of which could harm our operations and negatively impact our profitability. Our success depends upon our ability to continue our technological innovation and protect our intellectual property, including patents, trade secrets, copyrights, and know-how. We are currently engaged in litigation to enforce our intellectual property rights, and associated expenses have been, and are expected to remain, material and have adversely affected our operating results. We cannot assure that the steps we have taken to protect our intellectual property will be adequate to prevent misappropriation, or that others will not develop competitive technologies or products. From time to time we have received, and we may receive in the future, communications alleging possible infringement of patents or other intellectual property rights of others. Costly litigation may be necessary to enforce our intellectual property rights or to defend us against claimed infringement. The failure to obtain necessary licenses and other rights, and/or litigation arising out of infringement claims could cause us to lose market share and harm our business.

As our patents expire, we will lose intellectual property protection previously afforded by those patents. Additionally, the laws of some foreign countries in which our technology is or may in the future be licensed may not protect our intellectual property rights to the same extent as the laws of the United States, thus limiting the protections applicable to our technology.

**We depend on third-party suppliers to provide us with wafers for our products and if they fail to provide us sufficient wafers, our business may suffer.* We have supply arrangements for the production of wafers with MEI, OKI, XFAB and Epson. Our contracts with these suppliers expire in June 2010, April 2013, December 2009 and December 2010, respectively. Although certain aspects of our relationships with MEI, OKI (purchased by Rohm Co. of Japan as of October 1, 2008), XFAB and Epson are contractual, many important aspects of these relationships depend on their continued cooperation. We cannot assure that we will continue to work successfully with MEI, OKI, XFAB and Epson in the future, and that the wafer foundries capacity will meet our needs. Additionally, one or more of these wafer foundries could seek an early termination of our wafer supply agreements. Any serious disruption in the supply of wafers from OKI, MEI, XFAB or Epson could harm our business. We estimate that it would take nine to 18 months from the time we identified an alternate manufacturing source to produce wafers with acceptable manufacturing yields in sufficient quantities to meet our needs.

Although we provide our foundries with rolling forecasts of our production requirements, their ability to provide wafers to us is ultimately limited by the available capacity of the wafer foundry. Any reduction in wafer foundry capacity available to us could require us to pay amounts in excess of contracted or anticipated amounts for wafer deliveries or require us to make other concessions to meet our customers requirements. Any of these concessions could harm our business.

If our third-party suppliers and independent subcontractors do not produce our wafers and assemble our finished products at acceptable yields, our net revenues may decline. We depend on independent foundries to produce wafers, and independent subcontractors to assemble and test finished products, at acceptable yields and to deliver them to us in a timely manner. The failure of the foundries to supply us wafers at acceptable yields could prevent us from selling our products to our customers and would likely cause a decline in our net revenues. In addition, our IC assembly process requires our manufacturers to use a high-voltage molding compound that has been available from only one supplier. In December 2006, an alternative molding compound, made by a different supplier was qualified for use on our highest volume package type. These compounds and their specified processing conditions require a more exacting level of process control than normally required for standard IC packages. Unavailability of assembly materials or problems with the assembly process can materially adversely affect yields, timely delivery and cost to manufacture. We may not be able to maintain acceptable yields in the future.

In addition, if prices for commodities used in our products increase significantly, raw materials costs of our suppliers would increase and could result in increased product costs our suppliers charge us. If we are not able to pass these costs on to our customers, this would have an adverse effect on our gross margins.

Securities laws and regulations, including potential risk resulting from our evaluation of internal controls under the Sarbanes-Oxley Act of 2002, will continue to impact our results. Complying with the requirements of the Sarbanes-Oxley Act of 2002 and NASDAQ s conditions for continued listing have imposed significant legal and

financial compliance costs, and are expected to continue to impose significant costs and management burden on us. These rules and regulations also may make it more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified executive officers and members of our board of directors, particularly qualified members to serve on our audit committee.

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Additionally, because these laws, regulations and standards promulgated by the Sarbanes-Oxley Act are subject to varying interpretations, their application in practice may evolve over time as new guidance becomes available. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices.

**Changes in assumptions used for our Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), calculation may increase our stock-based compensation expense.* We determine the value of stock options granted using the Black-Scholes model. This model requires that we make certain assumptions, including an estimate of our expected life of stock options. Historically we have used the simplified method, in accordance with Staff Accounting Bulletin 107, or SAB 107, to calculate the expected life of stock option grants. This method assumes all options will be exercised midway between the vesting date and the contractual term of the option. Effective January 1, 2008, we have developed a model which uses historical exercise, cancelled and outstanding option data to calculate the expected life of stock option grants. As a result of our analysis, the expected life based on the historical trends yielded a decrease in the expected life for 2008 (which had the effect of decreasing the estimated fair value of stock options granted during the first quarter). However, as the company is required to continually analyze the data, option holders exercise behavior will have an impact on the outcome of the expected life analysis and, therefore, may result in substantially higher stock-based compensation expenses. These changes in assumptions may have a material adverse effect on our U.S. GAAP operating results and could harm our stock price.

If we do not prevail in our litigation against Fairchild Semiconductor and BCD we will have expended significant financial resources, potentially without any benefit, and may also suffer the loss of proprietary rights. We are in patent litigation with each of Fairchild Semiconductor and BCD Semiconductor Manufacturing Limited, and the outcome of this litigation is uncertain. While Fairchild has been found to willfully infringe four of our patents, and those patents have been found valid by a jury, there can be no assurance that we will be successful in obtaining financial damages or an injunction against the infringing products. In addition, there is no assurance that we will be successful in obtaining financial damages or an injunction against all BCD products that infringe our patents. We have incurred, and expect to continue to incur, significant legal costs in conducting these lawsuits. Thus, even if we are successful in these lawsuits, the benefits of this success may fail to outweigh the significant legal costs we will have incurred.

**Fluctuations in exchange rates, particularly the exchange rate between the U.S. dollar and the Japanese yen, may impact our gross margin*. The contract prices to purchase wafers from MEI and OKI are denominated in Japanese yen, and the contract prices to purchase wafers from Epson is denominated in U.S. dollars. The agreements with these three vendors allow for mutual sharing of the impact of the exchange rate fluctuation between Japanese yen and the U.S. dollar. Nevertheless, changes in the exchange rate between the U.S. dollar and the Japanese yen could subject our gross profit and operating results to the potential for material fluctuations.

**Matsushita has licenses to our technology, which it may use to our detriment.* Pursuant to a Technology Agreement with Matsushita, which expired in June 2005, Matsushita has the perpetual right to manufacture and sell products that incorporate our technology to Japanese companies worldwide and to subsidiaries of Japanese companies located in Asia. Matsushita does not have rights to utilize technology developed by us after June 2005, when the agreement expired. According to the expired Technology Agreement, we will continue to receive royalties on Matsushita s sales through June 2009 at a reduced rate. Royalty revenues were less than 1% of total net revenues in both of the nine months ended September 30, 2008 and 2007. However, these royalties are substantially lower than the gross profit we receive on direct sales, and we cannot assure that Matsushita will not use the technology rights to continue to develop and market competing products.

Because the sales cycle for our products can be lengthy, we may incur substantial expenses before we generate significant revenues, if any. Our products are generally incorporated into a customer s products at the design stage. However, customer decisions to use our products, commonly referred to as design wins, can often require us to expend significant research and development and sales and marketing resources without any assurance of success. These significant research and development and sales and marketing resources often precede volume sales, if any, by a year or more. The value of any design win will largely depend upon the commercial success of the customer s product. We cannot assure that we will continue to achieve design wins or that any design win will result in future

revenues. If a customer decides at the design stage not to incorporate our products into its product, we may not have another opportunity for a design win with respect to that product for many months or years.

Our products must meet exacting specifications, and undetected defects and failures may occur which may cause customers to return or stop buying our products. Our customers generally establish demanding specifications for quality, performance and reliability, and our products must meet these specifications. ICs as complex as those we sell often encounter development delays and may contain undetected defects or failures when first introduced or after

commencement of commercial shipments. We have, from time to time in the past, experienced product quality, performance or reliability problems. If defects and failures occur in our products, we could experience lost revenue, increased costs, including warranty expense and costs associated with customer support and customer expenses, delays in or cancellations or rescheduling of orders or shipments and product returns or discounts, any of which would harm our operating results.

**Our international sales activities account for a substantial portion of our net revenues, which subjects us to substantial risks.* Sales to customers outside of the Americas account for, and have accounted for a large portion of our net revenues, including approximately 96% of our net revenues for the nine months ended September 30, 2008, and 95% for the year ended December 31, 2007. If our international sales declined and we were unable to increase domestic sales, our revenues would decline and our operating results would be harmed. International sales involve a number of risks to us, including:

potential insolvency of international distributors and representatives;

reduced protection for intellectual property rights in some countries;

the impact of recessionary environments in economies outside the United States;

tariffs and other trade barriers and restrictions;

the burdens of complying with a variety of foreign and applicable U.S. Federal and state laws; and

foreign-currency exchange risk.

Our failure to adequately address these risks could reduce our international sales and materially adversely affect our operating results. Furthermore, because substantially all of our foreign sales are denominated in U.S. dollars, increases in the value of the dollar cause the price of our products in foreign markets to rise, making our products more expensive relative to competing products priced in local currencies.

If our efforts to enhance existing products and introduce new products are not successful, we may not be able to generate demand for our products. Our success depends in significant part upon our ability to develop new ICs for high-voltage power conversion for existing and new markets, to introduce these products in a timely manner and to have these products selected for design into products of leading manufacturers. New product introduction schedules are subject to the risks and uncertainties that typically accompany development and delivery of complex technologies to the market place, including product development delays and defects. If we fail to develop and sell new products in a timely manner, our net revenues could decline.

In addition, we cannot be sure that we will be able to adjust to changing market demands as quickly and cost-effectively as necessary to compete successfully. Furthermore, we cannot assure that we will be able to introduce new products in a timely and cost-effective manner or in sufficient quantities to meet customer demand or that these products will achieve market acceptance. Our failure, or our customers failure, to develop and introduce new products successfully and in a timely manner would harm our business. In addition, customers may defer or return orders for existing products in response to the introduction of new products. Although we maintain reserves for potential customer returns, we cannot assure that these reserves will be adequate.

If our products do not penetrate additional markets, our business will not grow as we expect. We believe that our future success depends in part upon our ability to penetrate additional markets for our products. We cannot assure that we will be able to overcome the marketing or technological challenges necessary to penetrate additional markets. To the extent that a competitor penetrates additional markets before we do, or takes market share from us in our existing markets, our net revenues and financial condition could be materially adversely affected.

We must attract and retain qualified personnel to be successful and competition for qualified personnel is intense in our market. Our success depends to a significant extent upon the continued service of our executive officers and other key management and technical personnel, and on our ability to continue to attract, retain and motivate qualified personnel, such as experienced analog design engineers and systems applications engineers. The competition for these

employees is intense, particularly in Silicon Valley. The loss of the services of one or more of our engineers, executive officers or other key personnel could harm our business. In addition, if one or more of these individuals leaves our employ, and we are unable to quickly and efficiently replace those individuals with qualified personnel who can smoothly transition into their new roles, our business may suffer. We do not have long-term employment contracts with, and we do not have in place key person life insurance policies on, any of our employees.

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Changes in environmental laws and regulations may increase our costs related to obsolete products in our existing inventory. Changing environmental regulations and the timetable to implement them continue to impact our customers demand for our products. As a result there could be an increase in our inventory obsolescence costs for products manufactured prior to our customers adoption of new regulations. Currently we have limited visibility into our customers strategies to implement these changing environmental regulations into their business. The inability to accurately determine our customers strategies could increase our inventory costs related to obsolescence.

In the event of an earthquake, terrorist act or other disaster, our operations may be interrupted and our business would be harmed. Our principal executive offices and operating facilities situated near San Francisco, California, and most of our major suppliers, which are wafer foundries and assembly houses, are located in areas that have been subject to severe earthquakes. Many of our suppliers are also susceptible to other disasters such as tropical storms, typhoons or tsunamis. In the event of a disaster, we or one or more of our major suppliers may be temporarily unable to continue operations and may suffer significant property damage. Any interruption in our ability or that of our major suppliers to continue operations at our facilities could delay the development and shipment of our products.

Like other U.S. companies, our business and operating results are subject to uncertainties arising out of economic consequences of current and potential military actions or terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. These uncertainties could also lead to delays or cancellations of customer orders, a general decrease in corporate spending or our inability to effectively market and sell our products. Any of these results could substantially harm our business and results of operations, causing a decrease in our revenues.

We have adopted anti-takeover measures which may make it more difficult for a third party to acquire us. Our board of directors may issue up to 2,925,000 shares of preferred stock and determine the price, rights, preferences and privileges of those preferred shares without any further vote or action by the stockholders. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance` of shares of preferred stock, while potentially providing flexibility in connection with possible acquisitions and for other corporate purposes, could make it more difficult for a third party to acquire a majority of our outstanding voting stock. We have no present intention to issue shares of preferred stock.

In addition, we have entered into a rights agreement, commonly referred to as a poison pill, to guard against abusive hostile takeover tactics. Further, the anti-takeover provisions of Section 203 of the Delaware General Corporations Law apply to us. Our rights agreement and Section 203 of the Delaware General Corporations Law may discourage, delay or prevent a change in control of Power Integrations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet be Repurchased Under the Plans or Programs (in millions)
July 1 to July 31, 2008	58,500	$ 30.00	58,500	$ 39.3
August 1 to August 31, 2008	181,500	$ 28.35	181,500	$ 34.2
September 1 to September 30, 2008	548,400	$ 24.32	548,400	$ 20.8
Total	788,400		788,400	

(1) On February 6, 2008, we announced that our board of directors had authorized the use of up to $50 million for the repurchase of shares of our common stock. During the three months ended September 30, 2008, we purchased 788,400 shares of our common stock for approximately $20.2 million. There is currently no expiration date for this stock repurchase plan. In October 2008, we announced that our board of directors had authorized the use of up to an additional $50 million for the repurchase of shares of our common stock. This amount is not reflected in the table above, as it occurred after the end of the quarter.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

On November 5, 2008, Power Integrations entered into an Executive Officer Benefits Agreements with Bill Roeschlein, Chief Financial Officer of Power Integrations. The Executive Officer Benefits Agreements provides for certain benefits, as described below, including:

acceleration of vesting of stock options upon a change of control of Power Integrations,

severance benefits in the event of termination of employment by Power Integrations without cause or resignation by the officer for good reason within 18 months after a change of control,

severance benefits in the event of termination of employment by Power Integrations without cause or resignation by the officer for good reason, and

retirement benefits.

During the first year of Mr. Roeschlein s employment, the benefits under the Executive Officer Benefits Agreement would not be available to Mr. Roeschlein other than benefits in the event of a change of control. Otherwise, the Executive Officer Benefits Agreement is in the standard form as previously filed with the Securities and Exchange Commission, and as described in Power Integrations latest definitive proxy statement.

ITEM 6. EXHIBITS

See the Exhibit Index immediately following the signature page to this Quarterly Report on Form 10-Q, which is incorporated by reference here.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

POWER INTEGRATIONS, INC.

Dated: November 6, 2008

By: /s/ BILL ROESCHLEIN

Bill Roeschlein
Chief Financial Officer (*Principal Financial and Accounting Officer)*

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INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
3.1	Restated Certificate of Incorporation. (As filed with the SEC as Exhibit 3.1 to our Annual Report on Form 10-K on March 16, 1999, SEC File No. 000-23441.)
3.2	Certificate of Amendment to Restated Certificate of Incorporation. (As filed with the SEC as Exhibit 3.3 to our Annual Report on Form 10-K on March 22, 2002, SEC File No. 000-23441.)
3.3	Form of Certificate of Designation, Preferences and Rights of the Terms of the Series A Preferred Stock filed as Exhibit A to the Form of Rights Agreement between us and BankBoston N.A., dated February 24, 1999. (As filed with the SEC as Exhibit 1 to our Current Report on Form 8-K on March 12, 1999, SEC File No. 000-23441.)
3.4	Certificate of Amendment to Restated Certificate of Incorporation. (As filed with the SEC as Exhibit 3.1 to our Current Report on Form 8-K on November 9, 2007, SEC File No. 000-23441.)
3.5	Amended and Restated Bylaws. (As filed with the SEC as Exhibit 3.2 to our Current Report on Form 8-K on November 9, 2007, SEC File No. 000-23441.)
4.1	Reference is made to Exhibits 3.1 to 3.5.
4.2	Fifth Amended and Restated Rights Agreement by and among us and certain of our investors, dated April 27, 1995. (As filed with the SEC as Exhibit 4.1 to our Registration Statement on Form S-1 on September 11, 1997, SEC File No. 000-23441.)
4.3	Investor s Rights Agreement between us and Hambrecht & Quist Transition Capital, LLC, dated as of May 22, 1996. (As filed with the SEC as Exhibit 4.2 to our Registration Statement on Form S-1 on September 11, 1997, SEC File No. 000-23441.)
4.4	Rights Agreement between us and BankBoston N.A., dated as of February 24, 1999 (As filed with the SEC as Exhibit 1 to our Current Report on Form 8-K on March 12, 1999, SEC File No. 000-23441.)
4.5	Amendment to Rights Agreement between us and BankBoston N.A., dated as of October 9, 2001 (As filed with the SEC as Exhibit 4.3 to our Quarterly Report on Form 10-Q on November 9, 2001, SEC File No. 000-23441.)
10.1	Wafer Supply Agreement, between Seiko Epson Corporation and Power Integrations International, Ltd. effective as of April 1, 2005.*
10.2	Amendment Number Four to the Amended and Restated Wafer Supply Agreement between Power Integrations International, Ltd. and OKI Electric Industry Co., Ltd., dated September 15, 2008.*
10.3	Transition and Separation Agreement with Rafael Torres, executed July 23, 2008 (As filed with the SEC as Exhibit 10.1 to our Current Report on Form 8-K on July 25, 2008, SEC File No. 000-23441.)
10.4	Director Equity Compensation Program

10.5 Forms of Stock Option Agreements to be used in Director Equity Compensation Program.

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EXHIBIT NUMBER	DESCRIPTION
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

All references in the table above to previously filed documents or descriptions are incorporating those documents and descriptions by reference thereto.

* Confidential treatment has been requested for portions of this exhibit.

** The certifications attached as Exhibits 32.1 and 32.2 accompanying this Form 10-Q, are not deemed filed with the SEC, and are not to be incorporated by reference into any filing of Power Integrations, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-Q,

irrespective of any general incorporation language contained in such filing.