September 29th, 2008

Dear Secretary,

Deerfield Management is an investment management company that focuses solely on healthcare companies. We have approximately $3 billion in assets, investments in over 80 companies and a successful 15 year history of performance. Our investments are based on comprehensive, bottoms-up analysis of the various aspects of our healthcare system ranging from emerging new treatments that require clinical study to new forms of insurance and medical delivery. The money that we manage is predominately from not-for-profit organizations. These include university endowments and groups which support essential non-industry sponsored research into medical research and health-related issues.

Deerfield has been a source of financing and stability in these turbulent times. In order to remain stable and perform the essential role that we do, the ability to reduce volatility and achieve returns in all markets through hedging is essential. The new rules and regulations have threatened our operations by reducing the number of healthcare organizations that can be shorted and by creating financial jeopardy to us through the publication of short positions. As I will describe, these new rules and regulations will reduce liquidity, reduce market participation by endowments and other important sources of capital, and remove a vital source of financing in poor market environments.

The Value We Bring to Markets

Outside of employment considerations, there are several valuable contributions that our firm provides. Hedge funds (that actually hedge as opposed to leverage) can provide a low volatility form of equity market exposure that can be maintained in all environments. This year, our long / short fund is up approximately 4%. Clearly our ability to have short exposure has been critical to this performance. If the recently implemented short restrictions are maintained, this fund will cease to function. To those who find shorting unappealing, this may seem like a positive outcome. However, like most long/short funds, we maintain a greater long exposure than short exposure. Right now our long exposure exceeds our short exposure by $500 million. What this means is that for every short share we cover, we have to sell even more of our long exposure. The net effect of removing us, like the vast majority of other similarly structured funds, is not only negative for liquidity, but for stock prices as well.

The elimination of firms that hedge but do not leverage has an even more profound effect on the broader markets when the actions of our investors in aggregate are considered. Endowment funds with only the option of long equity exposure (as opposed to hedged equity exposure) will greatly reduce equity market participation. Many larger funds have close to 50% of their U.S. equity exposure through funds which hedge. These funds have strategies that differ substantially enough that they can all be equity-based but yet have limited correlation. Were they all to become long only, correlations would increase markedly and as a result capital would have to be withdrawn. Over time this would remove hundreds of billions of dollars from the equity markets, much more of which would be long investments than short sales.

Perhaps more importantly, through our hedge fund and our private investment vehicles, we are a major source of funding for the healthcare industry. Each year the biotechnology industry requires billions of dollars in publicly raised funds to advance basic scientific research into human illness. Alzheimer's disease alone, affecting 1.5 million Americans, fills half of the nursing home beds in this country and costs our system over $100 billion per year, not including lost productivity. Several companies now have promising drugs entering late stages of testing, but these products will cost hundreds of millions of dollars to adequately test. Cancer continues to kills 500,000 Americans each year, and viruses ravage millions more. Research into new cures holds the answer.

In the current investment climate, there is little ability for the biotechnology industry to raise funds. Yet, because of our deep understanding of the industry, long-term view, and stable capital base, we have been able to invest over $500 million through private transactions into the healthcare industry since 2007. We completed a $65 million financing just last week at the pinnacle of market uncertainty.

By removing the ability to short, the means to hold steady during hard times is eliminated. Consider how difficult it has it been to find financing for floundering companies when so many investment-based companies are floundering themselves. We are one of those who can and is stepping in. However, as these regulations undermine our business model, we too will lose the ability to provide support.

The Damaging Effect of the "No Short" List and Short Sale Disclosures

While some of the regulations may have an important temporary role, they have been expanded more broadly to a level where they create harm. One example of this is the decision by the exchanges to include HMOs, prescription benefit managers, Brookdale Senior Living, Inc., and Five Star Quality Care, Inc. on the list of companies that cannot be shorted. These companies require no assistance from the federal government and have no exposure to distressed securities that could threaten their viability. While it may not seem important who specifically is on this list for short periods of time, it has a profound effect on business models such as ours which require the flexibility to short these names in order to maintain viable. It may be worth mentioning that despite the shorting restrictions, HMOs have not performed any better than the market and many have fared worse. With the rationale for inclusion unclear, no apparent stock price benefit, and clear hardship to organizations like ours who provide a benefit to the sector and the market, it seems prudent to expeditiously remove them from this list or to create strict criteria by which others can properly identify appropriate inclusion criteria.

Forcing the disclosure of short positions could have the same long-term effect as restricting short sales altogether for organizations that reduce risk through intelligent hedging. If large short positions are publicly known, there can be (and most certainly would be) collusion by existing shareholders to restrict borrow while purchasing shares of a target company. This would often force a fund to cover its short on a spike and lock in significant losses. Of course this is not possible to do on the long side and why disclosure is not an equivalent issue. There are additionally a host of competitive and financial issues specific to shorting which makes investment strategies immediately transparent and therefore lose value. There do not seem to be any benefits to the reporting of short positions in the healthcare industry, nor a legitimate concern that a short raid on pharmaceutical company or HMO could lead to anything but volatility in stock price and opportunity for people to purchase stock cheaply. The greatest good could be accomplished through eliminating these requirements or at a minimum confining them to financial stocks where there may be a rationale for oversight.

In summary, companies such as Deerfield manage money for critical social institutions and provide important services to companies and to the markets, particularly in distressed times. We provide returns on equity investments that are uncorrelated to the overall equity markets. This in turn allows institutions to increase their overall exposure to equities. Our stable returns in poor market environments allow rational behavior to have an influence on otherwise irrational market movements. And we are an important source of financing for companies that are vital to the development of technology and the advancement of human health. We encourage the elimination of short sale restrictions and reporting requirements. To the extent these extreme measures are necessary, we recommend that strict criteria be established such that they are confined to areas of defined need.

I appreciate your interest in our comments and am always available if I can be of any help in answering further questions.

Sincerely Yours,

James E. Flynn

General Partner
Deerfield Management
(212) 551-1619