

**Item 1. Cover Page**



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**Part 2A of Form ADV: Firm Brochure**

**December 2011**

**Item 2. Material Changes**

Item 2 is not applicable.

### Item 3. Table of Contents

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#### **Item 4. Advisory Business**

Shott Capital Management, LLC was founded in 1991. We are a registered investment adviser that provides investment management solutions for our clients: Distribution Management and Private Equity Fund Investments. Our Distribution Management team focuses on realizing private equity returns from venture and buyout fund distributions by providing specialized distribution management services through separately managed accounts. Our Private Equity Fund Investment team manages discretionary separate accounts which can be customized on a client-by-client basis and also offers advice on investing in venture capital and buyout limited partnerships. We are an affiliate of State Street Corporation and a member of State Street Global Alliance, LLC, the strategic venture partnership between State Street Global Advisors and the Dutch pension fund ABP. We are separately capitalized and independently managed with offices in San Francisco and Boston. Our principal owners are Capital Alliance Partners, LLC and State Street Global Alliance, LLC.

##### ***Distribution Management Accounts***

We offer two primary distribution management products, enhanced liquidation management and active management. Our goal for enhanced liquidation management is to quickly realize cash from stock sales in an amount equal to or exceeding the price on the date when the general partnership released the shares. For actively managed accounts, we seek to:

- i. improve overall returns by holding a core portfolio of securities with the potential for superior long-term growth, and
- ii. reduce risk by continuously returning cash from the sale of distributed securities.

We believe there are three critical components to successful distribution management. We use a portfolio management strategy based on:

- i. in-depth fundamental research,
- ii. a trading strategy focused on finding liquidity at the right price, and an operations strategy designed to expedite cash distributions.

##### ***Private Equity Accounts***

We offer clients customized fund investment solutions based on individualized needs for each client. Shott Capital Management has the flexibility to structure broadly diversified portfolios or ones with specific investment targets, such as venture capital only. Once an investment plan is formalized with a client, the SCM Private Equity Team uses its extensive network to identify, perform due diligence on, and manage funds that meet client criteria. Manager selection is based on underlying manager track record and strategy, organizational quality and continuity, incentive alignment, and portfolio fit.

## ***Client Qualification Requirements***

We usually require a \$10,000,000 minimum account value for new Distribution Management accounts opened for individuals, but we may waive this and other requirements based on special circumstances. These circumstances may include high asset growth potential, an existing or prospective account, or a prior relationship with us, our Managing Directors or employees.

Clients opening a discretionary account must meet the following standard:

- i. if you are a natural person, we require that you place \$500,000 under our management or have a net worth in excess of \$1,000,000 or;
- ii. if you are an entity, we require that you place \$500,000 under our management or have a net worth of \$1,000,000. If the entity is a partnership or limited liability corporation, each partner, member or equity owner must have a net worth in excess of \$1,000,000.

## ***Assets Under Management***

We managed \$1,516,139,804 on a discretionary basis as of December 31, 2010.

## **Item 5. Fees and Compensation**

### ***Public Company Investment Accounts***

For our clients who hold public company securities, we offer an asset-based fee, a liquidation fee and a performance-based fee.

#### ***Asset-Based Fee***

The asset-based fee is generally equal to 1% per annum of the net asset value of the account. The asset-based fee is accrued monthly and is calculated based upon the month-end value of the account. The fee is payable in arrears at the end of each calendar quarter.

#### ***Liquidation Fee***

The liquidation fee is generally based on the net asset value of securities sold during each calendar quarter based on the sliding scale in the following schedule:

#### **Market Value of Assets Sold - Basis Point Fee**

First \$50 million - 75 b.p.

Amount thereafter - 60 b.p.

The fee is calculated quarterly in arrears and the sliding scale is reset annually.

## **Item 6. Performance-Based Fees and Side-By-Side Management**

The fees paid to us under the performance fee structure consist of a Base Fee and an Incentive Fee. The Base Fee is an asset-based fee generally equal to 0.30% per annum, and is accrued and paid quarterly in arrears.

The Incentive Fee is calculated at the close of each specified 12-month period in an amount that ranges from 10% to 12% of the difference between:

- i. net realized gains and unrealized losses and other income on the account, and
- ii. net realized and unrealized losses.

The Incentive Fee is credited to a notional account. We are entitled to be paid an annual Incentive Fee equal to 70% of any positive balance in the notional account. The remaining 30% of any positive balance in the notional account is carried forward to the following year. If the calculation results in a negative amount in a given year, that amount is applied to reduce the balance in the notional account. We are not required to repay any negative balance in the notional account. Only “qualified clients,” as defined by federal securities laws, may be charged a performance fee.

### ***Private Equity Investment Accounts***

The management fee for the services we render to our Private Equity clients investments is generally based on the size and specificity of the mandate, with ranges as follows:

- i. in the case of new capital commitments, 0.50% to 1.00% of the aggregate capital committed to the client’s private equity investments that we manage; or
- ii. in the case of existing private equity investments under management, 0.15% - 0.40% of the net asset value of those investments.

The private equity management fee accrues monthly at the negotiated rate and is calculated based upon the month-end value of the account. The fee is payable and will be billed to the client in arrears at the end of each calendar quarter.

### ***Termination***

Unless we agree on different terms, your investment advisory contract may be terminated by either party at any time by written notice. Termination will be effective when received.

**Item 7. Types of Clients**

Our clients include major public and private pension plans, corporations, foundations, endowments, insurance companies, financial institutions, and family offices.

**Item 8. Methods of Analysis, Investment Strategies & Risk of Loss**

Our Distribution Management investment process employs a fundamental research philosophy to evaluate both private companies that have a high probability of being distributed, and public companies whose shares are being distributed. We use Reuters, The *Wall Street Journal*, various other financial industry publications and the Internet as our primary sources.

**Item 9. Disciplinary Information**

No material items exist as of this time.

**Item 10. Other Financial Industry Activities and Affiliations**

We are affiliated with several investment advisers that are registered with the Securities and Exchange Commission or are exempt from registration.

We are affiliated with State Street Bank and Trust Company (SSB&T is a state chartered member bank that provides custody, accounting, securities lending and administrative services to registered investment companies that are advised or sub-advised by companies that may or may not be affiliated with us. SSB&T is a wholly owned subsidiary of State Street Corporation (SSC) and is also a commodity pool operator and a commodity trading adviser. SSB&T also provides investment advisory services to its clients through its global investment arm, State Street Global Advisors (SSgA). We are also an affiliate of State Street Global Markets, LLC (SSGM, SSC's broker-dealer affiliate. We may utilize the services of employees who are also employees of SSgA.

**Item 11. Code of Ethics, Participation or Interest in Client Transactions & Personal Trading**

Our Managing Directors, employees, officers, and directors may purchase securities, which we do not recommend to our clients, for their own accounts. Our employees may personally invest in the same securities that are purchased for our clients, and their personal accounts may contain securities of issuers whose securities are subsequently purchased for our clients. Our employees may also sell a specific security in their own accounts for personal investment reasons that disregard issuer or industry fundamentals that form the basis for our recommendations. If security is

purchased or sold for a client and for any employee on the same day, subject to our pre-clearance procedures, either the client or the employee may pay or receive a favorable price. No Managing Director, employee, officer, or director may purchase or sell any security that we are trading for any client in his or her personal account(s) for 48 hours after the trade date that is not pre-cleared.

To help prevent conflicts of interest, our Managing Directors, employees, officers, and directors must comply with our Code of Ethics and Personal Securities Trading Policy, which imposes restrictions on the purchase or sale of securities for their own accounts and the accounts of certain affiliated persons, as defined by the federal securities laws. The Code of Ethics and Personal Securities Trading Policy requires the pre-clearance and regular reporting of all personal securities transactions, except certain exempt transactions. These are generally investments in U.S. registered open-end mutual funds, money market funds, bank instruments, unit investment trusts and U.S. government securities. We have also adopted certain policies and procedures in our Insider Trading Policy that prohibit the misuse of material nonpublic information. These policies and procedures are designed to prevent insider trading by any employee. You may request a copy of our Code of Ethics and Personal Securities Trading Policy from our Chief Compliance Officer.

## **Item 12. Brokerage Practices**

### ***Brokerage Arrangements***

We have a duty to seek best execution for our client's securities transactions. This duty requires us to attempt to execute transactions so that the total cost or proceeds in each transaction is the most favorable under the circumstances. When we seek best execution, we carefully consider the facts and circumstances involved, including the best combination of net price and prompt, quality execution. Best price is not the sole criteria. Other factors that we consider include: market liquidity, order size, the trading characteristics of the security involved, the broker-dealer's familiarity with the security, the difficulty of executing the trade, the ability of the broker-dealer to provide efficient execution at a favorable price, the fact that there may be a limited number of broker-dealers who can execute certain trades, and our past experience with the broker-dealer for prompt, competent, and reliable service in all aspects of order processing, execution, and settlement.

When we negotiate commission levels and assess net best execution, we must determine in good faith that the total cost (price plus commissions) is reasonable in relation to the value of the execution. In some cases, we may execute trades at a higher commission with brokers who provide research. This research is used solely for the benefit of our clients, as we do not conduct proprietary trading. Transactions in post-venture distributions of restricted stock may result in delayed settlement, ranging from four to six weeks. As a result, many of these trades are conducted on a delivery vs. payment basis, or may require the executing broker to extend the delivery date. While the delay does not affect the execution price, clients will not receive the proceeds from



the sale until settlement is achieved.

When we place orders for the purchase and sale of securities, we shall use our best judgment to select a broker-dealer for each specific transaction which we believe is most capable of providing the brokerage services necessary to obtain the best available price and most favorable execution.”

### ***Trade Allocation***

We have a fiduciary relationship with each of our clients that requires us to treat each client fairly and equitably. No client or group of clients may receive preferential treatment. Although we must treat our clients fairly, this does not necessarily mean that all of our clients will be treated identically. Allocation decisions are made based on a consideration of factors including portfolio composition and investment objectives. Allocation decisions are not based on a consideration of fee arrangements, differences in account performance, relationships to any of our Managing Directors, employees, officers, or directors, or the length of time that a client has been with a particular portfolio manager or with us. Our allocation decisions are made with a view to fair and equitable treatment of our clients over the course of our relationship.

Occasions may arise when we determine that the purchase or sale of a particular security is simultaneously a proper investment decision for more than one of our clients. When this occurs, share prices are averaged and shares are allocated equitably according to our best judgment. On occasions when we decide the purchase or sale of a security is in the best interests of a number of clients, we may aggregate the purchase or sale among multiple accounts with the goal of obtaining more efficient executions and lower brokerage commissions in a fair and equitable manner.

For example, in a liquidation agreement, certain clients may instruct us to sell securities within three days. All three-day liquidation clients receive the same pro-rated trade allocations. Where appropriate, we may combine three-day orders with those of other clients. When this occurs, each account will receive the average execution price.

### ***Private Equity Fund Allocations***

With respect to our private equity investment accounts, we make investments in private equity funds on a discretionary basis. Allocations of these investments involve careful balancing of various factors, including:

- i. the clients’ investment guidelines and diversification needs,
- ii. the clients’ instructions,
- iii. the clients’ available unallocated capital and existing investments,
- iv. our potential total allocation from a particular fund, and
- v. the clients’ prior relationship or investment with a fund manager.

## ***Directed Brokerage***

Generally, transaction costs, whether in the form of a commission, spread or other compensation, are a client asset. It is our responsibility to efficiently manage that asset and achieve the best overall net results when trading for our clients, subject to any restrictions that are placed on our ability to select brokers. We believe that our clients are more likely to receive the best results possible on transactions executed for their accounts when we are not limited in selecting executing brokers. Under very limited circumstances, we will accept written instructions from our clients to direct brokerage to a particular broker.

Due to the unique nature of managing the distribution process, we discourage the use of directed brokerage arrangements. Clients often enter into these arrangements to take advantage of certain benefits. We understand that clients may receive cash rebates, expense payments or expense reimbursements, custody, check writing, products, consulting and other services in return for the commissions generated when we place orders for their accounts with their chosen broker. We are responsible for seeking best execution for our clients. However, our ability to achieve best execution may be partially or completely limited by the nature of the directed brokerage arrangement a client has instructed us to follow. The following describes our procedure for handling directed brokerage transactions, and provides important information about directed brokerage arrangements generally:

- i. Depending on the directed broker a client has instructed us to use, the amount of brokerage a client has instructed us to direct to its directed broker, the commission rate and/or fees a client has agreed to pay its directed broker, and the securities we are purchasing and/or selling for the client's account, we may or may not achieve executions of the nature, quality, speed or price that we might otherwise achieve when we use a client's directed broker to execute transactions for its account.
- ii. We will not negotiate or re-negotiate commission rates with clients' directed brokers. We are unable to impact or improve the price or quality of the execution services provided by the directed broker.

As a result of the considerations detailed above, directed brokerage accounts may generate lower returns than non-directed accounts.

When we agree to satisfy a client's instructions to execute transactions for its account through a directed broker, the client is responsible for ensuring that:

- i. all services provided by the directed broker are for the benefit of the client's account and any beneficiaries of the account, all expenses paid are proper and permissible expenses of the account, and will be properly provided in consideration for brokerage commissions or other remuneration paid to the directed broker,
- ii. using the directed broker in the manner directed is in the best interests of the client's account and any beneficiaries of the account, taking into

- consideration the services provided by the directed broker,
- iii. its directions will not conflict with any obligations that persons acting for the client's account may have to the account, its beneficiaries or any third parties, including any fiduciary obligations that persons acting for the account may have to obtain the most favorable price and execution for the account and its beneficiaries, and
  - iv. persons acting for the client's account have the required power and authority to provide the directions on behalf of the account and have obtained all consents, approvals or authorizations from any beneficiaries of the account and third parties that may be required under any laws or instruments governing the account.

### ***Trade Errors***

All trading errors will be corrected within a reasonable time after discovery. When an error is discovered, we will correct the error in the client's favor. In the event that a broker-dealer commits an error, we will attempt to cancel or modify the order before settlement. If we are successful, the client will not bear any loss or expense as a result of the error. If the error settles in the account or the price quoted for a security has changed since the order was placed, we will correct the error under established industry practices. We do not allow broker-dealers to promise to make up any discrepancy or agree to other arrangements regarding trade errors. A broker-dealer is also not allowed to assume responsibility for any trading error caused on our part.

### ***Soft Dollars***

We do not use soft dollars to purchase or receive goods or services that are available for hard dollars.

### **Item 13. Review of Accounts**

Rod Berry, Managing Director and Stephen Minutoli, Managing Director are the reviewers for all equity security accounts. They review portfolios daily and have discretion to make buy (when appropriate) and sell decisions. Glen Holland, Managing Director, Maia Heymann, Managing Director, and Molly LeStage, Director, are the reviewers for all private equity partnership investments. Factors including percentage investment, cash management, asset allocation, industry weighting and concentrations, security positions and future prospects of each issue are noted. Reviews are also conducted at the request of clients or upon a significant change in company or industry characteristics, general economic fundamentals or market conditions.

We deliver quarterly reports to Private Equity clients and monthly reports for Public Equity clients. Each quarterly report will contain itemized statements showing funds and securities in the client's advisory account at the end of the quarter and all debits, credits and transactions in the client's advisory account during the quarter. We may occasionally recommend agency-cross transactions, but we do not receive any

additional compensation either directly or through an affiliate.

#### **Item 14. Client Referrals and Other Compensation**

State Street Bank & Trust has various internal programs for its employees who introduce clients. These programs may be extended to their employees if they introduce prospective clients to us. Referral awards are typically based on first year fees. Awards are only granted for referrals that meet program and regulatory requirements.

#### **Item 15. Custody**

Our clients choose their own custodians. We do not recommend custodians or engage in establishing custodial relationships.

#### **Item 16. Investment Discretion**

We generally have full discretion to sell securities for distribution management accounts without prior client approval. The specific details of the arrangements are stated in each client's investment advisory contract.

The total amount (in dollars or % terms) of the securities to be bought and sold in a discretionary advisory account will be determined by us on a daily and continuous basis, but only after an initial consultation with the client where the particular circumstances and objectives are determined. Clients will be consulted periodically to review their investment objectives and discuss the account's performance.

#### **Item 17. Voting Client Securities**

Upon request, we vote the shares of securities owned by clients according to our Proxy Voting Policy and Guidelines (Proxy Voting Policy?). A client may obtain a copy of our Proxy Voting Policy or information about how we voted his or her securities by contacting us at 415-394-7271 or submitting a written request to Paul Wozniak.

To assist us in our proxy voting responsibilities, we have retained the services of Institutional Shareholder Services, a third party proxy voting service, to serve as the voting agent for all domestic and global securities owned by and held in our clients' managed accounts. We have carefully reviewed their policies and procedures and determined that we generally agree with their policies on important corporate issues. They have represented to us that they have established policies and procedures adequately designed to detect and prevent conflicts of interest. They will contact us to obtain voting instructions for all non-routine or extraordinary annual or shareholder meetings, including proposals regarding cumulative voting, poison pills, mergers, shareholder corporate governance proposals, information barriers, stock splits, and new classes of stock or increased authorizations with unspecified voting/shareholder rights. If we want to override their stated position on an issue, we will notify them.

Conflicts between our interests and those of our clients may raise concerns regarding the effect the conflict may have on how we vote proxies. We address material conflicts of interest by:

- i. using the pre-determined voting guidelines outlined in our Proxy Voting Policy;
- ii. using the recommendations of an independent third party proxy voting service;
- iii. monitoring for potential conflicts; and/or;
- iv. disclosing material conflicts to clients and obtaining their consent before voting.

Institutional Shareholder Services maintains records of:

- i. all proxy statements and materials that we receive;
- ii. all proxy votes made on behalf of our clients; and
- iii. documentation of any reasons why we did not vote in accordance with their policies.

#### **Item 18. Financial Information**

Item 18 is not applicable to Shott Capital Management.

