Whitley Law Group, P.C.
1001 South Dairy Ashford, Suite 100 Houston, Texas 77077-2375
(281) 668 – 9200 Telephone (281) 668 – 9201 Facsimile

March 9, 2007

Attn.: Ms. Nancy M. Morris
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File Number S7-25-06

Dear Ms. Morris:

We are pleased to present the Securities and Exchange Commission ("SEC" or "Commission") with our comments regarding the Commission's proposed rules to prohibit fraud by advisers and to amend the definition of accredited investor for certain pooled investment vehicles.

For the Commission's convenience, following is an executive summary of our comments:

1. Our Firm has ample experience in securities law, and as a result, we believe that our comments are made on a knowledgeable basis.

2. We support the Commission's proposal to prohibit fraud by advisers to pooled investment vehicles.

3. We disagree with the Commission's proposal to increase the net worth requirement for natural person investors in private investment vehicles. Nonetheless, we believe that if these requirements are implemented, there could be beneficial effects for venture capital funds and accredited investor offerings by small businesses.

4. We support the Commission's decision to exclude venture capital funds from the definition of private investment vehicle. We also encourage the Commission to expand the rule's application to all companies investing in securities, not just those exempted by Sections 3(c)(1) and 3(c)(7) of the Investment Company Act.

5. We support the Commission's decision to define venture capital fund by reference to Section 202(a)(22) of the Investment Advisers Act, and urge the Commission not to use the definition in Section 2(a)(48) of the Investment Company Act, nor expand the rule's definition to include funds that invest significantly outside the United States.

6. We believe that the proposed rules will promote competition, efficiency, and capital formation.

I. Who We Are

Our Firm has an active corporate finance practice that caters to small publicly traded companies, investment banks, and private equity funds. Consequently, we have extensive knowledge of the principal federal securities statutes (1933 Act,

1934 Act, Investment Company Act, and Investment Advisers Act) and their state counterparts, as well as the business practices particular to the corporate finance and financial services sectors.

As a result, we believe that our experience enables us to comment knowledgeably on the Commission's proposed rules.

II. Prohibition of Fraud against Investors in Pooled Investment Vehicles

As a preliminary matter, we wholeheartedly endorse the Commission's proposed Rule 206(4)-8, which would prohibit fraud against investors in pooled investment vehicles. We agree with the Commission that these investors deserve protections against fraud regardless of whether the advisers of the investment vehicles are deemed to be investment advisers to the investors or to the investment vehicle.

We also agree with the Commission that this prohibition should extend to hedge funds, private equity funds, venture capital funds, and any other private offering pools that invest in securities. We would, however, encourage the Commission to extend the rule to all companies investing in securities, even those excluded by sections other than Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. To do otherwise would elevate form above substance and defeat the Investment Advisers Act's policy of preventing fraud.

We agree with the Commission that this rule is needed to extend to cases in which Rule 10b-5 under the Securities Exchange Act would be inapplicable because no sale or purchase of a security was made. For instance, under the proposed rule, use and distribution of a fraudulent private placement memorandum (including fraudulent financial figures) would be prohibited, even if no one purchased the offered securities. Such conduct would not be covered by Rule 10b-5, because that rule requires an actual purchase and monetary damages. We believe that a hard-and-fast rule against using fraudulent documents or making fraudulent statements prevents the commission of fraud and its concomitant losses in the first instance, and as a result, we support the proposed rule.

In sum, we support both the text and the policy of proposed Rule 206(4)-8, and encourage the Commission to adopt the rule as proposed.

III. Definition of Accredited Investor for Pooled Investment Vehicles

We disagree with the Commission's proposal to require investors in pooled investment vehicles to meet more stringent requirements than those for investors in companies that are not pooled investment vehicles.

There is no valid policy reason for having higher net worth requirements for investors in pooled investment vehicles than for investments in other types of companies. As the proposal currently stands, an accredited investor with less than $2.5 million in net worth could invest in a manufacturing company, a transportation company, a distributor, a service provider, and many other types of companies, but could not invest in a pooled investment vehicle.

We agree that many pooled investment vehicles are complex investments, but our experience has shown that investors that do not understand the complexities of these investments simply do not invest in them. As a result, limiting the pool of investors in these vehicles is unnecessary, since the investors in effect limit themselves; only those who are knowledgeable enough about the investment even purchase interests in the pooled investment vehicle.

This limitation is not only unnecessary, but is also undesirable. Pooled investment vehicles, despite their complexity, often enjoy spectacular investment returns. As a result, a person with $1 million in net worth could enjoy much higher returns by investing in these vehicles than in other types of investments. We do not believe that it is the Commission's role to in effect tell investors which investments are appropriate for them and which are not.

However, we do realize that certain beneficial effects could be produced if the Commission does require natural person accredited investors to have at least $2.5 million in net worth. The first beneficial effect is that accredited investors with less than $2.5 million will find that a venture capital fund will be the only available private investment vehicle for them. This effect would be positive because it would increase the amount of monies that venture capital funds can make available for investment in startup and small companies.

Another beneficial effect is that small companies that undertake their own accredited investor offerings will find a larger audience. If investors with net worths above $1 million but less than $2.5 million are unable to invest in pooled investment vehicles, they would look for other high-return investments, such as smaller companies with good growth and income prospects. As a result, these companies would likely enjoy greater success with their accredited investor offerings than they do currently.

In any event, we would submit to the Commission that the text of Rule 509(a) is simply too complicated and would suggest that the Commission simplify the language of the rule. We note that if the proposed rule is difficult for a securities lawyer to understand, it would likely be even more unintelligible by a person untrained in the area. As a result, we highly recommend revising the rule to make it more comprehensible.

An alternative would be as follows:

> (a) Notwithstanding the definition of "accredited investor" in Rule 215, a natural person investing in a private investment vehicle must own not less than $2.5 million in investments, or the issuer must reasonably believe that the person meets such qualifications.
>
> (b) Definitions. As used in this section, the following terms shall have the meanings indicated:

> (1) Private investment vehicle means any issuer that would be an investment company as defined in section 3(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(a)) but for the exclusion provided for in section 3(c)(1) (15 U.S.C. 80a-3(c)(1)) of that Act. Notwithstanding the foregoing, a venture capital fund shall not be considered a private investment vehicle for purposes of this rule.
>
> (2) Venture capital fund has the same meaning as "business development company" in section 202(a)(22) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(22)).

While the above language is only a suggestion and is certainly open to revision as necessary, we believe that it accomplishes the Commission's purposes and is easier to understand and interpret, an important consideration for securities lawyers and their clients.

In any event, we encourage the SEC to make the text of the rule more understandable for professionals in the securities industry and the public as a whole.

The Commission's proposed rule excludes venture capital funds from the application of the $2.5 million in investments rule for natural person accredited investors. The Commission solicited comment on this question.

We applaud the Commission for excluding venture capital funds from the reach of the proposed rule. Venture capital funds are an important source of capital for small and startup companies, and limiting these funds' source of investor monies would cause them to invest in less portfolio companies and/or in lower amounts.

The Commission also requested comment on the definition of venture capital fund proposed to be codified in Rule 509(b)(2). The current definition cross-references the definition of business development company in Section 202(a)(22) of the Investment Advisers Act. The Commission's main question was whether this cross-reference was appropriate, or whether the proposed rule should be amended to cite the definition of business development company contained in section 2(a)(48) of the Investment Company Act.

We believe that the current approach reflected in the proposed rule is more appropriate. A business development company under the Investment Company Act is required to register as such with the Commission, which is an expensive and time-consuming process.[1] However, a business development company is defined in the Investment Advisers Act as simply a fund that invests at least 60% of its assets in "eligible portfolio companies" (generally small businesses) and provides managerial assistance to those portfolio companies;[2] no registration with the SEC is required.[3]

[1] *See* Investment Company Act § 54, 15 U.S.C. § 80a-53 (2007).
[2] *See* Investment Advisers Act § 202(a)(22), 15 U.S.C. § 80b-2(a)(22); Investment Company Act § 2(a)(48).
[3] Investment Advisers Act § 202(a)(22)(B).

If the definition of venture capital fund were changed to refer to the definition of business development company contained in the Investment Company Act, then fewer funds would qualify as venture capital funds, because they would have to be registered with the Commission as business development companies in order to qualify. Because fewer entities would qualify as venture capital funds, this would mean that fewer venture capital funds would exist. This would translate into fewer sources of investment for small and startup companies. Furthermore, those venture capital funds that would qualify would likely become more selective and more demanding of their portfolio investments, which would lead to a decline in the amount of investment in small businesses generally.

The Commission also requested comment on whether venture capital funds that invest largely in foreign securities should be treated as venture capital funds for purposes of Rule 509(b)(2). While funds that invest abroad have valid arguments as to why they should be included in the definition of venture capital fund in the Commission's rules, we believe that the Commission's rules should encourage American capital to remain in America. American small businesses already have enough obstacles to their development, and lack of access to capital is still very much a reality for many businesses. We believe that this effect would be further exacerbated if venture capital funds investing abroad could enjoy the same regulatory exemptions as those investing in America.

Even apart from the "America-first" principle espoused above, there is a legitimate investor protection concern for limiting venture capital funds to investing in American companies: it will be easier for potential investors in the venture capital fund to conduct due diligence on the fund's portfolio companies if these companies are located in the United States. The same concern applies to reviews conducted by the Commission's staff in an investigation; it would be easier for the staff to secure information and cooperation from a domestic company than a foreign one.[4]

For the above reasons, we believe that the Commission should leave the definition of venture capital fund contained in proposed Rule 509(b)(2) unchanged.

IV. Promotion of Competition, Efficiency, and Capital Formation

Section 2(b) of the Securities Act of 1933 requires the Commission to consider the effect of any proposed rule on competition, efficiency, and capital formation.

Despite the Commission's concerns on these matters expressed in the Release, we believe that the proposed rules would actually *increase* competition, efficiency, and capital formation.

As stated earlier, if accredited investors with net worths of between $1 million and $2.5 million are excluded from pooled investment vehicles, they will seek

[4] The Commission's subpoena power is only nationwide; it is not extraterritorial. *See* Investment Advisers Act § 209(b); Investment Company Act § 42(b); Securities Exchange Act of 1934 § 21, 15 U.S.C. § 78u(b); Securities Act of 1933 § 19(c), 15 U.S.C. § 77s(c). The Commission would instead have to depend on the cooperation of foreign authorities, which could be withheld at the whim of a foreign government for any reason.

alternative investments. If venture capital funds are excluded from the definition of pooled investment vehicle, then more monies will likely flow to venture capital funds. These entities will then have more monies available to invest in portfolio companies, which by definition, must be small businesses in the United States.

In addition, small businesses may enjoy greater access to capital by having more accredited investors available to invest in their offerings. This would provide a beneficial effect to small businesses and economic growth in general. Competition would also be enhanced because more such accredited investor offerings would likely crop up to absorb the expected funds.

We would note that it is crucial to competition, efficiency, and capital formation that the definition of venture capital fund be limited to business development companies as defined in the Investment Advisers Act. If the definition were limited to business development companies as defined in the Investment Company Act, then less venture capital funds would exist, which would in turn mean less capital available for investment in small and startup companies.

The same concerns exist if venture capital funds are allowed to make significant investments in foreign issuers yet be exempt from the Commission's rules and oversight. American small businesses would suffer from an even greater lack of access to capital than they do already, and they would be unable to compete efficiently in the global marketplace. Consequently, competition, efficiency, and capital formation would suffer if the proposed definition of venture capital fund were expanded to include those funds that invest significantly abroad. We therefore encourage the Commission not to change this definition.

We do not foresee any effects on competition, efficiency, and capital formation by the promulgation of new Rule 206(4)-8 under the Advisers Act. However, to the extent that there are such effects, they are likely to be beneficial, because new investors coming into such funds will have the protection of the rule, thereby encouraging them to invest more.

V. Conclusion

As a whole, we agree with the Commission's proposed rules. Nonetheless, we believe that the Commission should consider further the aspects mentioned in this correspondence before adopting any new rule.

We appreciate the opportunity to have provided the Commission with our comments on these important matters and we hope that they are useful to the Commission in determining its policy.

Thank you.

Very truly yours,

WHITLEY LAW GROUP, P.C.

By:__/s/_____
Samuel E. Whitley