January 7, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File Number S7-37-04; *Definition of Eligible Portfolio Company under the Investment Company Act of 1940*

Dear Mr. Katz:

We appreciate the opportunity to express our views on the SEC's proposed rule to realign the definition of an "eligible portfolio company" set forth under the Investment Company Act of 1940 (the "1940 Act"), and the investment activities of business development companies ("BDCs").

We are a BDC that facilitates the transfer of technologies created by public and private not-for-profit universities and laboratory research centers to small, developing public and private businesses.[1] We believe that all of us are beneficiaries of innovations stemming from the licensing of university-developed technologies to new and existing businesses, and that we play an important role in assisting small, developing public and private businesses to acquire and finance the transfer of such technologies.

We support the SEC's efforts to mitigate the unintended consequence of limiting the investment opportunities of BDCs that resulted from the use of the Federal Reserve Board's evolving definition of a "margin security" in determining the types of securities that can be properly classified as securities of an "eligible portfolio company" under Section 2(a)(46)(C)(i) of the 1940 Act. However, we believe that the proposed rule does not fulfill Congress' stated mandate to the SEC to facilitate the flow of capital to small, developing public companies.

[1] The Bayh-Dole Act (1980) created the legal framework for licensing university-developed technologies to commercial businesses. Specifically, Bayh-Dole Act provided for greater university participation in commercializing discoveries valuable to the public, granted universities the right to enter into exclusive licensing arrangements with commercial businesses, and gave universities the right to retain ownership of inventions developed with federal funds. All of these new provisions made licensing university-developed technologies an attractive undertaking for U.S. universities. The importance of the Bayh-Dole Act in facilitating university-based technology transfer to commercial businesses was underscored by the recognition of the Bayh-Dole Act by The Economist as "perhaps the most inspired piece of legislation to be enacted in America over the past half-century." See The Economist (December 14, 2002).

Specifically, we believe that the proposed rule overlooks the fact that most small, developing public companies seeking to acquire new technologies to grow their businesses cannot afford to fund the research necessary to develop new technologies and are not able to access the public capital markets to finance the development or acquisition of such technologies. As a result, we believe that such businesses would greatly benefit from the funding and service that we provide to help them identify, research, and acquire such technologies.

I. Capital Formation

Section 2(c) of the 1940 Act requires that "[w]henever pursuant to this title the [SEC] is engaged in rulemaking and is required to consider or determine whether an action is consistent with the public interest, the [SEC] shall also consider, in addition to the protection of investors, whether the action will promote . . . **capital formation**."[2] [Emphasis added.] Moreover, through the Small Business Investment Incentive Act of 1980 (the "1980 Act Amendments")[3] and the recent passage by the House of Representatives of the Increased Capital Access for Growing Business Act (the "Increased Capital Act"),[4] Congress has clearly expressed its desire for the SEC to accommodate the capital formation needs of small and developing businesses in connection with the exercise of its rulemaking authority in general and in connection with administering the provisions of the 1980 Act Amendments in particular.

A. The 1980 Act Amendments

Congress stressed that the purpose of the 1980 Act Amendments was to make capital more readily available to small developing and financially troubled businesses.[5] The principal means by which Congress sought to accomplish this goal was through the creation of a new category of closed-end investment company known as a BDC. Congress intended BDCs to furnish capital to companies "which do not have ready access to the public capital markets because of their size, seasoning or financial condition."[6]

Aside from the BDC-related provisions of the 1980 Act Amendments, certain other provisions of the 1980 Act Amendments also highlight the importance Congress assigned to the SEC's role of facilitating the capital formation needs of small and developing businesses. In this regard, the 1980 Act Amendments requires the SEC to "gather, analyze, and make available to the public, information with respect to the capital formation needs, and the problems and costs involved with new, small, medium-sized, and independent businesses."[7] The 1980 Act

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[2] See also Section 202(c) of the Investment Advisers Act of 1940, Section 2(b) of the Securities Act of 1933 and Section 3(f) of the Securities Exchange Act of 1934.

[3] Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2274 (Oct. 21, 1980).

[4] H.R. 3170, 108th Cong. 1st Sess. (2003) (passed in the House of Representatives, Apr. 28, 2004).

[5] H.R. Rep. No. 1341, 96th Cong. 2nd Sess. 21 (1980).

[6] S. REP. 96-958 at 15; H.R. REP. 96-1341 at 30 (1980).

[7] Section 501 of the 1980 Act Amendments.

Amendments also requires that the SEC host an annual forum that focuses on the capital formation concerns of small business.[8] A major purpose of the forum is to provide a platform for small businesses to highlight perceived unnecessary impediments to the capital-raising process.[9] Called the "SEC Government-Business Forum on Small Business Capital Formation," this gathering has assembled annually since 1982, as mandated by the 1980 Act Amendments.

B. The Increased Capital Act

In April 2004, the House of Representatives passed the Increased Capital Act. This legislation would add a new "eligible portfolio company" standard based on criteria relating to the market capitalization of public companies. Specifically, a public company with a market capitalization of $250 million or less would be deemed to be an "eligible portfolio company." In seeking to add a new "eligible portfolio company" standard based on criteria relating to the market capitalization of public companies, Representative Nydia Velazquez stated that "[i]t is important to understand that just because a firm has gone public does not mean that it can access the financing necessary for growing and expanding."[10] Representative Sue W. Kelly noted that "the legislation permits BDCs to provide capital to a larger number of companies by increasing the size of companies that BDCs can invest in to reflect changes in the market since the creation of [BDCs]."[11]

C. The Proposed Rule Does Not Further Capital Formation

We do not believe that the proposed rule furthers Congress' expressed desire to foster the capital formation abilities of small, developing public businesses. We believe that it may be helpful to consult empirical and other evidence of the impediments to capital formation by such businesses in proposing a new "eligible portfolio company" standard. In this regard, we note that the annual small business forums sponsored by the SEC yield a wealth of information about the capital formation needs of small, developing public companies. For example, the following concerns or recommendations were highlighted in the *Final Reports of the SEC Government-Business Forum on Small Business Capital Formation*:

- Access to capital continues to be a major problem for many small businesses. Some have resorted to self-financing their capital needs by using credit cards for short and long-term capital. This type of financing is risky and expensive. Often, the interest rates on these outstanding credit card balances are far in excess of what would be charged for conventional business loans.[12]

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[8] Section 502 of the 1980 Act Amendments (now contained in Section 19 of the Securities Act of 1933).

[9] See SEC press release at http://www.sec.gov/info/smallbus/sbforum.shtml.

[10] Id.

[11] Id.

[12] Final Report of the SEC Government-Business Forum on Small Business Capital Formation, July 1999.

- The BDC Law has been a dismal failure. There is a need for a professionally managed fund/pool for venture capital in order to broaden the base beyond existing institutions and wealthy individuals to retail/individual investors. The SEC should work with the SBA to undertake a thorough study to the end of coming up with recommendations for such a financing source in order to provide an additional funding mechanism for small businesses.[13]

- The Investment Company Act should be amended to permit closed-end mutual funds that will provide "pooled capital" for small business venture capital investments.[14]

The proposing release highlights the fact that the proposed "eligible portfolio company" standard would create "a new, objective standard" for determining which companies qualify as "eligible portfolio companies." The proposing release also readily acknowledges the difficulty in determining which businesses are small and developing businesses and requests comment on whether "our approach adequately describe[s] the issuers that meet the purpose of the [1980 Act Amendments]." Thus, we assume that the reference to an "objective standard" in relation to the proposed "eligible portfolio company" standard means a static, bright line standard for determining which companies are "eligible portfolio companies." While we appreciate the benefits of, and sometimes even unreasonably make requests for, static, bright line standards in regulatory rulemaking, we believe that Congress intended the SEC to periodically determine the types of companies that do not have ready access to the public capital markets in connection with the "eligible portfolio company" standard. In this regard, it is clear from the legislative history of the 1980 Act Amendments that Congress envisioned that the definition of an "eligible portfolio company" would expand in order to ensure that those small, developing and financially troubled companies most in need of capital would be able to obtain such financing from a BDC.[15] According to the legislative history, Congress envisioned that "the [SEC] would institute proceedings to consider whether the definition of eligible portfolio company can be expanded, consistent with the purpose of the legislation, to increase the flow of capital to small, developing businesses or financially troubled businesses."[16] "Among the objective factors which the [SEC] may consider in such proceedings are the size of such companies, the extent of their public ownership, and their history as going concerns and public companies."[17]

[13] Id.

[14] Final Report of the SEC Government-Business Forum on Small Business Capital Formation, July 1998.

[15] H.R. Rep. No. 96-1341 at 23 (September 17, 1980) (noting that the SEC was granted rulemaking authority to expand the class of eligible portfolio companies); Section 2(a)(46)(C)(iv) of the Investment Company Act of 1940 (granting the SEC the authority to expand the definition of eligible portfolio company via a rulemaking consistent with the public interest, the protection of investors and the intention of Congress when enacting the 1980 Act Amendments).

[16] See H.R. Rep. No. 96-1341 at 31 (September 17, 1980).

[17] Id.

Due to the fact that we are a relatively small BDC and believe it is more appropriate for us to use our limited financial and managerial resources to operate our business, we have not undertaken any extensive research to determine an alternative approach to the one proposed. However, its has been our experience that many companies that have their securities listed on the American Stock Exchange and the Nasdaq SmallCap Market do not have adequate access to the public capital markets to finance the acquisition of new technologies to grow their businesses and, as a result, would greatly benefit from the funding we provide to help them identify, research, acquire and market such technologies. We also believe that the "eligible portfolio company" standard set forth in the Increased Capital Act merits significant consideration given that it is our experience that public companies with market capitalizations of $250 million or less generally do not have adequate access to the public capital markets to finance the acquisition of new technologies.

II. The Proposal Would Have the Effect of Limiting BDC Investments to Financially Troubled Public Companies

The proposed rule would largely require us to make investments in small, financially troubled public companies as opposed to small, developing public traded companies. In this regard, the proposed rule generally defines an "eligible [public] portfolio company" as a company that has a class of securities quoted on the over-the-counter bulletin board (the "OTCBB") and through the Pink Sheets LLC (the "Pink Sheets"). It is our experience that most public companies quoted on the OTCBB or through the Pink Sheets are financially troubled public companies. Such companies often do not seek to be quoted on the OTCBB or through the Pink Sheets but instead are relegated to having their securities quoted on or through such quotation mediums because they are financially troubled. As a result, the proposed rule does not further the Congressional intent behind the creation the BDCs which was to encourage capital investments in small and developing public companies and not just financially troubled public companies.[18]

III. Balancing the Mandate to Facilitate Capital Formation and Protect Investors

As recently stated by Alan L. Beller, the Director of the SEC's Division of Corporation Finance, in testimony given before the Subcommittee on Oversight and Investigations of the Committee of Financial Services of the House of Representatives regarding the Increased Capital Act, "[t]he Securities and Exchange Commission has long strived to balance its mission to facilitate capital formation with its mission to protect investors."[19] We do not believe that there

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[18] H.R. Rep. No. 96-1341 at 30 (September 17, 1980); House concurrence in the Senate amendments to H.R. 7554, October 1, 1980, 126 Cong. Rec. 30330 at 28634.

[19] See *Testimony Concerning Small Business Capital Formation* by Alan L. Beller**,** Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, Before the Subcommittee on Oversight and Investigations of the Committee on Financial Services, United States House of Representatives, available at http://www.sec.gov/news/testimony/ts092304alb.htm.

are any substantial investor protection issues implicated by the rationale expansion of the types of public companies that can receive financing from BDCs.

The proposing release cites as an "investor protection" concern the possibility that, if the definition of an "eligible portfolio company" were linked to a market capitalization standard, some registered investment companies may elect BDC status to take advantage of less restrictive provisions under the 1940 Act. First, we note that there remain significant regulatory burdens on any entity seeking to be regulated as a BDC under the 1940 Act. In this regard, notwithstanding the general exemption for BDCs from the 1940 Act, Section 59 of the 1940 Act provides that "Sections 1, 2, 3, 4, 5, 6, 9, 10(f), 15(a), (c), and (f), 16(b), 17(f) through (j), 19(a), 20(b), 32(a) and (c), 33 through 47, and 49 through 53 of this title shall apply to a business development company to the same extent as if it were a registered closed-end investment company."

Moreover, BDCs must comply with the periodic and current reporting requirements set forth in Section 13(a) of the Securities Exchange Act of 1934, including Forms 10-K, Forms 10-Q and Forms 8-K. Also, unlike registered closed-end investment companies, BDCs are required to comply with all of the disclosure and corporate governance provisions of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), including the requirement to evaluate and publicly issue a report on their internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. In this regard, we believe that the compliance costs associated with Section 404 of the Sarbanes-Oxley Act alone are sufficient to deter any registered investment company from electing to be regulated as a BDC. For example, 21% of public companies surveyed in a recent study considered going private or selling the company as a result of the Sarbanes-Oxley Act in general and Section 404 thereunder in particular.[20]

Thus, given the extensive regulatory regime under which BDCs operate, we do not believe that many registered investment companies would elect to be regulated as a BDC even if they agreed to limit the range of their investments to the narrower band of investments that BDCs are permitted to make. Moreover, if the use a market capitalization "eligible portfolio company" standard (or another standard which better measures a public company's inability to access the public capital markets) results in an increase in the number of registered investment companies that elect to be regulated as BDCs, we believe that such a result would be wholly consistent with the Congressional intent in establishing BDCs.

IV. Conclusion

We commend the SEC for its efforts to mitigate the unintended consequence of limiting the investment opportunities of BDCs that resulted from the use of the Federal Reserve Board's evolving definition of a "margin security" in determining the types of securities that can be properly classified as securities of an "eligible portfolio company" under Section 2(a)(46)(C)(i) of the 1940 Act. However, in order to effectuate the Congressional intent in establishing BDCs, we believe that the "eligible portfolio company" standard as amended must recognize that there is a universe of public companies listed on the American Stock Exchange and the Nasdaq

[20] See Marc Morgenstern and Peter Nealis, *The Impact of Sarbanes-Oxley on Mid-Cap Issuers*, available at http://www.sec.gov/info/smallbus/mmorgensternmidcap.pdf (citing Foley Lardner LLP, *The Cost of Being Public in the Era of Sarbanes-Oxley* (May 19, 2004)).

SmallCap Market that do not have adequate access to public capital to finance the development or acquisition of new technologies to grow their businesses. These are the very companies that the Bayh-Dole Act[21] intended to help by giving them access to important new discoveries developed by our best research universities and national laboratories.

We appreciate your consideration of these comments. We would be pleased to discuss these matters further or to meet with you if it would be helpful.

Sincerely,

Clifford M. Gross, Ph.D.
Chairman and Chief Executive Officer

[21] See note 1 above.