

Memorandum

TO: Judge Anthony Carpinello (ret.), JAMS
FROM: Henry Bregstein
DATE: June 24, 2011
SUBJECT: Expert Report and Curriculum Vitae of Henry Bregstein, Esq.

This memorandum provides in Section I a description of my professional background and experience relative to hedge funds. Section II to this memorandum provides a general discussion of domestic hedge funds and Section III provides my views as to the operation of withdrawal rights with respect to domestic hedge funds.

I. Henry Bregstein: Background

A. Experience

I serve as the Global Chair of the Financial Services Practice at Katten Muchin Rosenman LLP and am the Co-Managing Partner of the firm's New York office. In my practice, I advise banks, domestic and offshore hedge funds (and their general partners/managing members and investments managers), private equity funds, life insurance companies, investment advisers and broker-dealers on a broad range of regulatory, securities, tax, finance, licensing, general corporate and other legal matters. My practice focuses on the organization of and ongoing advice related to hedge funds and structured products. Specifically, I organize and provide ongoing advice related to domestic and offshore investment vehicles, securities and commodities hedge funds, private equity funds, funds of funds and managed account platforms having a broad range of investment strategies, including alternative investments, asset-backed, alpha transfer, roll-ups, incubators, emerging markets, event driven, market-maker and risk arbitrage. Additionally, I provide organizational and operational advice for investment advisers, introducers and broker-dealers.

I earned my undergraduate degree (B.A., 1970) from the University of Pennsylvania and my law degree magna cum laude (J.D., 1993) from the Benjamin N. Cardozo School of Law where I was Senior Editor of the Law Review. I am admitted to practice in New York. Additionally, I am a member of the following organizations: the New York State Bar Association, the New York City Bar Association and the NYCBA Committee on Commodities and Futures Law.

B. Recognition

I have been recognized by various institutions for providing quality legal services. Specifically, in 2010, I was named a Leading Lawyer by Legal 500 in the category of Investment Funds-Alternative/Hedge Fund Formation, hailed as “one of the best around” and praised for my “legally robust solutions that work from a business perspective.” I was also featured as one of Chambers Global’s Leaders in their Field in the category of Investment Funds: Hedge Funds in 2010 (and will be featured in the upcoming 2011 edition in the same category). I received the same honor from Chambers USA in 2009 and 2010 in which I am noted as having a “deep understanding” of the investment management industry and as being “articulate, concise and commercial.” In addition, I was featured in the most recent edition of IFLR’s Guide to the World’s Leading Investment Funds Lawyers in 2010 and was named among Lawdragon’s 3000 Leading Lawyers in America. I also was named a 2009 and 2010 New York “Super Lawyer,” a 2010 “Endorsed Individual” in Investment Funds: Hedge (USA) and a 2011 “Which lawyer” by Practical Law Company.

C. Lectures

I have participated both as a panelist and a moderator in numerous panels regarding various financial topics, including hedge funds. Recently, I participated in the following panels, among others: Moderator, “The Final Countdown...It’s Time to Prepare for the New Era of Investment Adviser Regulation!” Katten Seminar (March 2011); Panelist, “Trends in Capital Raising Through External Partnerships,” Managed Funds Association’s Trends in Capital Raising for Hedge Funds Conference (September 2010); Panelist, “The New and Evolving Regulatory Environment: What Matters for Hedge Funds and Their Clients,” Institutional Investor’s 9th Annual Hedge Fund Investor Symposium (June 2010); Participant, 2010 Reuters Global Financial Regulation Summit (April 2010); Guest “Hedge Fund Hangups Post-Madoff,” CNBC’s Squawk Box (December 2009); Moderator, “Managed Accounts,” HedgeFund Intelligence’s Absolute Return Symposium 2009 (November 2009); and Panelist, “Regulation: What Will the Attempt to Rein in OTC Derivatives Mean for Hedge Funds?” HedgeFund Intelligence’s Absolute Return Symposium 2009 (November 2009).

II. Hedge Funds in the United States

The term “hedge fund” describes a variety of different types of investment vehicles that share certain characteristics. Hedge funds formed in the United States are generally formed as limited partnerships or limited liability companies, though they may also be formed as trusts or pooled accounts, that are treated as partnerships for federal income tax purposes. Investors typically acquire limited partnership interests or non-managing membership interests in the hedge fund and play no role in the management of the fund. Where the fund is structured as a limited partnership, the management of the fund is vested in the general partner, which may delegate its investment management role to a separate advisor entity, which is typically under common control with the general partner. Please see Schedule A for an illustration of a typical U.S. hedge fund limited partnership structure. (The balance of this memorandum for ease of exposition refers to the limited partnership structure, though the concepts discussed apply

equally to domestic hedge funds established as limited liability companies, trusts and pooled accounts.)

A. Regulatory Framework

Hedge funds are structured to be exempt from registration under the Investment Company Act of 1940, as amended, (“1940 Act”) generally in reliance on either an exemption that provides for a limited number of investors (under Section 3(c)(1) of the 1940 Act) or an exemption (under Section 3(c)(7) of the 1940 Act) that generally requires investors to be “qualified purchasers.”¹ In each case, the sale of interests in the hedge fund cannot be offered or sold to the general public² or to persons that are not qualified purchasers.

B. Hedge Fund Fees

Typically, the investment manager of the fund (or, alternatively, the general partner affiliate of the investment manager) charges an annual management fee for its advisory services. These fees are generally higher in comparison to those charged for registered funds. In addition, a fund’s general partner is also usually entitled to receive incentive compensation based on the investment performance generally of each investor in the fund.

While the amount of such compensation varies, fees within the so-called “2 and 20” range are common in the hedge fund market. That is, the fund’s investment manager or general partner receives an annual fee of 2% of the value of the assets held by the fund (the “management fee”) and the fund’s general partner receives an allocation of 20% of any net profits (realized and unrealized), subject to the recovery of prior losses (the “performance allocation”). The performance allocation is usually contingently calculated at the end of each month for net asset value reporting purposes and crystallizes at the time of any withdrawal of capital by the investor from the fund and at the end of each fiscal year.

¹ A “Qualified Purchaser” includes, among other types of qualified entities, a natural person who owns not less than \$5,000,000 in investments or a company that owns not less than \$5,000,000 in investments as more fully described and defined in the Investment Company Act of 1940. See Pub. L. No. 111-257, 54 Stat. 841 § 2(a)(51) (1940) (codified at 15 U.S.C. § 80(a)(51)(A) (2006 & Supp. 2010)).

² Interests in a hedge fund are structured so as not to require registration under the Securities Act of 1933 (“1933 Act”) or corresponding state laws. Section 4(2) of the 1933 Act exempts “transactions by an issuer not involving any public offering.” See Securities Act of 1933, Pub. L. No. 22, 48 Stat. 74, § 4(2) (1933) (codified as amended at 15 U.S.C. § 77(d)(2) (2006 & Supp. 2010)). To fit within the exemption under section 4(2), hedge funds look to the safe harbor under Rule 506 of Regulation D, and raise capital through the offer and sale of interests through a private placement and only solicit potential investors that are “accredited investors,” which include among other types of qualified entities, a natural person whose individual net worth, or joint net worth with that person’s spouse, at the time of his or her purchase exceeds \$1,000,000 (excluding the value of the primary residence of such individual) or a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year and that have a “substantive and pre-existing relationship” with the hedge fund’s general partner, managing member or investment manager or customers of registered broker dealer third-party marketers. See 17 C.F.R. § 230.501(a) (2008).

In calculating the performance allocation, funds typically track losses and rely upon a “high water mark” concept so that an investor does not bear a performance allocation with respect to the recoupment of losses from prior periods.

Illustration One: The High Water Mark Concept

- Investor X invests \$10 in Hedge Fund A in January 2011. Investor X’s initial high water mark is said to be \$10.
- By December 31, 2011, the value of Investor X’s investment in the fund is \$20.
- The general partner is entitled to a performance allocation of \$2, or 20% of the \$10 of profits and Investor X’s investment balance is now \$18. Investor X’s new high water mark is \$18.
- By December 31, 2012, Investor X’s investment balance is \$16. As a result, the general partner is not entitled to any performance allocation because Investor X has experienced a net loss since December 31, 2011. Investor X now has a so-called “loss carryforward” of \$2 (i.e., the amount by which the investment balance is below the high water mark).
- By December 31, 2013, Investor X’s investment balance is \$17. Though there is \$1 of new profits for the year 2013, Investor X’s investment balance is still below its high water mark of \$18. As a result, the general partner is not entitled to any performance allocation in respect of the \$1 in profits, though the loss carryforward has been reduced to \$1.
- By July 31, 2014, Investor X’s investment balance is \$20. If Investor X withdraws its entire investment as of July 31, the general partner will be entitled to a performance allocation of \$.40, or 20% of the \$2 in excess of Investor X’s high water mark.

C. Investment Strategies

Hedge funds have a great amount of flexibility in the investments they can make and are not constrained or restricted in their investment activities other than by their own investment guidelines and laws and regulations that apply generally to all market participants. Hedge funds often pursue investment strategies that use derivatives, leverage and short selling. They use a diverse array of financial strategies and tools and can invest in either relatively liquid assets, which permit investors to withdraw funds frequently, or invest in assets that have limited liquidity, which in turn dictate that the withdrawal rights of investors (as further discussed below) are more restrictive.

III. Withdrawal Rights

Hedge Fund Withdrawal Rights Generally. A common feature among hedge funds is that they are open ended. In other words, they provide liquidity (i.e., withdrawal) rights to investors. A hedge fund’s withdrawal provisions take into consideration many factors, including the

frequency of the right to withdraw, any lock-up period (i.e., a period during which no withdrawal is permitted), any advance notice requirement prior to a withdrawal, the time period prior to payment of withdrawal proceeds and the permissible form of payment of withdrawal proceeds. The liquidity of a hedge fund is typically designed to correspond to the investment strategy and portfolio of the hedge fund. Considerations in determining the appropriate withdrawal scheme include without limitation: (i) the liquidity profile of the underlying assets in the portfolio, (ii) the time required to sell underlying positions, (iii) the valuation considerations relating to whether an immediate sale could adversely affect the value of the hedge fund's assets (e.g., avoiding fire sale of assets to meet immediate withdrawals) and (iv) the need to ensure consistent accounting principles³ in valuing the hedge fund's assets to determine a withdrawing investor's net asset value.

Frequency of Withdrawals. Hedge funds typically permit withdrawals monthly, quarterly, semi-annually, annually or bi-annually (or even less frequently). There are certain hedge funds that provide for withdrawal dates as often as daily or as infrequently as every 4 years. Advance notice is required prior to requesting a withdrawal, ranging generally from one-day prior notice to 180 days' prior notice.

Lock-Up Restrictions. In addition, some hedge funds include "lock-up" restrictions on an investor's investment in a hedge fund, such that interests in a hedge fund may only be withdrawn after the expiration of a certain period of time, typically one, two or five years after an investment is made. Annual, bi-annual or longer permissible withdrawal dates can also be viewed as rolling "lock-up" periods. Please refer to Schedule B hereto for a chart illustrating examples of withdrawal rights and the corresponding investment strategies of various hedge funds.

"Gates"; Suspension of Withdrawals. A material percentage of hedge funds now have "gating" provisions that provide that the general partner may limit withdrawals to a certain percentage of the fund's net asset value or an investor's investment on any withdrawal date. The purpose of these provisions is to prevent the forced liquidation of a hedge fund's portfolio. Historically, general partners and investment managers resisted including gating provisions as they believed that such provisions would be impediments to marketing and sales. Therefore, the further back in time gating provisions were utilized provides a stronger indication of the expected illiquidity of a fund's portfolio. (Understandably, post-2008, gating provisions have become more common.)

It is standard practice for the general partner to have the ability to suspend all withdrawals. Again, the purpose of this provision is to prevent the forced liquidation of a hedge fund's portfolio. However, the grounds for such suspension vary broadly from so-called "standard" provisions (e.g., a general partner may suspend where markets are disrupted) to provisions that allow the general partner broad discretion to suspend withdrawals (e.g., the

³ Typically, hedge funds apply U.S. generally accepted accounting principles (GAAP) including the Statement of Financial Accounting Standards ASC 820-10, Fair Value Measurements and disclosures (formerly FAS No. 157).

general partner may suspend where in its opinion it would be prejudicial to the limited partners). Similar to the analysis of gating provisions in the preceding paragraph, broad suspension rights are also a potential sign of a more illiquid portfolio.

The general partner's rights to impose a gate and suspend withdrawals allow the general partner or investment manager to prevent forced liquidation of a hedge fund's portfolio, which is of particular importance where the fund pursues an illiquid strategy.

Payout of Withdrawal Proceeds. Withdrawal proceeds are generally paid out within 30 business days after a withdrawal date with generally a hold back of 10% that is paid after the net asset value determination is finalized (usually after the annual audit of the hedge fund). This means that even in a hedge fund offering frequent rights of withdrawal with no lock-up, it may be an entire year before a withdrawing investor receives the totality of its withdrawal proceeds.

The withdrawal period (i.e., the period beginning on the date notice is required and ending on the date withdrawal payments are made) is intended to correspond to the characteristics and features of the hedge fund's underlying portfolio. Certain hedge funds incorporate provisions for exit accounts or liquidating trusts, so that a portion of the hedge fund's assets can be liquidated over time and withdrawal payments can be made in accordance with a liquidation schedule. This provides the general partner or investment manager with the ability to continue to manage assets relating to withdrawn interests in a hedge fund and for the account of a withdrawn limited partner to ensure an orderly liquidation of fund assets for the benefit of the withdrawn investor without affecting the investment performance of the fund as a whole.

For example, according to the Supplement to the Confidential Memorandum of the D.B. Zwirn Special Opportunities Fund, L.P. (the "Zwirn Fund") dated November 2004, the Zwirn Fund implemented an optional withdrawal provision (referred to therein as the "One-Year Plus Liquidity Option") that allows investors to elect at the time of making an investment to be eligible for annual withdrawals. In such a case, a pro rata portion of the Zwirn Fund's cash and liquid assets would be paid to the withdrawing investor. In addition, an allocable portion of the Zwirn Fund's remaining assets would continue to be managed (and be subject to management fees and performance allocations) on behalf of the withdrawn investor and liquidated by the investment manager over time with the expectation to liquidate such portion over a two-year period following the relevant withdrawal date.

Tracking Investments of the Same Investor. As discussed in more detail below, in my experience it is routinely the case that hedge funds that have lock-up features and/or longer withdrawal periods treat investments made on different dates by an investor as separate interests in the hedge fund so that the investment manager knows how long it can deploy the proceeds of each subscription.⁴ Profits and losses related to each of such interests are also separately tracked so that the amount that the investor may withdraw after the end of the applicable lock-up period can be properly determined.

⁴ Further, it is commonplace that hedge funds without such features or withdrawal periods also treat investments made on different dates by an investor as separate interests.

The primary purpose for tracking multiple investments as separate interests is to prevent a forced liquidation of a hedge fund's portfolio. Rolling two-year lock-up provisions (i.e., bi-annual withdrawal rights) are considered a particularly effective structure to protect a fund from forced liquidations and their concomitant negative effects. This purpose cannot be achieved if separate investments are aggregated for the purpose of applying a hedge fund's withdrawal provisions.

Illustration Two: The Importance of Tracking Investments for Managing a Strategy

- Hedge Fund A provides for monthly subscriptions, a 1 year lock-up of investments and quarterly withdrawals thereafter upon 30 days' prior notice.
- Investor X invests \$1 million on January 1, 2011.
- Investor X makes a subsequent investment of \$100 million on November 1, 2011.
- Investor X submits notice for a full withdrawal from Hedge Fund A on November 30, 2011 for the effective withdrawal date of January 1, 2012.

If the two investments were aggregated together for the purpose of determining the expiration of the lock-up period, the investment manager would not be able to deploy the assets of the hedge fund in accordance with the expected investment strategy, given that the second subscription of \$100 million could be withdrawn in a very short amount of time after the investment was made (i.e., from November 1, 2011 to January 1, 2012). This problem is amplified and would result in a more dramatic problem for the investment manager the longer the terms of a lock-up period or withdrawal period relative to a more illiquid strategy. In addition, not being able to invest a significant subscription into the hedge fund's primary illiquid strategy could cause a substantial drag on the fund's performance. Thus, in my experience, where lock-ups are utilized with respect to funds having illiquid strategies, hedge funds are structured such that investments be treated separately for purposes of the lock-up.

Investment managers also need to be able to track performance separately with respect to each investment in a fund. Hedge funds therefore treat investments made on different dates separately so that they can track the "high water mark" and profits and losses appropriately.

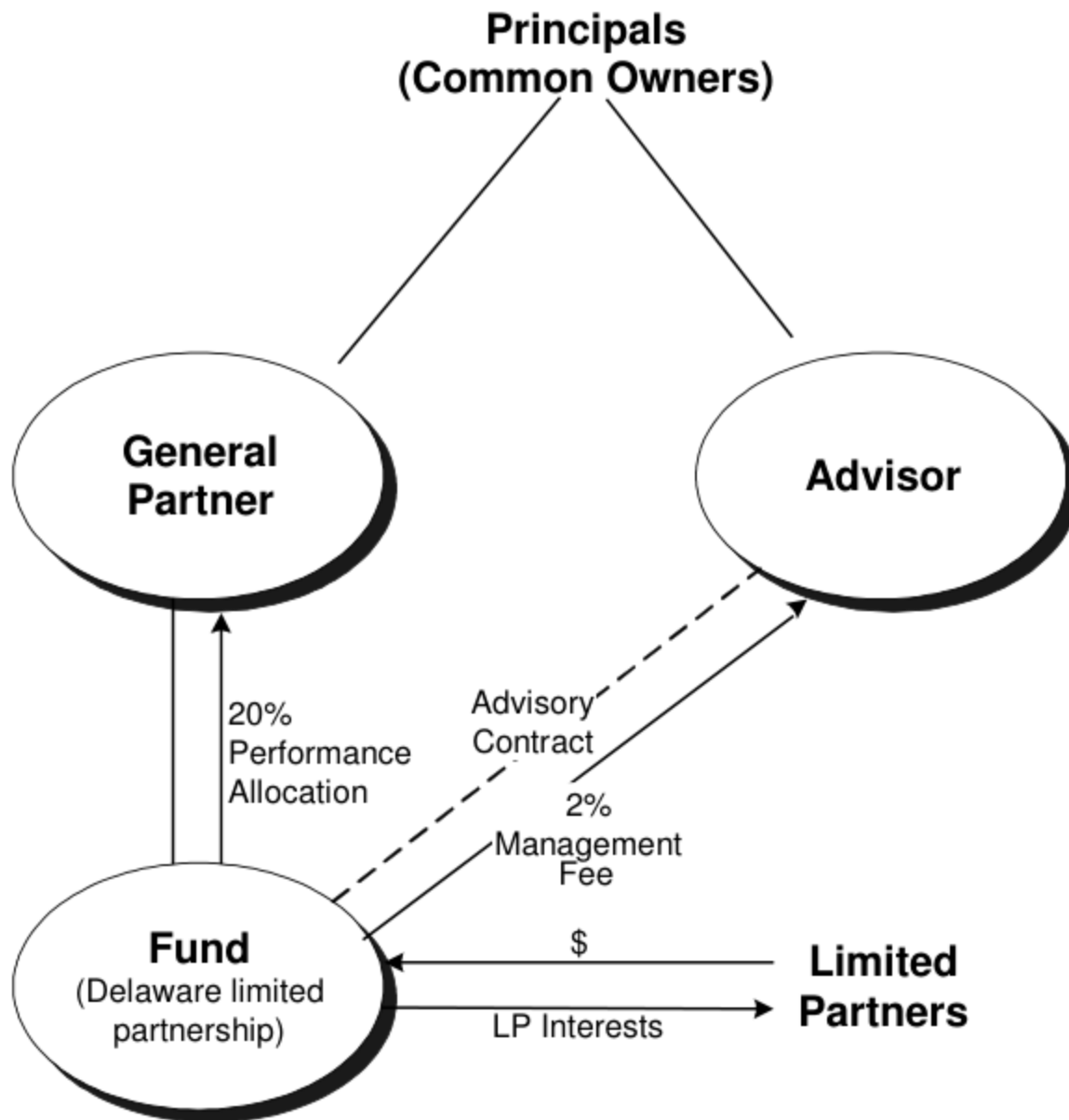
Illustration Three: The Importance of Tracking Investments Separately

- Investor X invests \$10 in Hedge Fund A in January 2011 (the "First Investment"). Investor X's initial high water mark with respect to the First Investment is said to be \$10.
- By December 31, 2011, the value of Investor X's investment balance is \$8.
- On January 1, 2012, Investor X invests an additional \$10 (the "Second Investment"). Investor X's initial high water mark with respect to the Second Investment is said to be \$10.

- By December 31, 2012, the First Investment is now worth \$9 and the Second Investment is now worth \$11.25.
- The general partner is not entitled to any performance allocation in respect of the First Investment because it is still below its high water mark. However, the general partner is entitled to a performance allocation of \$.20 (or 20% of \$1) in respect of the Second Investment.

Without tracking the investments separately it would not be possible to calculate the performance allocation properly because one investment was in a loss position and, because of the timing of the other, the other was in a gain position.

Schedule A



Schedule B

	Strategy	Lock-Up	Withdrawal Notice	Withdrawal Frequency	Withdrawal Payments
Sponsor A	Exchange-listed futures and options on government and quasi-government exchange-traded agency bonds	None	1 day	Daily	Within 2 business days (subject to 10% holdback pending final determination of NAV)
Sponsor B	Exchange listed futures and commodities quantitative systematic strategy	None	14 days	Monthly	As soon as possible but no later than 30 days
Sponsor C	Multi-Strategy of merger, credit and special situation strategies, primarily in the Americas, Western Europe and Australia	6 months (redemption fees applicable for withdrawals from 6 months through 24 months after an investment)	90 days	Quarterly	30 days (subject to 10% holdback if withdrawal is 90% or more of the investors' entire investment)
Sponsor D	Investments in Sub-Sahara African capital markets	12 months	90 days	Quarterly (subject to 20% annual withdrawal limit and ability to designate up to 30% of side-pockets)	Withdrawal payments depend on amount of investment being redeemed and can be delayed and made over the course of four subsequent calendar quarters
Sponsor E	Fund of funds focused on underlying distressed-high yield and emerging markets strategies	18 months	18 months	Semi-annual (ability to designate side-pockets)	35 days (subject to 5% holdback if withdrawal is 95% or more of the investors' entire investment)
Sponsor F	Significantly distressed public and private companies	24 months	90 days	Semi-annual (subject to a 15% withdrawal date and ability to designate up to 20% of side-pockets)	30 days (subject to 10% holdback pending annual audit)

	Strategy	Lock-Up	Withdrawal Notice	Withdrawal Frequency	Withdrawal Payments
Sponsor G	Global long-short; event oriented, credit distressed, capital structure arbitrage, convertible arbitrage, volatility trading, real estate and privately sourced transactions	9 full fiscal quarters	90 days	Quarterly subject to 12.5% limitation or additional withdrawal fees (ability to designate up to 15% of side-pockets)	45 days (subject to 5% holdback if withdrawal is 95% or more of the investors' entire investment)