June 14, 2022

**VIA ELECTRONIC SUBMISSION**

Ms. Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: ***Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (File No. S7-03-22)***

Dear Ms. Countryman:

We appreciate the opportunity to provide our views to the Securities and Exchange Commission on its proposed rulemaking in File No. S7-03-22, and specifically the portions of that proposed rule that seek to limit contractual arrangements between private venture capital funds and their limited partner investors.

We believe that the restrictions the SEC seeks to impose—in addition to being not authorized by the relevant statutes[1]—will dampen the ability of funds to take risks in emerging areas of the economy. This will put venture capital funds' investors at a disadvantage, result in less venture investment flowing to nascent businesses, and ultimately stifle U.S. innovation and economic growth, all for no appreciable gain in investor protection.

**True Ventures' Interest in the Proposed Rule**

Before we discuss the proposed rule, a bit about us. True Ventures, founded in 2006, is a Silicon Valley-based venture capital firm. Since our founding we have raised and advised 11 funds. True invests in the earliest rounds of funding for high growth technology startups in sectors such as enterprise software, connected hardware devices, consumer brands, internet technologies, digital biosciences, and digital assets. True's strategy is to become the first institutional investor in capital-efficient, early-stage companies, managed by exceptional entrepreneurs, that create

[1] Other commenters have covered the legal infirmities in the proposed rule. *See*, *e.g.*, NVCA Comment Letter (Apr. 25, 2022) (hereinafter "NVCA Letter"), available at https://nvca.org/wp-content/uploads/2022/04/NVCA-Comment-on-Private-Fund-Advisers-Proposal.pdf. We support and adopt NVCA's comments, including the legal argument that the relevant sections of Dodd-Frank only authorize the SEC to conduct rulemaking to protect *retail* investors—not sophisticated venture capital investors.

products and services in potentially large, rapidly growing markets. Simply put, we invest behind the bold dreams and vision of America's most talented entrepreneurs.

One of True's three core investment tenets—well known to and encouraged by our funds' investors—is to "maximize risk." Our most recent private placement memorandum spells this out: True's philosophy is to "[e]mbrace early markets and early-stage deal structures that maximize possibility and upside—and constrain downside. [We r]ecognize that failure is part of success while pursuing big ideas." This, when combined with True's other investing theses, has led to enormous success for True-managed venture capital funds over its history. We have funded over 300 companies, including many that have become household names, such as Ring (acquired by Amazon), Fitbit (IPO), Peloton (IPO), Duo Security (acquired by Cisco), Goodreads (acquired by Amazon), Bandcamp (acquired by Epic Games), Hashicorp (IPO), and many others. We estimate that the companies we have funded have created over 40,000 jobs.

A U.S. regulatory regime that discourages risk taking, as the proposed rule certainly would, is sure to profoundly disrupt True's ability, and the ability of all U.S. venture capital firms, to maximize returns for their investors. Consequently, U.S. venture capital will fund fewer innovations that will power U.S. economic growth.

**A Flawed Premise: Venture Capital Investors Require the SEC's Protection**

The proposed rule seeks to justify its intrusion into the contractual relationship between sophisticated parties by stating the following:

> Private funds and their advisers also play an increasingly important role in the lives of everyday Americans saving for retirement or college tuition. Some of the largest groups of private fund investors include state and municipal pension plans, college and university endowments, non-profit organizations, and high net worth individuals.[2]

This statement, while true as far as it goes, omits several material facts. Most notably, it neglects to disclose that the organizations through which "ordinary everyday Americans" are "saving for retirement or college tuition" are generally led by knowledgeable, experienced and savvy Chief Investment Officers and their teams, that they are represented by counsel who specialize in the negotiation of limited partnership agreements, and that venture capital funds vie mightly for their investment. These factors give venture capital investors superior information and significant bargaining power; this is decidedly *not* Mom and Pop vs. Silicon Valley, as the above paragraph

[2] Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 Fed. Reg. 16,886, 16,887 (proposed Mar. 24, 2022) (hereinafter "Private Funds Rule").

implies. These sophisticated investors can (and routinely do) seek changes to limited partnership agreements. If they are not satisfied with the results of those negotiations, they can take their investment dollars to a different adviser's fund.

Given these dynamics, it is difficult to see how the SEC's investor protection mission is satisfied by restricting these parties from making contractual arrangements that they have determined are beneficial—especially when the restrictions are likely to affect venture capital funds' performance for their investors. The SEC should refrain from elevating its judgment over that of market participants.

**Prohibiting Indemnification Will Impede Venture Capital Risk-Taking**

Though we join in the comments made by NVCA,[3] in this letter we focus on two of the activities that the proposed rule seeks to prohibit:

- "[c]harging . . . fees or expenses associated with an examination or investigation of the adviser or its related persons by governmental or regulatory authorities"; and
- "[s]eeking reimbursement, indemnification, exculpation, or limitation of its liability by the private fund or its investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to the private fund."[4]

These prohibitions, if finalized, would upset the carefully-negotiated risk allocation scheme between venture capital funds and their investors, resulting in venture capital funds shying away from the very types of investments that their limited partners want them to make.

This view is borne out in True's own experience. Under our indemnification provision the fund indemnifies the adviser and its associated persons for "any claim, action, proceeding or demand, whether judicial, administrative, investigative or otherwise . . . that arise out of or in any way relate to or are incidental to the Partnership, its properties, business, or affairs (including acting as a director, manager, officer, member or the equivalent of a person any securities of which the Partnership owns or has owned). . . ." The agreement also contains carefully crafted limitations:

> "[T]his indemnity shall not extend to (i) conduct not undertaken in good faith, (ii) any criminal conduct, recklessness, fraud, intentional wrongdoing or gross negligence, in each case directly causing such loss, cost, expense, fine or damage. . . ."

[3] NVCA Letter, *ibid*.

[4] Private Funds Rule at 16,920.

These terms are standard. They mirror what public company directors negotiate for their roles. Importantly, in True's long memory, *no investor* has asked for what the SEC seeks in the proposed rule: to (i) outlaw indemnification for ordinary negligence, and (ii) prevent indemnification for governmental or regulatory examinations or investigations of the adviser. And this is *not* because investors are not paying attention to these provisions, or that they lack the negotiating power to do so.[5] Instead, it is because sophisticated parties have decided that this risk allocation between the adviser and the fund is correct.

And the indemnification that the SEC seeks to prohibit is even more important to venture capital than in other contexts. People who serve as public company directors, for example, often have at least two sources of indemnification before their fund's indemnification kicks in: the portfolio company's directors' and officers' insurance coverage, and the portfolio company's indemnification obligations. For venture capital firms—which invest in the earliest stages of a company's lifecycle, and serve those companies as directors or advisers—those other sources of funding may not exist or may not be robust enough to provide comfort. The indemnification that this rule would bar is, in many cases, the only safety net that allows venture capitalists to take the risks of investing in and advising early-stage companies.

In an industry where investments in unproven (and sometimes seemingly outlandish) ideas often result in the greatest returns, but also create the greatest risk; where in some cases 80% of a venture capital fund's portfolio fails to yield a return (and thereby increases the possibility of conflict), but the 20% that does provides massive value to investors; where founders and venture capital investors (as well as other U.S. regulatory schemes[6]) expect venture capitalists to serve on boards of directors or otherwise advise their portfolio companies, the SEC's proposed rule would make these types of investment downright dangerous.

One additional note: For venture capital funds that invest in digital assets, it is difficult to decouple these proposed prohibitions from the SEC's review of the industry. The SEC has been criticized for pursuing a strategy of "regulation by enforcement" over crypto. That may be somewhat unfair, given the difficulty of regulating a space as fast-moving and varied as crypto. However, the combination of evolving regulatory guidance, increased SEC enforcement,[7] and this proposed ban on adviser indemnification for government investigations, might have the

[5] Investors have requested, and True has agreed to make, other changes to our limited partnership agreement, including changes related to the scope of indemnification.

[6] *See*, *e.g.*, 29 C.F.R. 2510.3-101 (Dept. of Labor's Venture Capital Operating Company ("VCOC") exemption).

[7] *See* "SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit," No. 2022-78, available at https://www.sec.gov/news/press-release/2022-78.

foreseeable consequence of dampening venture capital investment in crypto (as well as in other areas where regulation is uncertain). This would not be a positive development. We believe that having experienced venture capital investors involved in the crypto industry and other nascent fields is a constructive force—tending to increase companies' focus on consumer protection, risk mitigation, legal compliance, and other important public policy goals.

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For these reasons, we request that the SEC remove these provisions from the proposed rule.

Respectfully submitted,

/s/ *Gus P. Coldebella*

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