

Memorandum

To: Rule-comments@sec.gov

From: Philip C. Thompson [REDACTED]

Date: March 8, 2022

RE: SEC Release – File Number 57-03-22

Section II D.4 – Limiting or Eliminating Liability for Adviser Misconduct

Section D. Prohibited Activities

D.4 pp. 150-152

The proposed prohibited activities rule would inter alia prohibit “... limitation of [adviser’s] 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.”

SEC Staff has observed that many limited partnership agreements used for private offerings state that the fund adviser or its related person, which is often the general partner to the fund, to the maximum extent permitted by applicable law, will not be subject to any duties or standards (including fiduciary or similar duties or standards) existing under the Advisers Act, Delaware law, or Cayman Islands law or will not be liable to the fund or investors for breaching its duties (including fiduciary duties) or liabilities (that exist at law or in equity). The prohibited activities rule would specify the types of contractual provisions that would be invalid.

Concurrently there is an analysis and discussion among both academicians and practitioners as to whether or not there has been an “evolutionary erosion” both as to corporate fiduciary duties, as well as fiduciary duties of general partners of limited partnerships (or managers of LLCs) to their investors under state limited partnership or limited liability company statutes. Professor William Clayton is cited in Footnote 173 on p. 151 as questioning the practice of satisfying a general partner or manager’s fiduciary duties under federal law by providing generic and all-encompassing disclosures and for the requirement of investors to indemnify managers for liabilities resulting from an extremely broad range of misconduct including criminal acts by managers.

At the ABA/Business Law Section (BLS) meeting to be held in Atlanta On Thursday, March 31, 2022 there will be a program sponsored by the Private Equity and Venture Capital Committees of the BLS on evolving changes in investment requirements of PE and VC funds, including the status of fiduciary duties. Thus, coincidentally or not, there is a convergence of scrutiny of the fiduciary duties of managers and sponsors of such private equity funds. From my personal experience in representing both managers and sponsors of such private fund offerings as well as “sophisticated” investors in such funds, I concur with Professor Peter Molk cited in footnote 170 that investors in such funds are induced to “sign away fundamental protections” without understanding the legal implications and sometimes – often – without reading the disclosure and subscription documents.

My response to your solicitation for comments contained on page 152 are set forth in red font in all CAPS below.

- We have observed these types of contractual provisions among private fund advisers and their related persons; do advisers to clients other than private funds typically include these types of contractual provisions? **FIDUCIARY DUTIES AND REPONSIBILITES**

ARE TYPICALLY AGREED TO AND CONTRACTUALLY NEGOTIATED BETWEEN PARTIES TO A CONTRACT.

- Are there other types of contractual provisions we should prohibit as contrary to the public interest and the protection of investors? **ALTHOUGH I DON'T ADVOCATE CHANGE, REQUIREMENT FOR PARTIES TO RESOLVE CONFLICTS IN CHANCERY COURT IN DELAWARE IS SIGNIFICANT DETERRENT.**
- Should this aspect of the final prohibited activities rule prohibit limiting liability for “gross negligence,” or would prohibiting limitations of liability for ordinary negligence, as proposed, be more appropriate? Why? **ORDINARY NEGLIGENCE AS GROSS NEGLIGENCE IS TOO HIGH A STANDARD DUE TO REQUIREMENT OF KNOWLEDGE OF FORESEEABLE CONSEQUENCE OF HARM.**
- Should the proposed rule prohibit contractual provisions that limit or purport to waive fiduciary duties and other liabilities in situations where state law permits such waivers? **YES.**
- Do commenters believe that the proposed rule would increase operating expenses for advisers? For example, would the proposed prohibition on receiving indemnification/exculpation for negligence cause an adviser's insurance premium to increase? **UNCERTAIN, BUT D&O INSURANCE WILL NOT INSURE AGAINST FRAUD OR INTENTIONAL WRONGDOINGS.**