January 4, 2011

VIA E-MAIL

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-37-10

Dear Ms. Murphy:

This comment letter relates to the rules (the "Proposed Rules") recently proposed by the Securities and Exchange Commission (the "Commission") in Release IA-3111 (the "Proposing Release") published in 75 Fed. Reg. 77190 (December 10, 2010). The Proposed Rules would implement new exemptions from the registration requirements of the Investment Advisers Act of 1940 (the "Advisers Act") for advisers to certain funds that were enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

As noted in the Proposing Release, the Dodd-Frank Act, among other things, repealed Section 203(b) of the Advisers Act to eliminate the exemption from registration of "private" advisers. The Dodd-Frank Act replaced the broad exemption contained in Section 203(b) with three new exemptions under the Advisers Act, one of which, Section 203(l), would apply to an adviser that solely advises private venture capital funds (the "VC Exemption"). Section 203(l) of the Advisers Act, as added by the Dodd-Frank Act, also directs the Commission to define the term "venture capital fund."

In the Proposing Release, the Commission proposed Rule 203(l)-1 to define the term "venture capital fund." The Proposed Rules would define a "venture capital fund" as a private fund that, among other things: "owns solely: (i) equity securities issued by one or more qualifying portfolio companies, and at least 80 percent of the equity securities of each qualifying portfolio company owned by the fund was acquired directly from the qualifying portfolio company; and (ii) cash and cash equivalents…and U.S. Treasuries with a remaining maturity of 60 days or less…." The Proposed Rules would also define a "qualifying portfolio company" as one which, among other things "(i) at the time of any investment by the private fund, is not publicly traded…."

We are concerned that, as written, the Proposed Rules would have a chilling effect on the ability of smaller public companies to raise capital. If the Proposed Rules are adopted as proposed, venture capital funds will be prohibited from investing in a public company unless the fund adviser is willing to register under the Advisers Act. We believe this is an unintended consequence of the Proposed Rules and is inconsistent with legislative intent of Congress in creating the VC Exemption.

As noted in the Proposing Release, the purpose of the Dodd-Frank Act provisions repealing Section 203(b) of the Advisers Act was to close a perceived "loophole" under which private investment advisers were able to create large pools of highly leveraged capital that were not subject to Commission oversight. Congress was concerned that such large unregulated funds played a disproportionate role in creating the atmosphere that led to the financial crisis of 2007-08. This concern was magnified by the extensive use of leverage by unregulated hedge funds. See Sen. Rep. No. 111-176 at 38 (2010).

Congress, however, recognized that venture capital funds did not present the same systemic risks as unregulated hedge funds, primarily because venture capital funds were long-term investors, did not use leverage and were not "interconnected" with the global financial system. As stated in the Senate Report accompanying the Dodd-Frank Act:

> "The Committee believes that venture capital funds…specializing in long-term equity investment in small or start-up businesses, do not present the same risks as the large private funds whose advisers are required to register with the SEC under this title. Their activities are not interconnected with the global financial system, and they generally rely on equity funding, so that losses that may occur do not ripple throughout world markets but are borne by fund investors alone."

Sen. Rep. 111-176 at 74.

No where does the legislative history indicate that Congress intended that exempt venture capital funds limit their investment activity solely to private companies. While indicating that venture capital funds typically contribute capital to "early-stage" and "small" companies, the Proposing Release acknowledges the difficulties inherent in trying to define a "start-up" company or a "small company" and notes that there is "little consensus …as to what a start-up company is." 75 Fed. Reg. at 77192.

While it is certainly true that venture capital funds traditionally invest primarily in private companies, the Proposed Rules ignore the important role that venture capital funds play in funding small public companies, many of which would clearly meet accepted standards of "start-ups" or "small" companies. Many smaller companies have been forced to turn to the public markets for capital because of a lack of other financial alternatives, particularly in periods of high stress and uncertainty in the financial markets. As a result, many smaller companies, particularly in capital intensive industries such as the life sciences industry, have been forced to go public through reverse mergers or direct registration in order to attract investment capital. Many of these companies are pure start-ups with no revenue. At the same time, there are plenty of large private companies that are not "start-ups." It is hard to rationalize why an investment in Facebook, which according to recent press reports has a market valuation of approximately $50 billion, should be exempt when an investment in a pre-revenue drug discovery company with a $50 million market cap would not be merely because the company is publicly traded. In those circumstances, it is obvious that the public company is the "start-up" and not Facebook. Accordingly, we believe that the Proposed Rules arbitrarily limit the VC Exemption to private investments. We believe that the California VC exemption discussed in the Proposing Release more accurately captures the investment activity of venture capital companies and is a more appropriate standard by which to measure exempt venture capital investments, especially given the concentration of venture capital investment in California.

We believe that the proposed definition of venture capital fund in the Proposed Rules could have a chilling effect on the ability of smaller public companies to raise capital. Under the Proposed Rules, the adviser to any venture capital fund that invests in even one publicly traded company would lose the benefit of the VC Exemption.

In our view, there is no reason to limit the investment portfolio of venture capital funds solely to privately traded companies. As noted above and as acknowledged in the Proposing Release, the express justifications given by Congress for the VC Exemption were that venture capital funds (i) typically invest in long-term equity investments in "small or start-up businesses", (ii) are not "interconnected" with the global financial system and (iii) do not use leverage. Sen. Rep. 111-176 at 174. Permitting venture capital funds to invest at least some portion of their portfolios in smaller public companies would not negatively implicate any of these justifications.

Venture capital companies have become a large and important source of capital for smaller publicly traded companies, especially during the recent financial crises. According to statistics obtained through *Sagient Research* and *PlacementTracker*, between 2005 and 2009, venture capital funds participated in approximately 540 PIPE and RD investments which raised a total of approximately $25.2 billion. The average market capitalization of the companies receiving these investments was under $150 million in every year other than 2008, when the average market capitalization was $317.6 million. Significantly, in 2008 in the middle of the worst financial crisis since the Great Depression, venture capital PIPE and RD investments totaled nearly $15 billion, 3.5 times higher than in 2007 and 6 times higher than in 2009. As these statistics show, venture capital funds were most active during exactly the time when smaller public companies had nowhere else to turn for financing.[1]

If the Proposed Rules are adopted as proposed, we believe that venture capital fund investment in public companies will virtually end. If venture capital funds are prohibited from investing in public companies, the effects are likely to be catastrophic for smaller public companies, especially at times of maximum stress in the financial markets. We see no reason, either from the legislative history, or from a historical perspective, for adopting such a limited definition.

No abuse of the sort that the Dodd-Frank Act was designed to counteract would be permitted if a less restrictive definition of "venture capital fund" was adopted by the Commission. We believe that it is consistent with the legislative intent and the Commission's mission to assure orderly financial markets to broaden the definition to include at least some level of public investment. The unintended consequences of the Proposed Rules could easily be avoided by either allowing venture capital firms to make a limited amount of public investments (for example, 20% of assets under management) or by allowing them to invest in smaller public companies (for example, publicly traded companies with a public float of less than $500 million at the time of the investment).

If the Commission is unwilling to permit exempt venture capital funds to make investments in existing public companies, the Commission should modify the proposed transition rules to allow venture capital funds a reasonable period of time to dispose of any disqualifying investments. We are concerned that the proposed transition rules contained in the Proposing Release could also have a significant negative impact on smaller public companies. As written, the transition rules would require the adviser of a venture capital company to register under the Advisers Act if any fund it advises holds any investment in any company that was made at the time the issuer was already public after July 21, 2011, unless the adviser ceases to take in new money. Without an adequate transition period to dispose of disqualifying investments in an orderly fashion, venture capital funds are likely to have no alternative other than to dump their existing investments into markets which in many cases are already illiquid. This massive

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[1] Statistics relating to the participation of venture capital funds in underwritten public offerings are not readily available. However, based on our experience, we believe that venture capital funds also participate significantly in such public offerings by smaller public companies.

selling is likely to put significant downward pressure on the common stock prices of smaller issuers. Given the low trading volumes in many of these companies, an exit by a venture capital investor may be -- in all practical effect -- impossible. In the face of such selling pressure, raising new money will be virtually impossible for smaller public companies and the resulting volatility in the prices of smaller public companies will affect even companies that are not backed by venture capital funds.

In the Proposing Release, the Commission recognized that imposing rules that would force venture capital funds to modify investment criteria or to liquidate portfolio holdings is fraught with peril. 75 Fed. Reg. at 77206 ("Moreover, requiring existing venture capital funds to modify their investment conditions or characteristics [or to] liquidate portfolio company holdings … in order to satisfy the proposed definition of a venture capital fund would likely be impossible in many cases and yield unintended consequences for the funds and their investors."). However, without a realistic transition period, that is exactly what would happen if the Proposed Rules are adopted as proposed.

Accordingly, if the Commission does not broaden the definition of venture capital fund, the Proposed Rules should provide for a realistic time period for venture capital funds to exit existing investments on a time frame that is more likely to minimize any disruption on the financial markets. In other circumstances, transition period of two or three years have been used.[2] We believe it would be appropriate for venture capital funds to have a similar period to sell off their stakes in existing public companies.

Very truly yours,

Lowenstein Sandler, PC

By: John D. Hogoboom
A Member of the Firm

John D. Hogoboom | Member of the Firm
Lowenstein Sandler PC | 65 Livingston Avenue
Roseland | NJ | 07068-1791