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May 11, 2020

Paul G. Cellupica, Esq.
Deputy Director and Chief Counsel
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Hercules Capital, Inc.

Dear Mr. Cellupica:

We write on behalf of Hercules Capital, Inc. (the "Company"), a Maryland corporation and an internally managed, non-diversified, closed-end investment company that has elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940, as amended (the "1940 Act"), to request assurance that the staff of the Division of Investment Management (the "Staff") will not recommend enforcement action to the Securities and Exchange Commission (the "Commission" or "SEC") under Section 12(d)(3) of the 1940 Act, made applicable to BDCs by Section 60 of the 1940 Act, if the Company organizes and acquires the securities of Adviser Sub LLC,[1] an entity that would be a direct or indirect wholly-owned subsidiary of the Company, organized as a Delaware limited liability company, and that intends to operate as an investment adviser (the "Adviser Sub"), and registers Adviser Sub with the SEC as an investment adviser under the Investment Advisers Act of 1940, as amended ("Advisers Act").

## I. Background

On February 22, 2005, the Company filed with the Commission its initial registration statement on Form N-2 under the Securities Act of 1933, as amended, in connection with its initial public offering of common stock and the Company's common stock began trading on June 9, 2005. The Company's investment objective is to maximize its portfolio's total return by generating current income from debt investments and capital appreciation from warrant and equity-related investments. The Company is focused on providing senior secured loans to high-growth, innovative venture capital-backed companies in a variety of technology, life sciences, and

[1] Adviser Sub LLC has not yet been formed, and does not intend to otherwise commence operations unless and until the relief requested herein has been granted. As a result, the legal name of the Adviser Sub is subject to change.

sustainable and renewable technology industries. As an internally managed BDC, the Company does not have an investment adviser and is managed by its executive officers under the supervision of its Board of Directors.[2] As a result, the Company does not pay an advisory fee, but instead pays the operating costs associated with employing investment management professionals directly. Unlike other asset managers, the Company is a single purpose entity that does not currently offer, advise, or sponsor financial products, other than the Company, which limits the Company's investment abilities and the available benefits to shareholders. The single-purpose structure has served the Company well, however, the Company believes it is appropriate, given the current competitive business environment, to seek to offer a wider variety of financial products and investment services and that such change is in the best interest of the Company and its shareholders.

Although the Company could explore the potential for serving as an adviser directly, rather than through the Adviser Sub, the Company believes doing so would make it more difficult to maintain its current tax status. The Company has elected to be treated for tax purposes as a regulated investment company, or "RIC," under the Internal Revenue Code of 1986, as amended (the "Code"). As a RIC, the Company is required to, among other things, receive 90% or more of its income from qualified earnings ("Good Income") as well as satisfy asset diversification and income distribution requirements. Importantly, investment management fee income received in connection with the provision of advisory services does not constitute Good Income. However, income distributed in the form of dividends from a wholly owned subsidiary to a parent company does constitute Good Income. The utilization of a subsidiary as a tax "blocker" entity in such a manner is a common and lawful method of tax planning under the Code. Therefore, in order for the Company to both maintain its RIC status under the Code and receive investment management fee income, management believes it would be in the best interest of the Company and its shareholders for investment management fee income to be generated by a proposed wholly-owned subsidiary, Adviser Sub. Furthermore, the potential provision of investment advisory services through a wholly-owned and controlled subsidiary of the Company has been approved by the Board of Directors of the Company, including a majority of the Board of Directors who are not "interested persons" of the Company within the meaning of Section 2(a)(19) of the 1940 Act. It is expected that the Board of Directors will oversee the Adviser Sub and its activities consistent with its oversight responsibilities for the Company. Shareholder approval for the formation and operation of the Adviser Sub is not necessary under either Maryland law or the Company's charter or bylaws. Shareholders of the Company will be provided with notice, in advance of, or concurrent with, the Adviser Sub's start of investment advisory activities.

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[2] The Company currently has a nine-member Board of Directors of whom eight are not "interested persons" of the Company within the meaning of Section 2(a)(19) of the 1940 Act.

It is expected that the Adviser Sub would allow the Company to use its current resources and investment professionals to increase the Company's gross revenue and income, while at the same time allow for expansion of advisory personnel and advisory activities. It would allow the Company to shield itself from potential liabilities associated with such activities to which the Company would be exposed if it were to engage in those activities directly. In addition, from a practical standpoint, the new investment advisory services that the Company would offer may be less marketable to potential new investors if the services were provided directly by the Company.

The Company will control the Adviser Sub, and the Company's Board of Directors and executive officers directly or indirectly will oversee the Adviser Sub's activities. The Adviser Sub will be a limited liability company that will elect to be treated as a taxable entity and taxed at corporate tax rates based on its taxable income. The Company expects the Adviser Sub to serve as investment adviser or sub-adviser to one or more privately-offered pooled investment vehicles, registered management investment companies, business development companies, and/or investment accounts (collectively, "Managed Accounts") and to receive fees in connection with its management of the Managed Accounts similar to those received by comparable investment advisers. The Company will capitalize the Adviser Sub with an amount of assets reasonably necessary to cover the Adviser Sub's organizational expenses, and Adviser Sub expects to share certain executive officers, investment personnel, other employees, facilities, and other resources of the Company to meet the investment advisory requirements of the Managed Accounts.

## II. Applicable Law

### Section 12(d)(3)

Section 12(d)(3) of the 1940 Act provides that it is unlawful for a registered investment company to purchase or otherwise acquire a security issued by a person who is, among other things, an investment adviser registered under the Advisers Act. Section 60 of the 1940 Act makes Section 12(d)(3) of the 1940 Act applicable to a BDC as if it were a registered closed-end investment company.

### Legislative History

Congress adopted Section 12(d)(3) for two primary purposes:

First, Congress wished to limit the exposure of registered investment companies to the entrepreneurial risks of a securities-related business.[3] This concern stemmed from the fact that, in

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[3] *See* Exemption of Acquisitions of Securities Issued by Persons Engaged in Securities Related Businesses, Investment Company Act Release No. 19204 (Jan. 4, 1993) (proposing release), at nn.

1940, when Section 12(d)(3) was adopted, most securities-related businesses were organized as privately held general partnerships.[4] Consequently, an investment in such a company would expose an investment company to the unlimited liabilities of a general partner if such business failed.[5]

Second, Congress wanted to mitigate potential conflicts of interest and reciprocal practices between registered investment companies and securities-related businesses. This concern arose in situations in which brokers, securities dealers and other financial intermediaries were in a position to dominate investment companies. The Commission provided examples of situations where brokers, securities dealers and other financial intermediaries were in a position to dominate investment companies in the Report on the Study of Investment Trusts and Investment Companies (the "Study"). For example, concerns were raised that investment company sponsors, such as investment banks, were using investment companies to purchase or otherwise acquire securities issued by securities related businesses affiliated with the sponsor, regardless of the value to the investment company, to prop-up the value of the affiliate's stock. However, the concerns raised in the Study and by Congress primarily related to an investment company's ownership of a brokerage or underwriting business, rather than the ownership of an advisory business.[6]

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10-11 and accompanying text; Exemption of Acquisitions of Securities Issued by Persons Engaged in Securities-Related Businesses, Investment Company Act Release No. 19716 (Sept. 16, 1993) (adopting release), at n. 4 and accompanying text; Exemption for Acquisition by Registered Investment Companies of Securities Issued by Persons Engaged Directly or Indirectly in Securities Related Businesses, Investment Company Act Release No. 13725 (Jan. 17, 1984) (proposing release).

4 *Id.*

5 *Compare* Section 12(c)(2)(B) in H.R. 8935, 76th Cong. (3d Sess. 1940) at 30, S. 3580, 76th Cong. (3d Sess. 1940) at 30, and Investment Trusts and Investment Companies: Hearings on S. 3580 before the Subcomm. on Securities and Exch. of the Senate Comm. on Banking and Currency, 76th Cong (3d Sess. 1940), pt. 1, at 10 ("Senate Hearings") with Section 12(d)(3)(B) of the 1940 Act. *See also* H.R. Rep. No. 76-2639, at 16 (1940); S. Rep. No. 76-1775, at 15-16 (1940); Senate Hearings, pt. 1, at 243. *See also* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979) ("the legislative history ... suggests that its purpose principally was to prevent investment companies ... from exposing their assets to the entrepreneurial risks of an investment banking business, as would be the case where an investment company took a partnership interest in a broker/dealer").

6 *Id.*

**Staff Precedents**

The Staff has issued various letters granting no-action relief to registered closed-end and open-end management investment companies that proposed to organize wholly-owned subsidiaries that would operate as registered investment advisers to third-party clients.[7] The relief requested by the Company in this letter is similar to these precedents except that the Company has elected to be regulated as a BDC and is not a registered investment company.

The Staff also has issued similar no-action relief to BDCs. In Main Street Capital Corporation ("Main Street"),[8] the Staff granted no-action relief to an internally managed BDC that itself was operating as a registered investment adviser to unaffiliated third-party clients. In order to meet the source-of-income standards under the Code, and limit its income to Good Income, Main Street sought to assign its third-party advisory agreement to its wholly-owned subsidiary, which had been managing the day-to-day operational and investment activities of Main Street. In order for the subsidiary to accept the assignment, the subsidiary would have been required to register under the Advisers Act, which would have been prohibited by Section 12(d)(3). In granting Main Street's request, the Staff noted that (a) the entrepreneurial risks that stirred Congress to enact Section 12(d)(3) were not present where an advisory subsidiary is a limited liability company and (b) the conflicts of interest and reciprocal practices of concern to Congress were not present because (i) Main Street's subsidiary was wholly-owned and controlled by Main Street and overseen by Main Street's board of directors, (ii) Main Street could have provided the advisory services directly and requested relief for bona-fide tax planning purposes, and (iii) Congress was primarily concerned about an investment company owning a brokerage or underwriting business, not an advisory business.

We believe the facts presented by the Company in this request are substantially similar to the facts cited in the Staff's correspondence with Main Street and other previous precedents.

## III. Analysis

We believe that ownership by the Company of the Adviser Sub should be permitted for the following reasons. The Company's proposal to enter into the advisory business through a wholly-owned and controlled subsidiary will benefit the Company's shareholders by allowing them to share in the profits from the new advisory business, by allowing that advisory business to be more

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[7] *See, e.g.*, AFL-CIO Housing Investment Trust (pub. avail. Aug. 5, 2016); Adams Diversified Equity Fund Inc. (pub. avail. Apr. 30, 2015); ASA Limited (pub. avail. July 23, 2010).

[8] Main Street Capital Corporation (pub. avail. Nov. 7, 2013).

marketable than if provided directly by the Company, by allowing the Company to add advisory personnel such as additional portfolio managers and investment analysts who will be available to provide advisory services both to the Company and to the Managed Accounts of the Adviser Sub, and by limiting any potential liabilities arising from Adviser Sub's provision of advisory services.[9]

In addition, the potential for conflicts of interests or overreaching is mitigated due to the fact that the Company will remain internally managed and will wholly-own and control the Adviser Sub and the concern of potential conflicts of interests or overreaching in the context of Section 12(d)(3) was raised by Congress primarily with respect to an investment company's ownership of a brokerage or underwriting business, and not the ownership of an advisory business. The Company's ownership of a wholly-owned and controlled adviser subsidiary will not disadvantage any of the Adviser Sub's Managed Accounts because the Adviser Sub will be a fiduciary of its clients, will be subject to the anti-fraud provisions of the Advisers Act and the other federal securities laws, and will be subject to and will comply with all of the duties and responsibilities required of a registered investment adviser under the Advisers Act. Also, it is expected that certain types of Managed Accounts will be represented by a board of directors or similar entity or person that will be responsible for protecting the client's interests vis-à-vis the Adviser Sub.

Moreover, by providing advisory services through the Adviser Sub, the Company ensures that with respect to such advisory services, shareholders will receive Good Income under the Code through bona fide tax planning and yet receive the benefit of the advisory arrangement.

Finally, the Staff has previously granted similar relief from Section 12(d)(3) of the 1940 Act to permit registered closed-end and open-end investment companies and BDCs to establish wholly-owned investment adviser subsidiaries.[10]

## IV. Conditions

The Company proposes to organize and operate the Adviser Sub in accordance with the following representations, which are designed to ensure that the Company's ownership and operation of the

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9 Unlike a general partnership, the liability of the owners/members of a limited liability company is generally limited.

10 *See* AFL-CIO Housing Investment Trust (pub. avail. Aug. 5, 2016); Adams Diversified Equity Fund Inc. (pub. avail. Apr. 30, 2015); Main Street Capital Corporation (pub. avail. Nov. 7, 2013); ASA Limited (pub. avail. July 23, 2010).

Adviser Sub involve no conflicts of interest that would disadvantage the Company's shareholders or the Adviser Sub's clients:

1. The determination to enter into the advisory business through the Adviser Sub has been made by a vote of at least a majority of the Board of Directors who are not "interested persons" of the Company as defined in Section 2(a)(19) of the 1940 Act.

2. The Company will wholly own and control the Adviser Sub. The Company will not have an investment adviser within the meaning of Section 2(a)(20) of the 1940 Act. Only persons acting in their capacities as directors, officers or employees of the Company will provide advisory services to the Company.

3. In each of its annual reports to shareholders and in future registration statements, the Company will discuss the existence of the Adviser Sub and the provision by the Adviser Sub of outside advisory services as well as include an assessment of whatever risks, if any, are associated with the existence of the Adviser Sub and its provision of such services.

4. The Adviser Sub will not make any proprietary investment that the Company would be prohibited from making directly under the Company's investment objectives, policies and restrictions or under any applicable law.

5. In assessing compliance with the asset coverage requirements under Section 18 of the 1940 Act, the Company will deem the assets, liabilities, and indebtedness of the Adviser Sub as its own.

6. The Company's Board of Directors will review at least annually the investment advisory business of the Adviser Sub to determine whether such business should be continued and whether the benefits derived by the Company from the Adviser Sub's business warrant the continued ownership of the Adviser Sub and, if appropriate, approve (by a vote of at least a majority of its directors who are not "interested persons" as defined in the 1940 Act) at least annually such continuation. In determining whether the investment advisory business of the Adviser Sub should be continued and whether the benefits derived by the Company from the Adviser Sub's business warrant the continued ownership of the Adviser Sub, the Company's Board of Directors will take into consideration, among other things, the following: (a) the compensation of the officers of the Company and of the Adviser Sub; (b) all investments by and investment opportunities considered for the Company that relate to any investments by or investment opportunities considered for a client of the Adviser Sub; and (c) the

allocation of expenses associated with the provision of advisory services between the Company and the Adviser Sub.[11]

**V. Conclusion**

Based on the foregoing, we request that the Staff provide assurance that it will not recommend enforcement action to the Commission under Section 12(d)(3) of the 1940 Act against the Company if the Adviser Sub registers as an investment adviser under the Advisers Act.

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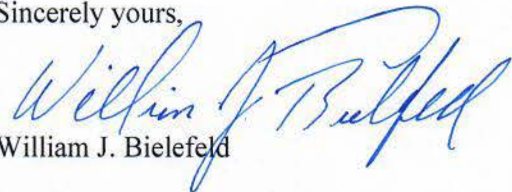
We appreciate your assistance in this matter. Please do not hesitate to call William J. Bielefeld of Dechert LLP at (202) 261-3386 (or by e-mail at william.bielefeld@dechert.com) if you would like to discuss any of the issues posed herein.

Sincerely yours,



William J. Bielefeld

cc: Melanie Grace, Hercules Capital, Inc.
Scott Bluestein, Hercules Capital, Inc.
Jay Alicandri, Dechert LLP

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[11] Such expenses may include: administration and operating expenses; investment research expenses; sales and marketing expenses; office space and general expenses; and direct expenses, including legal and audit fees, directors' fees and taxes.