GUNDERSON DETTMER

January 24, 2011

*VIA EMAIL*

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
rule-comments@sec.gov

***Re: Release No. IA-3111, File No. S7-37-10, Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers; and Release No. IA-3110, File No. S7-36-10, Rules Implementing Amendments to the Investment Advisers Act of 1940 (the "Proposed Rules")***

Dear Ms. Murphy:

We are pleased to have the opportunity to submit this comment letter in response to the open process for regulatory reform rulemaking in connection with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "***Dodd-Frank Act***"). We greatly appreciate the occasion to provide the Securities and Exchange Commission ("***SEC***" or the "***Commission***") with these comments, which focus on the impact of the Proposed Rules on the venture capital industry. In September 2010, representatives from our firm traveled to Washington DC and met with certain Commissioners and selected members of the Staff who were responsible for drafting the Proposed Rules. This letter reflects our positions discussed during such conversations and further clarify our comments as they apply to the Proposed Rules.

By way of background, this law firm serves as primary outside counsel to over 125 venture capital fund managers who collectively manage over one thousand venture capital funds. We have been recognized as a national and international leader in the venture capital industry, and our client base represents some of the most active, influential and highly respected venture capital firms in the world. More importantly, for purposes of this response letter, we advise venture capital funds with respect to their structure, formation, organization and operations so as to ensure their compliance with applicable law. As such, we possess a particular expertise for the manner in which venture capital funds must be structured so as to operate properly.[1] It is our belief that the Proposed Rules are too restrictive and do not properly define a venture capital fund.

[1] We are not submitting this comment letter on behalf of any specific client.

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## I. OVERVIEW.

### A. VENTURE CAPITAL FUNDS.

While we support the general approach taken by Congress in exempting from registration those advisers who solely advise venture capital funds, we are concerned with the inflexible approach that the Commission has adopted in defining a *venture capital fund*. We acknowledge the daunting task imposed upon the Commission in coming up with a legitimate, workable definition of a *venture capital fund*. However, the Commission's methodology has produced an unyielding definition that, in the end, fails to protect the venture capital industry as Congress intended.

The venture capital industry is not one that may be readily categorized by rigid elements in which a single deviation somehow causes a fund manager to be subject to regulatory registration. The data gathered by the Commission in developing the Proposed Rules reflect a simple snapshot of the industry today, and do not represent the innovative manner in which venture capital has historically evolved to best find, finance and support innovative emerging growth companies. With the continual changes in the U.S. economy and constant technological advances, venture capital must remain malleable and likewise adapt to an ever-changing domain. An inflexible definition of a *venture capital* fund is short-sighted, as the test of the Commission's definition will not be today or tomorrow, but instead in ten years and beyond as the venture capital industry must evolve to meet the competitive challenges imposed domestically and internationally.

The regulatory definition of a *venture capital fund* must be one that properly identifies and captures how such investment vehicles have historically, currently and will prospectively operate. Otherwise, the definition will serve to constrain vital investing activities, and will force venture capital funds to change the way they do business so as to fit within the confines of an artificial construct. Congress did not task the Commission to provide a definition of what the Commission would *like* a venture capital fund to be. Instead they tasked the Commission to properly define what a venture capital fund *is* so as to exempt them from unnecessary and burdensome regulation that will stifle job creation. More to the point, our belief is that if the venture capital funds that gave us Cisco, Sun, Apple, Google and now Facebook cannot fit within the Proposed Rules, then the Proposed Rules have to be fixed.

We advise the Commission to avoid establishing obdurate parameters that are based primarily on what it believes the "average" venture capital fund to be. The US census tells us that the average persons-per-household is 2.59, yet we all know that no such household with a fraction of a person actually exists. Similarly, the Proposed Rules put forward an unbending definition based on industry averages, and we are not aware of any venture capital fund whose current operations would allow it to fit neatly within the strict boundaries established by the Proposed Rules. We urge the Commission to adopt a more flexible, realistic approach.

Although the venture capital industry is an indigenous American institution, the model is being successfully replicated around the world. Unnecessary restrictions imposed on U.S. advisers can only serve to further encourage offshore operations, particularly in jurisdictions lacking the basic oversight that currently exists in the United States. We advise the Commission to take this consideration into account when revising the Proposed Rules. Congress intended the Dodd-Frank Act to strengthen, not weaken, the United States' competitive business position in the world.

## B. IMPROVING REGULATION AND REGULATORY REVIEW – EXECUTIVE ORDER.

On January 18, 2011, President Barack Obama issued an Executive Order requiring federal agencies to review regulations and remove those that stifle job creation and make the U.S. economy less competitive. Specifically, this Executive Order states the following as a general principle to improve regulation and regulatory review:

> "*Our regulatory system must protect public health, welfare, safety, and our environment <u>while promoting economic growth, innovation, competitiveness, and job creation</u>. It must be based on the best available science. It must allow for public participation and an open exchange of ideas. <u>It must promote predictability and reduce uncertainty</u>. <u>It must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends</u>. It must take into account benefits and costs, both quantitative and qualitative. It must ensure that regulations are accessible, consistent, written in plain language, and easy to understand. It must measure, and seek to improve, the actual results of regulatory requirements.*"

In an op-ed piece in the Wall Street Journal the same day, President Obama acknowledges that federal regulations have "gotten out of balance, placing unreasonable burdens on business – burdens that have stifled innovation and have had a chilling effect on growth and jobs." We believe that the "balance" our President refers to is critically important. Given the focus of our practice, we understand well the "cost" this burdensome regulation will impose on the venture capital community and the vibrant job market they support but we struggle to understand the "benefit." In the history of our firm and in the memory of even our most senior partners, we are simply unaware of a single instance of a venture capital fund engaging in the kind of abusive practices or creating the systemic risk that Congress was concerned about when adopting the Dodd-Frank Act. Given the heavy "cost" of the regulation and the limited benefit, we believe that the timing of President Obama's Executive Order provides the Commission with a wonderful opportunity to review the Proposed Rules in a new light.

# II. <u>SEC RELEASE IA-3111</u>: EXEMPTIONS FOR ADVISERS TO VENTURE CAPITAL FUNDS AND PRIVATE FUND ADVISERS WITH LESS THAN $150 MILLION IN ASSETS UNDER MANAGEMENT

## A. DEFINITION OF A VENTURE CAPITAL FUND.

### 1. Qualifying Portfolio Companies.

Proposed rule 203(l)-1(c)(4) generally defines a "qualifying portfolio company" as any company that (i) is not publicly traded; (ii) does not incur leverage in connection with the investments by the private fund; (iii) uses the capital provided by the fund for operating or business expansion purposes rather than to buy out other investors; and (iv) is not itself a fund (i.e., is an operating company).

a. *Private Companies.*

Under this definition, at the time the venture capital fund makes an investment, the subject portfolio company cannot be publicly traded or cannot control, or be controlled by, or be under common control with, a publicly traded company. We see a real problem with applying such an absolute restriction. While many venture capital funds do make all of their investments in privately held companies, virtually all funds retain limited flexibility to make certain types of investments in publicly traded companies. For example, a venture capital fund should at a minimum be permitted to maintain its pro rata ownership of a portfolio company after it has gone public. This is a common investment strategy of certain late-stage venture capital funds, and the subject portfolio companies benefit from having their venture capital funds support them in this manner during the tumultuous period of an initial public offering. Furthermore, certain types of private investments in public companies (i.e., PIPES) should also be permitted within reason. Consequently, we would propose that this constraint be relaxed and a reasonable limit of 20 percent of a venture fund's committed capital be allowed to be invested in publicly traded securities.

Tying the definition of a qualifying portfolio company to a "start-up company" or to a "small company" would ignore the complexities of the venture industry in the United States. Portfolio companies come in all shapes and sizes, and while predominately privately held, venture capital funds must maintain reasonable flexibility to pursue their stated investment strategies, which may include limited follow-on investments in companies that subsequently go public.

Furthermore, we believe that the broad prohibition that a qualifying portfolio company may not be controlled by a publicly traded company must be modified. There are many publicly held companies in the technology and medical fields that have investment arms.[2] Given the broad definition of "control" for purposes of this proposed rule, investments by these corporate venture arms in start-up companies could effectively prohibit a venture capital fund from simultaneously or subsequently financing such companies. Not only would the portfolio company that takes such strategic financing be disadvantaged, but the strategic investors themselves would be effectively shut out of venture capital investments. We propose that the Commission refine this restriction such that control by a public company only apply if a majority of the equity interests of the portfolio company in question are owned by a particular publicly traded company.

*b. Equity Securities, Cash and Cash Equivalents and Short-Term U.S. Treasuries.*

The Proposed Rules define a venture capital fund for purposes of the exemption as a fund that invests in equity securities of qualifying portfolio companies, cash and cash equivalents and U.S. Treasuries with a remaining maturity of 60 days or less.

We believe that the Proposed Rules should maintain a broad definition of equity securities (e.g., convertible debt, warrants etc.), and should allow significant leeway for short-term (e.g., 1 year) bridge financings, regardless of whether the instruments used in such bridge financings are convertible into equity. Furthermore, the Proposed Rules should allow for extraordinary, unplanned situations where a fund receives assets (e.g., from a portfolio company going through liquidation, etc.). Finally, we believe that venture capital funds should be able maintain capital in a wide variety of liquid instruments so as to properly account for liabilities or other obligations that may extend beyond 60 days.

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[2] Examples include Intel Capital, Google Ventures and GenenFund (the corporate venture capital arm of Genentech, Inc.).

*c. Portfolio Company Leverage.*

Proposed rule 203(l)-1 would define a qualifying portfolio company for purposes of the exemption as one that does not borrow, issue debt obligations or otherwise incur leverage in connection with the venture capital fund's investments.

We believe that any prohibition on portfolio company leverage should be limited to such leverage incurred for the purpose of buying out shareholders at the demand of the venture capital fund or its adviser. Portfolio companies often use a combination of debt and equity to legitimately finance future operations, and such borrowings can occur simultaneously with a venture capital financing. Lease lines, credit facilities and similar arrangements used for operating and business purposes should be permitted (including acquisition of companies and business segments), as should the commonplace repurchase of unvested shares of former employees and service providers.

*d. Capital Used for Operating and Business Purposes.*

Under proposed rule 203(l)-1, a venture capital fund is defined as a fund that holds equity securities of qualifying portfolio companies, and at least 80 percent of each company's equity securities owned by the venture capital fund were acquired directly from each such qualifying portfolio company.

As currently drafted, the 80-20 test is applied on a portfolio company-by-portfolio company basis. Thus, if a minimal amount of capital (say, $1) were used to acquire the securities in the secondary market, and this was the only investment made by the fund in such portfolio company, then the fund would lose its status as a venture capital fund. We believe that the proper approach would be to instead apply this limitation to the fund's entire portfolio. Thus, a venture capital fund could use up to 20 percent of its committed capital to acquire securities other than directly from the issuer.

To the extent that the Commission elects to keep this concept in the final rules, we believe that additional guidance must be provided as to how a venture capital fund must make such calculations. For example, is the 80-20 test measured on a dollar-invested basis? Or must it be done based on the number of securities acquired by the venture capital fund? (and then, by class or series, or on an as-converted basis?). Finally, we believe that any securities acquired by a venture capital fund from an underwriter of the issuer should be counted as received from the issuer so long as a portion of the proceeds (less commission, etc.) actually go to the issuer.

We believe that an operating company should be permitted to engage in a variety of activities for which capital is required. Such operating and business purposes my include research and development or expansion via merger and acquisition. In addition, as part of a company's regular operating business, operating companies customarily repurchase unvested stock from former employees and service providers. Such actions should not be construed as a "buy out" of existing security holders, as such repurchases are tied to a cessation of services. Thus, so long as the venture capital fund does not direct the issuer to use the proceeds from its financing to buy out other institutional shareholders, then the issuer should be free to operate as it pleases without risk of causing the adviser to the venture capital fund to lose its exemption.

*e. Operating Companies.*

Proposed rule 203(l) defines the term qualifying portfolio company for the purposes of the exemption to include any private fund or other pooled investment vehicle.

We note that it is not unusual for venture capital fund investments to be structured by using one or more holding partnerships, blocker corporations or other such arrangements in order to alleviate tax, legal or other regulatory concerns. We do not believe that the use of such intermediary vehicles should be problematic provided that the underlying investment is made into a bona fide operating company.

**2. Management Involvement.**

To qualify as a venture capital fund under the proposed definition, the fund or its adviser must: (i) have an arrangement under which it offers to provide significant guidance and counsel concerning the management, operations or business objectives and policies of the portfolio company (and, if accepted, actually provides the guidance and counsel) or (ii) control the portfolio company.

While we agree that venture capital funds provide meaningful capital to privately held companies, mandating that, in all cases, "significant guidance and counsel" be offered and provided creates an odd obligation that may not necessarily work in all cases. Venture capital funds and their advisers should be free to offer such guidance and counsel as they see fit and in accordance with their fiduciary duties, on a case-by-case basis. Requiring the provisions of such services to all companies in a venture capital fund's portfolio, no matter their size or size of the venture capital fund's investment, would essentially legislate how a professional fund manager must allocate his or her time and resources. We do not believe that this is appropriate. At the end of the day, an adviser provides advisory services to its managed funds, and should not be forced to serve as a third-party consultant solely for the sake of meeting a statutory requirement. In all cases, a venture capital fund should have the right (not the obligation) to greater management involvement. An adviser should be free to choose the level of participation necessary, such that lagging investments may require more time while those on track may require less.

Modeling this requirement on the existing BDC provisions is misplaced. Venture capital funds have been in existence well before Congress first introduced BDC's into the Advisers Act. Furthermore, venture capital funds do not as a matter of ordinary course set out to invest in "troubled businesses," as is a described principal activity of a BDC. Thus, it seems inappropriate to force a venture capital fund to operate as a BDC.

Instead, we propose that the Commission use existing legislation to address this issue. Since 1987, numerous venture capital funds have qualified as a "venture capital operating company" pursuant to the Department of Labor's rulemaking (29 CFR 2510.3-101 – Definition of "plan asset" – plan investments). We believe that if a venture capital fund obtains management rights from a majority of its investments, in all cases as measured and determined in accordance with the existing VCOC rules, then it would satisfy the general requirement that it have an arrangement under which it offers to provide significant guidance and counsel concerning the management, operations or business objectives and policies of its portfolio. By following the VCOC approach, the Commission would also eliminate the concern raised regarding multiple investors participating in a syndicate. All venture capital fund investors should be able to obtain such necessary management rights, and their respective advisers should individually be able to decide when to exercise such rights.

With respect to the second part of the requirement, the term "control" is not clearly defined, and additional guidance should be provided. For purposes of the Proposed Rule, we believe that the term "control" should be defined in such a way so as to be easily understood and applied. For example, having a representative serve as a director of the company, holding 10% or more of the voting securities of a particular class of securities of the issuer or otherwise being an affiliate of the issuer (as such term is used Rule 144) should be factors that a venture capital fund could affirmatively rely upon to satisfy this element.

### 3. Limitation on Leverage.

Under the proposed rule 203(l)-1, the definition of a venture capital fund for purposes of the exemption is limited to a private fund that does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15 percent the fund's capital commitments.

We agree that that a percentage limitation is appropriate, though we believe that (i) the percentage threshold should be raised to 20 percent (to reflect the upper range of guarantees, etc. typically used by venture capital funds) and (ii) the calculation should be made based on outstanding indebtedness amounts at any one time. Furthermore, venture capital funds often engage in short-term borrowing in anticipation of receiving capital from their investors. Accordingly, we do not believe that this sort of narrow, short-term borrowing should raise any systemic risk concerns, and any such short-term borrowing should be excluded from the calculation of such percentage limitation..

Finally, in the ordinary course, venture capital funds often guarantee indebtedness of their portfolio companies. Such indebtedness may very well be for longer than 120 days, and we believe that imposing a 120-day limitation is neither in the best interests of the industry or the operating companies that benefit from such guarantees.

### 4. No Redemption Rights.

We agree with the Commission's proposal that investors in a venture capital fund should not have redemption rights except in extraordinary circumstances. Virtually all institutional investors are subject to some sort of potential event that could give rise to withdrawal or exclusion rights. The phrase "extraordinary circumstances" is sufficiently clear to distinguish the type of withdrawal circumstances that could arise with a venture capital fund versus those of a typical hedge fund. In our opinion, imposing a minimum period would not make sense, as the timing of such withdrawals are, by definition, unexpected. Also, the right to transfer an interest should not be construed as a withdrawal right. Tax laws, for example, would prevent the general partner of a venture capital fund from permitting extensive trading that could cause the partnership to no longer be treated as a partnership for tax purposes. Furthermore, we believe that imposing a percentage maximum would not be helpful. For example, if a significant portion of a venture capital fund's investors were comprised of investors subject to ERISA, a change or violation of ERISA may necessitate the withdrawal of all such ERISA investors, and not just a pre-determined statutory threshold.

### 5. Represents Itself as a Venture Capital Fund.

Proposed rule 203(l)-1 would limit the definition of a venture capital fund for the purposes of the exemption to a private fund that represents itself as being a venture capital fund to its investors and potential investors.

In theory, we are fine with this requirement, though we request that the Commission provide confirmation of more examples of what constitutes representing oneself as a venture capital fund. Many venture capital funds do not use private placement memorandums or other offering materials during fundraising, so it would be useful if the Commission could articulate a more expansive (though understandably not comprehensive) list of affirmative examples whether the element of proposed rule 203(l)-1 would be met. For example, we assume that indicating in part 4 of a Form D filed with the Commission that the issuer is a "venture capital fund" would satisfy this requirement. Likewise, we expect that a statement on an adviser's website to effect that all of the funds managed by the adviser are venture capital funds would be satisfactory.

### 6. Is a Private Fund.

The Commission proposes to define a venture capital fund for the purposes of the exemption as a private fund, which is defined in section 202(a)(29) of the Advisers Act, which excludes funds that are registered investment companies or that have elected to be regulated as BDCs. We agree with this approach.

### 7. Other factors.

The Commission has requested comment on whether any other factors should be considered in the definition of a venture capital fund. The release accompanying the Proposed Rules cites examples of various criteria that could be included, to include focusing on capital contributions made to the fund by the adviser, length of investment period, contributions to the economy by creating jobs, fostering competition and facilitating innovation.

Certain of these other factors may be elements that are present in some, though not all, venture capital funds. As discussed above, adopting such additional requirements can only constrict those venture capital funds that may already comply, while needlessly excluding bona fide venture capital funds that may have slightly different terms (such as varying contribution amounts or differing stated terms). It is unclear, for example, why a venture capital fund would have to have a minimum term of 10 years. Imposing such a term on an investment vehicle that might otherwise have a term of 7 or 8 years could inadvertently cause harm to its investors, as additional fees and expenses would be needlessly incurred for the additional statutory period.

### 8. Application to Non-U.S. Advisers.

The Commission requests comment as to whether the Proposed Rules should specify that an adviser with its principal office and place of business outside the United States (a non-U.S. adviser) is eligible to rely on the exemption even if it advises funds that do not meet the proposed definition of a venture capital fund.

We believe that private funds organized under the laws of jurisdictions outside of the United States and managed by non-U.S. investors should be permitted to rely on the exemption even if they advise non-US funds that do not meet the proposed definition of a venture capital fund. This is consistent with the Commission's historical approach of focusing only on clients of an adviser that are residents of the United States.

### 9. Grandfathering Provision.

The proposed rule includes in the definition of a venture capital fund any private fund that (i) represented to investors and potential investors at the time the fund offered its securities that it is a venture capital fund; (ii) has sold securities to one or more investors prior to December 31, 2010; and (iii) does not sell any securities to, including accepting any additional capital commitments from, any person after July 21, 2011.

Similar to paragraph 5 above, we request that the Commission provide more examples of what constitutes a fund as having representing itself as a venture capital fund. However, for purposes of this grandfathering provision, we believe that greater leeway should be afforded to those advisers who have historically held themselves out as being primarily in the venture capital business. We do not believe that any prior disclosed strategies by a particular private fund should be *per se* disqualifying, so long as venture capital would have been considered a primary component of any such multi-strategy approach. Given the current difficulty of establishing a workable definition of a "venture capital fund," we find it patently unfair were the Commission to apply anything close to 20:20 hindsight when scrutinizing the representations of such grandfathered venture capital funds that engaged in fund raising activities prior to the enactment of the final rules. We certainly do not condone buy-out funds or hedge funds trying to squeeze into a grandfathered position, but do believe that the Commission should provide assurances that the benefit of the doubt will be given to advisers that, in good faith, believed that such funds would be characterized as venture capital funds based on the then-prevailing understanding of venture capital within the greater industry.

As a technical matter, we note that a venture capital fund may be grandfathered only to the extent that such fund has sold securities to one or more investors that are not related persons, as defined in § 275.204-2(d)(7), of any investment adviser of the private fund. First, we believe that the appropriate cross reference should be to § 275.206(4)-2(d)(7). Second, many private funds are established to allow internal managers to make additional investments, and such private funds therefore sell securities solely to related persons. We request that the Commission clarify that any private fund that consists solely of related persons, or otherwise does not charge a fee or carried interest (i.e., no compensation element for purposes of section 202(a)(11)), need not be considered a private fund of the adviser for purposes of compliance with, or reporting under, the Advisers Act.

## B. Exemption for Investment Advisers Solely to Private Funds with Less Than $150 Million in Assets Under Management

### 1. Advisers Solely to Private Funds.

Proposed rule 203(m)-1 limits an adviser relying on the exemption to advising "private funds," as that term is defined in the Advisers Act. In the case of an adviser with a principal office and place of business outside of the United States, the Commission proposed to provide the exemption as long as all of the adviser's clients that are United States persons are qualifying private funds.

We agree that any adviser relying on the exemption provided under section 203(m) of the Advisers Act should advise only private funds. Furthermore, we agree that a non-U.S. adviser should not lose the private fund advisers exemption as a result of its business activities outside of the United States.

### 2. Private Fund Assets.

Under proposed rule 203(m)-1, an adviser would have to aggregate the value of all assets of private funds that it manages in the United States to determine if the adviser remains below the $150 million threshold.

We agree with this aggregation concept, but believe that using the fair market value of a fund's assets is a misplaced metric. Valuing privately held assets is incredibly difficult and may be subject to wide swings based solely on public perception. For example, valuations of certain "hot" privately held companies in the social media sectors (such as Facebook, Twitter, Groupon, LinkedIn and the like) have reportedly gone through astronomical increases in recent months. However, investors consider any such holdings by a private fund in such companies to be illiquid until actually realized by the private fund. Such illiquid "paper profits" should not serve to cause an adviser to a private fund to register, as we all know that there is no guarantee that such paper profits will ever be realized. Furthermore, if wild swings in private company valuations could cause an adviser to have to register, there could be a misalignment of incentives, as the exempt adviser would be inclined to immediately dispose of such assets in order to keep under the $150 million threshold.

We believe that the Commission should instead base the $150 million threshold on the aggregate capital raised by the private fund. Specifically, if the amount of capital commitments that is being actively managed by an adviser exceeds $150 million, the registration should be required. For purposes of this calculation, a private fund would include all uncalled capital as well as the cost basis of the capital that is currently invested and under management. Capital commitments that have been called to pay expenses, as well as capital previously invested in companies the proceeds of which have been liquidated and distributed (or written off for federal tax purposes), would be excluded.

### 3. Assets Managed in the United States.

Under proposed rule 203(m)-1, all of the private fund assets of an adviser with a principal office and place of business in the United States would be considered to be "assets under management in the United States," even if the adviser has offices outside of the United States. A non-U.S. adviser, however, need only count private fund assets it manages from a place of business in the United States toward the $150 million asset limitation exemption.

We agree with this approach, and believe that even if certain day-to-day management activities take place in the United States, the touchstone should be whether the management is ultimately controlled from outside the United States. We recognize that determination of a single principal place of business may be difficult for certain organizations. Thus, after taking all factors into account, we agree that if an adviser in good faith determines that its principal place of business where the predominant investment management of its private funds takes place is outside the United States, such private funds (even if organized as U.S. persons) should not be counted towards this $150 million threshold.

### 4. United States Person.

Under proposed rule 203(m)-1(b), a non-U.S. adviser could not rely on the exemption if it advised any client that is a United States person other than a private fund. The Commission proposes to define a "United States person" generally by incorporating the definition of a "U.S. person" in existing Regulation S. We agree with this approach.

### 5. Transition Rule.

Proposed rule 203(m)-1 contains a provision giving an adviser one calendar quarter (three months) to register with the Commission after becoming ineligible to rely on the exemption due to an increase in the value of its private fund assets.

To the extent that the Proposed Rules are revised per our comments in paragraph 3 above such that the $150 million threshold is calculated based solely on uncalled capital and the cost basis of invested capital, then we believe that the three-month period is reasonable. However, if events beyond the adviser's control, such as increases in the valuation of privately held companies, could cause the adviser to register, then we believe that an extended period of time should be allowed, such as six months or more. Registration is not something that should be taken lightly, and forcing an accelerated registration under such circumstances is unwarranted.

## III. SEC RELEASE IA-3110: RULES IMPLEMENTING AMENDMENTS TO THE INVESTMENT ADVISERS ACT OF 1940

*"We're also getting rid of absurd and unnecessary paperwork requirements that waste time and money."* President Barack Obama, January 18, 2011

The Dodd-Frank Act repealed the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act. In doing so, Congress tasked the Commission to require exempt advisers to maintain such records and provide the Commission such annual or other reports as the Commission determines *necessary or appropriate in the public interest or for the protection of investors.*

Proposed rule 204-4 requires exempt reporting advisers to file reports with the Commission on Form ADV, the same form that registered advisers are currently required to use. Exempt advisers would be required to pay a filing fee, and all such reports would be immediately available to the public. The type and amount of information that would have to be publicly disclosed consists of matters that venture capital firms have never been required to disclose to the public, to include the ownership of the adviser and the net asset value of each venture capital fund that they advise. The Commission cites the avoidance of expenses and delay of developing a new form as rationale for requiring exempt advisers to report on Form ADV through the IARD.

We disagree that certain savings in time and expenses should be the driving rationale for imposing such a system on all exempt advisers, regardless of size. More importantly, we fail to see how the public disclosure of such information could in any way be deemed *necessary or appropriate in the public interest or for the protection of investors*. The release accompanying the Proposed Rules indicated that this was meant to be census-like data. Individual respondents to the U.S. census are afforded basic confidentiality protections, and the data is made available to the public only in aggregate form. We believe that, absent a compelling reason, all such information filed by an exempt reporting adviser should be provided with similar confidentiality protections.

Simply put, we believe that requiring all exempt advisers (no matter the minimum assets under management) to use a Form ADV and publicly disclose what may be considered confidential information is tantamount to registration. This does not follow the Congressional mandate, and we believe that certain Commissioners have publicly expressed concern over the conflation of the regulatory burden imposed on registered versus exempt advisers. Accordingly, we strongly believe that there should not be any public filing requirement for exempt advisers.

## IV. <u>CONCLUSION</u>.

We request that the Commission carefully consider these comments and others submitted from the venture capital industry when revising the definition of a *venture capital fund* and when implementing those provisions that are truly *necessary or appropriate in the public interest or for the protection of investors*. The thrust of our comments can be characterized as respecting the balance our President is seeking to strike. The venture capital industry has no history of public abuse or systemic risk. No venture capital fund has ever received a government bailout. Venture capital funds are responsible for the lions' share of new job growth in this country (e.g., Intel, Cisco, Apple, Sun, EMC, Google, Facebook, Groupon, Twitter etc.). Failure to strike the right balance could be catastrophic. We therefore believe that the benefit of all doubt should be given to the manager operating as a venture capital fund. To the extent possible the Commission should avoid "single points of failure." What we mean by this is that wherever possible, the Commission should avoid definitions that prohibit specific acts or events that would categorically disqualify a fund, but instead should use definitions that consider aggregate fund and portfolio company behavior. If by reasonably objective measures the fund holds itself out as and behaves as a venture capital fund (as measured by the preponderance of the funds activities), then the fund should be exempt. Venture capitalists are obligated to generate returns for their investors. The fact that a venture capitalist might use 0.5 percent of their committed capital to purchases $1 million of Facebook stock in the secondary market simply cannot mean that that firm loses its exempt status. That kind of regulation would do serious damage to this otherwise vibrant industry and would be inconsistent with the goals recently expressed by our President.

*This is the lesson of our history: Our economy is not a zero-sum game. Regulations do have costs; often, as a country, we have to make tough decisions about whether those costs are necessary. But what is clear is that we can strike the right balance. We can make our economy stronger and more competitive, while meeting our fundamental responsibilities to one another.* President Barack Obama, January 18, 2011

We thank the SEC very much for the opportunity to comment on this important matter and greatly appreciate all of the time and effort that the Commission and Staff have spent on this formidable task. We look forward to reviewing the Commission's efforts in revising the Proposed Rules and expect that the "right balance" will be struck. If the Commission has any questions concerning these comments, or if we may be of further assistance in connection with this matter, please do not hesitate to contact us.

Very truly yours,

Gunderson Dettmer Stough Villeneuve Franklin & Hachigian, LLP
By: Robert V. Gunderson, Jr. Founding Partner