Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Comments on Proposed Rules:
Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles Release No. 33-8766; IA-2576; File No. S7-25-06 (the "Proposed Rules")

Dear Ms. Morris:

We are pleased to have the opportunity to comment on the Proposed Rules, with a specific focus upon the Proposed Rules' impact on the venture capital industry.

The National Venture Capital Association represents approximately 450 venture capital and private equity firms. In this capacity, we seek to communicate the public policy interests of the venture capital community, promote and maintain high professional standards, provide reliable industry data, sponsor professional development, and facilitate productive interactions among our members.

Summary of Principal Conclusions

1. The Proposed Rules appropriately exclude venture capital funds from the new requirement that a natural person have at least $2.5 million in investments to qualify as an accredited investor (the "New Accredited Investor Rule"). Venture capital funds rely upon broad networks of individual scientists, engineers, academics, entrepreneurs and others ("Network Individuals") to assist in the identification and development of portfolio companies. Allowing Network Individuals to invest in venture capital funds is an important method by which these individuals are incentivized to apply their talents for the benefit of the funds and their portfolio companies. Because many Network Individuals lack the personal wealth to make and hold $2.5 million in investments, application of the New Accredited Investor Rule to venture capital funds would disrupt this incentive mechanism and thereby impair the functioning of the venture capital industry.

2. The definition of "venture capital fund" contained in the Proposed Rules (i) is extremely complex and (ii) as a result of recent trends in the industry, fails to capture many true "venture capital" funds. If this definition were not corrected, the New Accredited Investor Rule would apply with respect to a substantial and growing number

of bona fide venture capital funds, causing significant harm to the venture capital industry.

(i) As an initial matter, we believe it would be simpler and more appropriate to define venture capital funds by reference to their lack of elective redemption rights, similar to the exclusion set forth in Rule 203(b)(3)-1 under the Investment Advisers Act. We suggest that a general prohibition on elective redemptions for a period of 5 years would effectively distinguish venture capital funds from hedge funds and similar pooled investment vehicles.

(ii) If the Commission elects to proceed with a definition of venture capital fund similar to that contained in the Proposed Rules, several technical corrections would be necessary to address the evolution of the venture capital industry in recent years, particularly in connection with the internationalization of venture capital activities and the development of various feeder/conduit structures. These technical corrections are proposed in our detailed comments below.

3. The Proposed Rules appropriately reaffirm investor protections under the Investment Advisers Act's antifraud rules in the context of all types of pooled investment vehicles, whether they be hedge funds, venture capital funds or other types of funds (the "Antifraud Rules"). However, as currently proposed, the Antifraud Rules also introduce enhanced "10b-5" style obligations, with potential consequences that are difficult to predict and could be highly disruptive to the venture capital industry. Even if the Commission were to conclude that enhanced obligations are necessary to address concerns relating to the hedge fund industry, we are unaware of any basis for exposing venture capital funds to such additional obligations and risks. Accordingly, with respect to venture capital funds, we suggest limiting the Antifraud Rules to reinstating the pre-Goldstein *status quo ante*.

Background on the Venture Capital Industry

Venture capital plays a unique and valuable role in the U.S. economy. Venture capital plays a unique and valuable role in the U.S. economy. From 1970-2005 venture capital funds invested $385 billion dollars into more than 23,703 U.S. companies. Companies that received venture financing between 1970 and 2005 accounted for 10 million jobs and $ 2.1 trillion in revenue in 2005, corresponding to 9.0% of US private sector employment and 16.6% of GDP respectively. These companies registered 4.1% and 11.3% gains in jobs and revenues respectively between 2003 and 2005, while national employment grew only 1.3% and U.S. company revenues rose 8.5%. Prominent companies that have received venture financing include: Microsoft, Federal Express, AOL, Apple, Office Depot, Intel, Home Depot, Cisco, Compaq, Genentech, Amgen, Starbucks, Amazon, e-Bay, JetBlue, Seagate, Yahoo, Google and YouTube.

Traditionally, venture capital funds have invested in, and promoted the development of, the most innovative and dynamic sectors of the U.S. economy, including computing and software, internet and telecommunications, biotechnology, pharmaceuticals and medical devices. Today, venture capital funds also are investing in "clean" and "green" technologies, new energy sources, homeland security, nanotechnology, health-care services and more. The venture capital model of accelerating innovation has been so successful that branches of the U.S. government (including the CIA and NASA) have sponsored venture capital funds focused on technologies of special value to the national interest.[1]

Distinguishing Venture Capital Funds from Other Pooled Investment Vehicles

Investment Strategy

Venture capital funds invest directly into young and growing businesses ("portfolio companies") and hold investments for long-term capital appreciation. Unlike certain other pooled investment vehicles, venture capital funds generally do not seek to profit from short-term swings in market prices or financial arbitrage based upon derivative financial instruments. Most venture investments are illiquid for long periods of time and cannot be disposed of in the short term. If a venture capital fund were to use derivative financial instruments, it typically would utilize only those instruments designed to support/complement a long-term commitment to a portfolio company. For example, a fund may acquire an option to purchase additional equity interests in a portfolio company, hedge currency exchange risks associated with a foreign portfolio company, or acquire a put/collar to lock-in capital appreciation generated over a period of years. It would be highly unusual for a venture capital fund to sell short, issue an uncovered call, or engage in similar speculative transactions involving a company with which it has no substantial long-term relationship.

Managerial Assistance

Venture capital funds provide portfolio companies with more than just financial capital. They actively seek to aid portfolio companies through many forms of managerial assistance including: strategic planning; mentoring; validation of technical concepts; recruiting key employees; introductions to key customers, consultants, suppliers and business partners; business development; marketing development; and general business guidance. Considering the primary functions of a venture capitalist (selecting target portfolio companies, consummating investments, assisting portfolio companies, and disposing of portfolio investments), it is quite common for the time spent by a venture

[1] CIA: In-Q-Tel; NASA: Red Planet Capital.

capitalist assisting portfolio companies to exceed time spent on all other functions combined.

Characteristics of Venture Capital Funds Relevant to the Proposed Rules

Investors in Venture Capital Funds

Approximately 90 percent of the capital committed to venture capital funds consists of large commitments (e.g., $1 million or more) from professional, institutional investors.[2]

However, the typical venture capital fund also will admit Network Individuals, who may provide much smaller amounts of capital, but are part of the fund's network of individual relationships and are expected to supplement their capital contributions with personal efforts on behalf of the fund and/or its portfolio companies.

Network Individuals typically are scientists, engineers, academics, entrepreneurs and others who are highly sophisticated in their respective fields, but who lack great personal wealth. The skills that these individuals bring to a venture capital fund are so important that many venture capital firms create specialized "affiliate" or "sidecar" funds for the specific purpose of attracting smaller investments from Network Individuals and thereby incentivizing them to help the firm and its portfolio companies prosper.

Subjecting venture capital funds to the New Accredited Investor Rule would greatly diminish the ability of venture capital funds to tap into the time, energy and skills of Network Individuals. This, in turn, would reduce the overall effectiveness of the venture capital industry as a facilitator of innovation, new companies, new jobs and economic growth.

Furthermore, excluding Network Individuals from venture capital funds under the New Accredited Investor Rule would be particularly inappropriate because the Rule does not provide a good measure of their sophistication. Typically, these investors have the ability to "fend for themselves" that has been the touchstone of the private offering exemption.[3] In many cases, a venture capital fund will seek out a particular Network Individual because that individual is more knowledgeable about a topic relevant to the fund's investments than the managing venture capitalists themselves.[4]

[2] 2004 NVCA Yearbook prepared by Thompson Financial.

[3] See SEC v. Ralston Purina Co. 346 U.S. 119 (1953).

[4] For larger venture capital funds, it is rare for an individual investor to be admitted with a small capital commitment unless he or she is a Network Individual. Smaller venture capital funds (that have less access to institutional capital) may admit individual investors primarily to obtain their capital

Angel Investors

In addition to professionally managed venture capital funds, the venture capital industry includes a class of individual investors known as "angel" investors. Angel investors typically make "seed" investments in the range of $25,000 to $500,000 per investment.[5] Because investments in this range often are not practicable for larger venture capital funds, angel investors fill a critical "gap" in financing between founders and professional venture capital. Although many angel investors operate as individuals, others make investments through pooled investment vehicles. Coordinating their investment activities through a pooled investment vehicle allows angel investors to share insights, diversify risks, and amass larger capital reserves to support portfolio companies through multiple rounds of financing.

If angel investors were subject to the New Accredited Investor Rule, it would significantly impair their ability to organize themselves into, or otherwise participate in, funds because many angel investors do not have $2.5 million in investments.[6] Perversely, by making it more difficult to pool their capital, the New Accredited Investor Rule would harm many angel investors by forcing them to make solitary direct investments and deny to them the benefits associated with pooled investment vehicles.

Internationalization of the Venture Capital Industry

In recent years, the venture capital industry has expanded its focus from a few regions in the United States (e.g., Silicon Valley in California and Route 128 in

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commitments, but due to the long-term nature of the venture capital process and the corresponding long-term commitment made by participants in venture capital funds, those individual investors typically have strong relationships with the managing venture capitalists. We understand that the Commission has noted a growing trend in the hedge fund industry of "retailization" or the expansion of marketing activities to attract investors who may not previously have participated in high-risk investments. However, there is no equivalent trend in the venture capital industry. It would be inappropriate to subject the venture capital industry to the substantial harms described in this letter in order to address marketing trends identified solely with the hedge fund industry.

[5] See MIT Venture Support Systems Project: Angel Investors, MIT Entrepreneurship Center, February 2000, available at <http://angelcapitaleducation.org/dir_downloads/resources/Research_VentureSupportProject.pdf>.

[6] We note that many angel funds are actively managed by all investors. As a result, interests in these funds would not be securities because such interests are not interests in profits "derived solely from the efforts of others" as set forth in SEC v. W.J. Howey Co., 328 U.S. 293. Nevertheless, requiring such funds to rely upon the subjective Howey test could seriously harm their ability to pool their capital and would be contrary to the Commission's policies encouraging certainty in private offerings that underlie the adoption of Regulation D.

Massachusetts) to a large number of regions in the United States and abroad. Today, portfolio companies may be located in Seattle, Washington or Beijing, China. The international aspects of this expansion, in particular, serve U.S. interests in a variety of ways. For example, venture capital funds often help U.S. based portfolio companies develop sales and operations in foreign countries, while helping foreign portfolio companies bring new products and technologies to the United States. The resulting large-scale cross-fertilization of ideas, techniques, technologies and people is widely seen as further accelerating innovation around the globe – and helping to implant U.S. business practices, standards, ethics and ideals into foreign communities.

As a result of this internationalization, many venture capital funds make substantial investments in portfolio companies organized or operated outside the United States, and many venture capital funds are themselves organized in foreign jurisdictions in order to address issues arising under international tax treaties, currency control regimes and other regulatory structures.

As discussed below, certain components of the New Accredited Investor Rule would exclude from the definition of "venture capital fund" many funds participating in this process of internationalization – to the detriment of those funds and U.S. interests.

Feeder/Conduit Structures

As the venture capital industry has matured, so have the structures used to organize venture capital funds. Modern structures include:

1. Venture capital funds investing in other venture capital funds. There are many reasons for this including: (i) large funds with a later-stage focus investing in smaller funds with an earlier-stage focus in order to gain exposure to potential portfolio companies; (ii) established funds investing in newer funds in order to develop personal relationships among venture capitalists that may subsequently lead to a merger of their respective firms; and (iii) funds based on one region investing in funds based in other regions in order to gain insights and/or develop skills.

2. "Funds-of-funds" organized to enable Network Individuals and other smaller investors (who might individually be able to invest in only one or two venture capital funds) to pool their capital and thereby diversify their risk across many venture capital funds.

3. Affiliated venture capital funds co-investing through a single subsidiary fund in order to more efficiently benefit from international tax treaties or to address currency control or other tax/regulatory issues.

Defining Venture Capital Funds by Reference to Elective Redemption Rights

For purposes of the New Accredited Investor Rule, we believe it would be most appropriate to define venture capital funds by reference to the absence of elective redemption rights -- similar to the exclusion of certain funds in the definition of "private funds" set forth in recently adopted Rule 203(b)(3)-1 under the Investment Advisers Act.

Due to the long-term nature of venture capital investments and their general illiquidity, a venture capital fund typically cannot offer elective redemptions during most, if not all, of the fund's term. Occasionally, venture capital funds do permit limited redemptions in extraordinary circumstances, such as death or conflict with an investor's obligations under applicable law.[7] In contrast, a fund that invests in publicly traded securities or other relatively liquid assets generally can permit investor redemptions without undue burden, and periodic redemption rights are common in the hedge fund industry. While it is true that only a real-world test would answer the question with certainty, we believe that a general prohibition on elective redemptions for a period of 5 years would effectively serve to identify venture capital funds and distinguish them from hedge funds and similar pooled investment vehicles.[8]

Defining venture capital funds by reference to an elective redemption feature is preferable to the approach set forth in the Proposed Rules for three reasons. First, the definition in the Proposed Rules is extremely complex, involving multiple layers of definitions and exclusions. This would result in uncertainty and increased costs. Second, ensuring that a venture capital fund complies with the operating restrictions set forth in the Proposed Rules would prove burdensome in practice, again resulting in uncertainty and increased costs. Finally, as discussed in this letter, the complex definition set forth in the Proposed Rules fails to address a variety of issues attributable to the evolution of the venture capital industry in recent years. Even assuming that our proposed technical corrections were adopted, a complex definition would have an increased likelihood of conflict with the future evolution of the venture capital industry.

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[7] We note that Rule 203(b)(3)-1 permits extraordinary redemptions.

[8] The key question, of course, is whether hedge funds would evolve away from periodic redemption rights in response to a new rule defining venture capital funds. We believe that a 5-year prohibition on elective redemptions would conflict, as a business matter, with the annual "high water mark" accounting method used by most hedge funds in calculating the fund managers' "carried interest" profit share. Eliminating annual high water mark accounting would be costly for hedge fund managers, so we consider it likely that most hedge fund managers would prefer to operate under the New Accredited Investor Rule. If the Commission were concerned that 5 years would not be long enough to ensure this result, we believe that the venture capital industry would not be unduly burdened by a prohibition on elective redemptions for the longer of (i) 5 years or (ii) 80 percent of the relevant fund's term of existence.

In contrast, the exclusion of venture capital funds in Rule 203(b)(3)-1 under the Investment Advisers Act is simple, compliance is inexpensive, and the likelihood of future conflict is low.

For these reasons, we believe that it would be most appropriate to define venture capital funds by reference to their absence of elective redemption rights -- similar to the definition of "private funds" set forth in Rule 203(b)(3)-1 under the Investment Advisers Act.

Technical Corrections to the Proposed Definition of Venture Capital Fund

If, notwithstanding the foregoing, the Commission elects to proceed with a definition of venture capital funds similar to that contained in the Proposed Rules, the following technical corrections would be necessary to address the evolution of the venture capital industry in recent years, particularly in connection with the internationalization of venture capital activities and the development of various feeder/conduit structures. Failure to include these corrections would cause the New Accredited Investor Rule to apply with respect to a substantial and growing number of true venture capital funds – causing significant harm to the venture capital industry.

Non-United States Portfolio Companies

Section 2(a)(46)(A) of the Investment Company Act requires that an "eligible portfolio company" (*i.e.* a company in which a business development company can generally invest) be organized, and have its principal place of business, in the United States. This requirement is inconsistent with the increasingly international character of the venture capital industry, as discussed above, and (if not modified for purposes of the Proposed Rules) would subject many venture capital funds to the New Accredited Investor Rule.

We would suggest that "eligible portfolio company" be defined for purposes of the Proposed Rules without regard to where the company is organized or conducts business.

Non-United States Venture Capital Funds

Section 2(a)(48)(A) of the Investment Company Act requires that a business development company be organized, and have its principal place of business, in the United States. This requirement is inconsistent with the increasingly international character of the venture capital industry, as discussed above, and (if not modified for purposes of the Proposed Rules) would subject many venture capital funds to the New Accredited Investor Rule.

We would suggest that "business development company" be defined for purposes of the Proposed Rules without regard to where the company is organized or conducts business.

Feeder/Conduit Structures

Section 2(a)(46)(B) of the Investment Company Act excludes investment companies from the definition of an eligible portfolio company. This exclusion is inconsistent with the variety of feeder/conduit structures described above and (if not modified for purposes of the Proposed Rules) would subject some venture capital funds to the New Accredited Investor Rule, while depriving others of the benefits of feeder/conduit structures described above.

We would suggest that "eligible portfolio company" be defined for purposes of the Proposed Rules to include, without limitation, entities that themselves qualify as venture capital funds. Further, this definition should clarify that tiered structures are acceptable (so that, e.g., several tiers of parent vehicles culminating in a single entity that actually invests in portfolio companies can all qualify as venture capital funds).

Text of Suggested Definition of Venture Capital Fund

The following modifications to proposed rule 203.216(b)(2) would satisfy the specific concerns expressed above:

> 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)), except that for purposes of determining whether a company is a venture capital fund –
>
> A. The term business development company as defined under section 2(a)(48) of the Investment Company Act of 1940 shall include a company that does not meet the requirements of subsection A. of section 2(a)(48) of the Investment Company Act of 1940;
>
> B. The term eligible portfolio company as defined under section 2(a)(46) of the Investment Company Act of 1940 shall include a company that does not meet the requirements of subsection A. of section 2(a)(46) of the Investment Company Act of 1940; and

> C. The term eligible portfolio company as defined under section 2(a)(46) of the Investment Company Act of 1940 shall include a company that is itself a venture capital fund.

Guidance on the Meaning of "Operated for the Purpose"

Section 2(a)(48)(B) of the Investment Company Act provides that, *inter alia*, a company is a business development company (and hence, a venture capital fund under the Proposed Rules) if it "is operated for the purpose of making investments in securities described in paragraphs (1) through (3) of [Section 55(a) of the Investment Company Act]."

We believe that this language is intended to pick up the 60 percent[9] limitation set forth in the opening paragraph of Section 55(a), but which occurs outside the scope of Sections 55(a)(1)-(3); *i.e.* that a company is a business development company if it is operated for the purpose of making at least 60 percent of its investments in such securities. It would be appropriate and useful for the Commission to clarify this intent in its adopting release.

Many venture capital funds invest through "tiered" structures in which some or all investors are equityholders of a parent vehicle, and a subsidiary vehicle actually makes the investments in portfolio companies. In certain cases, different classes of investors are admitted to the "upper-tier" and "lower-tier" entities. As described above, such structures often are used to obtain the benefits of international tax treaties or to comply with other regulatory requirements. An ownership interest in the subsidiary vehicle held by the parent vehicle is not a security described in paragraphs (1) through (3) of Section 55(a) of the Investment Company Act. We believe that the Commission would not intend that the holding of such interests would be inconsistent with the purposes of a business development company (and hence, a venture capital fund) as described above. It would be appropriate and useful for the Commission to clarify this intent in its adopting release.

Finally, many venture capital portfolio companies are acquired in "stock-for-stock" transactions, where the venture capital fund receives securities of the acquiror. Many, perhaps most, of the securities received in such transactions would not be described in paragraphs (1) through (3) of Section 55(a) of the Investment Company Act because the acquiror is not an "eligible portfolio company." In many cases, the venture capital fund is required to retain such securities for long periods after the acquisition due to limitations imposed by the securities laws or contractual "lock-up" provisions. We believe that the Commission would not intend that the receipt and holding of such securities would be inconsistent with the purposes of a business development company

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[9] 70 percent in the text of the rule, but modified to 60 percent per Section 202(a)(22)(A) of the Investment Advisers Act.

(and hence, a venture capital fund) as described above. It would be appropriate and useful for the Commission to clarify this intent in its adopting release.

Responses to Specific Requests for Comments from the Commission

In Release No. 33-8766, the Commission requested comments on a variety of specific issues. We respond to certain of those requests below.

1. *We solicit comment on whether defining venture capital fund with reference to the definition [of business development company] provided in the Advisers Act is appropriate [as compared to the definition in the Investment Company Act].*

While it would be possible to base the definition of venture capital fund for the purposes of the New Accredited Investor Rule upon the definition in the Investment Company Act (instead of the definition in the Investment Advisers Act) we believe that doing so would require substantial modification to the basic definition.

The most important difference between the definition of business development company under the Investment Company Act and that definition under the Investment Advisers Act is the application of Sections 55 through 65 of the Investment Company Act. Among other things, such provisions would:

(a) Require that a venture capital fund register its securities under Section 12 of the Securities Exchange Act and file annual financial statements with the Commission pursuant to Section 13 of the Securities Exchange Act;

(b) Require that a venture capital fund be managed by directors or general partners, a majority of whom are independent of the fund;

(c) Prohibit many common transactions among fund managers and venture capital funds as a result of "conflict-of-interest" rules; and

(d) Impose limitations on a venture capital fund's capital structure and distributions that are inconsistent with the practices of many venture capital funds.

More generally, the definition of a business development company under the Investment Company Act contemplates a publicly traded, highly regulated investment vehicle that has a very different nature than the privately offered, and intensively negotiated, character of venture capital funds.

2. *Would it be more appropriate to define venture capital funds in terms of their investment objective and strategy (e.g., investing in and developing start-up and early phase businesses)?*

As described above, we believe the distinguishing characteristics of venture capital funds are (i) an investment strategy characterized by direct investment in portfolio companies for long-term capital appreciation, and (ii) provision of managerial assistance to portfolio companies. We believe it is appropriate to rely upon these characteristics to define venture capital funds. Subject to the comments set forth above, the Proposed Rules incorporate these concepts by reference to the definitions of "eligible portfolio securities" and "substantial managerial assistance."

3. *[W]ould it be more appropriate to define private investment vehicles to be 3(c)(1) Pools that do not permit their investors to redeem their interests in the pools within a specified period of time ("holding period")? Would such an approach cause most 3(c)(1) Pools to simply extend their holding periods sufficient to avoid application of the proposed rules?*

As discussed above, in order to avoid the unnecessary regulatory complexity and compliance costs of the definition set forth in the Proposed Rules, we believe it would be more appropriate to define venture capital funds by reference to their lack of elective redemption rights -- similar to the exclusion in Rule 203(b)(3)-1 under the Investment Advisers Act.

4. *We particularly solicit the views of commenters on the different types of investments made by venture capital funds, as currently operating in the market, and business development companies, as defined under the Advisers Act. ... If we were to adopt a definition of venture capital fund based on either of the statutory definitions of business development company, should we modify that definition to include venture capital funds that invest a significant amount of their assets in foreign securities and other private pools?*

As described above, we believe that the definition of "venture capital fund" should include funds that invest a significant amount of their assets in foreign securities, other venture capital funds, and feeder/conduit entities.

5. *We request comment on whether excluding venture capital funds from the application of the proposed rules is appropriate at all. If so, would applying the proposed definition to them affect their ability to raise capital? Are there other policy reasons for excluding venture capital funds? For example, are there aspects of such funds that make them more appropriate investments for less wealthy investors?*

As described above, application of the New Accredited Investor Rules to venture capital funds would substantially harm the venture capital industry. Venture capital funds would be unable to admit many Network Individuals, thereby impairing the funds' ability to identify attractive investments and provide managerial assistance to portfolio companies. Many angel investors would be unable to organize as collective investment

pools, thus denying them the benefits of collective investing and reducing capital available to finance small businesses in the "gap" between founders and professional venture capital. Moreover, many Network Individuals and angel investors are sophisticated participants in the venture capital industry and able to "fend for themselves," despite not meeting the $2.5 million-in-investments standard under the New Accredited Investor Rule.

For these reasons, we believe it would be highly inappropriate to subject venture capital funds to the New Accredited Investor Rule.

Having made this point, we note that some commentators have suggested that it would serve an investor-protection rationale better to rely upon diversification of investments in lieu of a net wealth or investments test. This approach may eliminate the need to distinguish between venture capital funds and other types of pooled investment vehicles. In principle, we would not object to applying the New Accredited Investor Rule only to those individual investors who wish to invest more than 10% of their net worth into a single pooled investment vehicle, although this approach would require a highly detailed framework to avoid conflicts with the normal operations of venture capital funds. We believe that few venture capital funds would wish to accept more than 10% of the net worth of an investor who has less than $2.5 million in investments. However, we would express caution about setting the standard below 10%. It would be difficult to utilize investments by Network Individuals as an incentive mechanism if such Individuals were not permitted to invest an amount that is, in a real sense, material to them. Furthermore, depending upon how the Commission decides to proceed with respect to the Antifraud Rules (discussed below), a distinction between venture capital funds and other pooled investment vehicles may be required in any event.

The Antifraud Rules and General Concern with Regulation of the Venture Capital Industry

In light of the court's opinion in Goldstein v. SEC,[10] we acknowledge the appropriateness of reaffirming the application of investor protections under the Investment Advisers Act's antifraud rules in the context of all types of pooled investment vehicles, whether they be hedge funds, venture capital funds or other types of funds. However, as currently proposed, the Antifraud Rules impose obligations that go far beyond what is necessary to reaffirm the pre-Goldstein *status quo ante*. Moreover, we are concerned that the Antifraud Rules could presage further burdensome regulatory activity that would include the venture capital industry.

[10] 451 F.3d. 873 (D.C. Cir. 2006).

Expansion of Antifraud Rules

Subsection 206(4)-8(a)(2) of the Antifraud Rules reiterates the obligations of investment advisers set forth in Section 206(4) of the Investment Advisers Act and clarifies that obligations are owed both to the adviser's client (i.e. a fund) and to the investors and prospective investors in that fund. We do not have any criticism of this aspect of the Antifraud Rules.

Subsection 206(4)-8(a)(1), however, would impose additional obligations that go far beyond the pre-Goldstein *status quo ante* . While superficially similar to Rule 10b-5 under the Exchange Act, subsection 206(4)-8(a)(1) on its face appears to cover situations not connected with the purchase or sale of a security.

We are deeply concerned about subsection 206(4)-8(a)(1) for three reasons.

First, we note that there already is a material degree of legal uncertainty over how Rule 10b-5 should be applied to particular circumstances. This uncertainty would be greatly compounded if applied to the general operations of investment funds beyond securities offerings. In other words, subsection 206(4)-8(a)(1) would expose investment funds to significant new regulatory burdens of uncertain scope. This alone would be highly detrimental to the venture capital industry.

Second, and even more important, subsection 206(4)-8(a)(1) would directly interfere with important communications between venture capital funds and their Network Individual investors. As noted above, venture capital funds often work closely with Network Individuals who assist in the selection and mentoring of portfolio companies. In this context, venture capitalists and Network Individuals typically discuss current and prospective portfolio companies in a frank and informal manner. Subjecting these discussions to the diligence and caution that are appropriate for a securities offering would, as a practical matter, prevent many such discussions from ever taking place and thereby substantially burden the ability of Network Individuals to provide their highly valued assistance to venture capital funds and portfolio companies.

Finally, as an essential component of their role as portfolio company mentors, venture capital funds often are in possession of material confidential information relating to portfolio companies that they are prohibited from disclosing to their investors (e.g., information obtained by venture capitalists in their capacity as portfolio company board members). If subsection 206(4)-8(a)(1) were interpreted to require disclosure of such information in ordinary communications with fund investors, fund managers could face an irreconcilable conflict – their duty to protect the confidentiality of portfolio company information versus their duty under subsection 206(4)-8(a)(1) to make greater disclosure.

We are unaware of any basis for subjecting the venture capital industry to these burdens and risks. Even if the Commission determines to adopt subsection 206(4)-8(a)(1) in order to address concerns relating to the hedge fund industry, venture capital funds should be exempt.

General Concern Regarding Regulation of the Venture Capital Industry

The current mix of legislative and regulatory exclusions and exemptions has appropriately balanced the interests of investors and venture capital funds for many years. We believe that further government regulation could substantially harm the venture capital industry without any apparent rationale based on investor protection. Moreover, we are very aware that regulation tends to grow over time.

In this regard, we believe it would be useful and appropriate for the Commission, in its adopting release, to clarify that the use of the term "private investment vehicle" in the Antifraud Rules is not intended to serve as a basis for future regulation of hedge funds and other types of private investment vehicles that "sweeps-in" venture capital funds by default.

Conclusions

We believe that the Proposed Rules generally reflect an appropriate and workable approach for the venture capital industry, but require the modifications described above in order to avoid unintended harm. We would be pleased to provide additional information or clarification upon request.

Yours truly,