Keith Paul Bishop

January 17, 2011

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

Re: File No. S7-37-10

Dear Ms. Murphy:

I am writing to comment on the proposal by the Securities and Exchange Commission (the "**Commission**") to implement new exemptions from the registration requirements of the Investment Advisers Act of 1940 for advisers to certain privately offered investment funds. These exemptions were enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"). The Commission's proposal is set forth in Release IA•3111 (the "**Proposing Release**").

1. Background.

I am an attorney in private practice in Irvine, California and an Adjunct Professor of Law at Chapman University Law School. I previously served as California's Commissioner of Corporations and Interim Savings & Loan Commissioner. I have also served as a member of the California Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions; Co-Chairman of the Corporations Committee of the Business Law Section of the California State Bar; and Chairman of the Business and Corporate Law Section of the Orange County (California) Bar Association. I am writing in my individual capacity and not on behalf of my law firm, the law school, any of my law firm's clients or the aforementioned groups.

2. The Commission's Characterization Of Legislative Intent Is False And Misleading.

In the Proposing Release, the Commission rejected the definition of "venture capital companies" adopted by the California Commissioner of Corporations[1] in 10 CCR

[1] The Proposing Release erroneously refers to the "California Corporations Commission". In fact, a single Commissioner, rather than a Commission, heads the California Department of Corporations. Cal. Corp. Code § 25600 ("The chief officer of the Department of Corporations is the Commissioner of Corporations.").

§ 260.204.9. According to the Commission, California's rule is inconsistent with the Commission's understanding of Congressional intent.[2] Accordingly, the Commission has proposed to exclude from the definition of "venture capital fund" a fund that invests in securities that are publicly traded at the time of investment. The Commission's expression of Congressional intent is false and misleading in two key respects.

First, the Commission cites as authority the testimony of two individuals before Congressional committees in the summer and fall of 2009.[3] This testimony was given *before* Representative Barney Frank introduced the bill, H.R. 4173, that Congress ultimately enacted as the Dodd-Frank Act in July 2010.[4] The Commission cites no evidence that any member of Congress actually adopted, considered or relied upon the testimony of either of these two individuals in drafting and voting on the Dodd-Frank Act. Without any evidence that Congress adopted, considered or relied upon the testimony of either of these two private citizens, their testimony can not be evidence of legislative intent.[5]

Second, the Proposing Release mischaracterizes the testimony of these two individuals. In fact, neither witness testified that venture capital companies never hold securities in publicly traded companies. Mr. Loy stated in relevant part: "Most venture capital funds restrict or prohibit: (i) investments in publicly traded securities . . .". Mr. McGuire testified in relevant part: "Most venture capital funds restrict: (i) investments in

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[2] "The California VC exemption does not limit permitted investments to companies that are start-up or privately held companies, which were cited as characteristic of venture capital investing in testimony to Congress." Proposing Release at 20, fn. 72.

[3] Trevor Loy, Flywheel Ventures and Terry McGuire, General Partner, Polaris Venture Partners, and Chairman, National Venture Capital Association. *Id.*

[4] Representative Barney Frank introduced HR 4173 on December 2, 2009. The Proposing Release itself notes that Mr. Loy testified before the Senate Banking Subcommittee on Securities, Insurance and Investment on July 15, 2009 and Mr. McGuire testified before the U.S. House of Representatives Committee on Financial Services, October 6, 2009. *Id.* at 11, fns. 40 & 41.

[5] For the same reason, the Commission should not rely on the testimony of Messrs. Loy and McGuire to support the imposition of other requirements, such as a minimum capital contribution by the general partner or retail investors. *See, e.g.*, Proposing Release at 52, fns. 163-64. Indeed, the Proposing Release is rife with false and misleading statements characterizing Congressional intent. For example, the Proposing Release states at page 49 "Congressional testimony cited an investor's inability to withdraw from a venture capital fund . . .". Obviously, this statement is made in an attempt to imply that Congress actually considered this testimony in enacting Section 407 of the Dodd-Frank Act. The footnote supporting this statement (fn.153) cites no testimony but refers to footnotes 149 and 150. Footnote 149 cites no Congressional testimony – only two treatises. There is no evidence cited that any member of Congress consulted these two treatises. Footnote 150 cites Mr. Loy's testimony that, as noted above, preceded Representative's Frank's introduction of HR 4173 by several months.

publicly traded securities . . .". Thus, neither individual testified that venture capital funds never invest in publicly traded securities.

3. The Commission Has Failed To Identify Any Problems With The California Definition.

The California Commissioner of Corporations adopted Rule 260.204.9 in March 2002.[6] This rule, which was adopted after public notice and comment, has been in effect for nearly nine years without engendering regulatory issues. Indeed, California leads the country in venture capital financing.[7] California, moreover, leads all other states in terms of venture capital investing. The current Commissioner of Corporations has said "the existing California definition of VC Fund provides the optimal flexibility for VC Fund advisers . . .".[8] Rather than relying on fantastical interpretations of legislative intent, the Commission should consider California's extensive experience with venture capital funds and venture capital investing.

4. The Definition Of "Venture Capital Fund" Should Include Venture Capital Funds That Invest In Debt Securities.

The Commission has proposed excluding from the definition of "venture capital fund" a venture capital company that acquires debt securities from, or otherwise lends money to a portfolio company. The Commission again bases its proposal on pseudo legislative history.[9] I recommend that the Commission allow venture capital funds to make bridge loans consonant with the California's statutory exemption in Financial Code § 22062.

The California definition of "venture capital company" does not preclude the acquisition of debt securities or loans to portfolio companies.[10] Indeed, it was recognized

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[6] *California Regulatory Notice Register* 2002, No. 14.

[7] Scott Shane, California Rules the Venture Capital Ecosystem, Dec. 22, 2010, avail. at http://smallbiztrends.com/2010/12/california-rules-venture-capital-ecosystem.html ("California has been the number-one state for venture investing for more than 30 years. It doesn't matter whether you measure VC activity in dollars, deals done, or capital under management.").

[8] Letter from Commissioner Preston DuFauchard dated January 21, 2011 addressed to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission.

[9] The Commission misleadingly cites the testimony of Messrs. Loy and McGuire. Proposing Release at 22 ("Congress received testimony that, unlike other types of private funds, venture capital funds 'invest cash in return for an equity share of the company's stock'").

[10] "A 'venture capital investment' is an acquisition of securities in an operating company . . .". 10 CCR § 260.204.9(b)(4). The term "security" is defined in Cal. Corp. Code § 25019 to include, among other things, a note or evidence of indebtedness.

that the venture capital lending activity could subject venture capital companies to the licensing and other requirements of the California Finance Lenders Law.[11]

Thus, the California Legislature in 2003 enacted AB 169 (Chavez), Cal. Stats. 2003, c. 163. The Business Law Section of the California State Bar, the National Venture Capital Association, and the American Electronics Association, among others, supported this legislation.[12] The purpose of the bill was to clarify that "clarify the law to make it clear that venture capital companies, as defined by the Commissioner of Corporations, are not subject to the CFL Law [California Finance Lenders Law] when making short-term commercial bridge loans that are not secured by real property".[13]

If venture capital funds did not find it necessary or desirable from time to time to make short-term "bridge" loans, then there would have been no need for this legislation. However, this legislation was needed because venture capital funds do make bridge loans from time to time:

> Equity financing in [sic] provided by venture capital firms in stages, based on the start-up company's progress towards achieving its business plan goals. In some instances, interim financing in the form of a bridge commercial loan is necessary as the company moves from product development to manufacturing and product sales.[14]

5. The Commission Should Make It Clear That A Venture Capital Fund May Own Membership Interests In Portfolio Companies.

The Commission has proposed to use the definition of "equity security" in Section 3(a)(11) of the Securities Exchange Act of 1934 and Rule 3a11-1. Neither the statute nor the rule refers explicitly to membership interests in limited liability companies. The Commission should therefore make it clear that a venture capital fund may own a membership interest in a qualifying portfolio company that is organized as a limited liability company.

Very Truly Yours,

/s/ Keith Paul Bishop

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[11] Cal. Fin. Code § 22000 *et seq.* The Commissioner of Corporations also administers and enforces the California Finance Lenders Law. *See* Cal. Fin. Code § 22005.
[12] Senate Floor Analysis, June 16, 2003, *available at* http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_0151-0200/ab_169_cfa_20030616_150923_sen_floor.html.
[13] *Id.* Among other requirements, a "commercial bridge loan" must be made with a maturity date not to exceed one year, and in connection with or in bona fide contemplation of, an equity investment in the operating company. Cal. Fin. Code § 22062(b)(3)(B).
[14] *Id.*