

February 19, 2019

Mr. Gregory A. Hook, CPA -Legislative Auditor
Department of Legislative Services
301 West Preston Street
Room 1202
Baltimore, Maryland 21201

Re: February 2019 Audit Report for the Maryland Technology Development Corporation

Dear Mr. Hook:

This letter responds to the final Audit Report (the "Audit") dated February 2019 regarding the Maryland Technology Development Corporation (TEDCO) and follows up on additional issues we addressed in our initial letter to you dated February 4, 2019 ("the Initial Response"), which is attached.

We appreciate the care and cooperation of your staff during the course of the Audit. However, since the Audit's release, we have noted confusion and misunderstanding about the compliance of the Maryland Venture Fund ("MVF") and the Audit's findings. This letter provides additional facts and context about the MVF findings that the Audit and the Initial Response omitted to ensure that the Department of Legislative Services ("DLS") has a complete response from TEDCO and to inform DLS's future work.

As we explain further below, it is important for DLS to understand four foundational facts about TEDCO:

- (1) TEDCO helps create Maryland jobs and growth;
- (2) MVF makes investments that benefit Maryland, carefully due-diligencing companies to ensure the companies will lead to Maryland economic growth;
- (3) MVF's prior Advisory Committee always acted properly; and
- (4) MVF properly supervises the venture funds that receive MVF investments.

I. TEDCO HELPS CREATE MARYLAND JOBS AND GROWTH

At a high level, TEDCO provides investment and technical assistance to early-stage companies and entrepreneurs in Maryland and supports the State's strong research capabilities. Through all of our activities, TEDCO's mission is to enhance economic development and generate returns on investment for funds invested on the State's behalf. TEDCO's programs have supported the development of a large, diverse, and growing portfolio of companies that supports the Maryland economy's growth and diversification, and MVF is one of a number of programs TEDCO administers. The Office of Attorney General signs off on each investment, including reviewing all legal documents and approving outbound wires of funds before closing an investment.

By any measure, TEDCO (including MVF) has delivered successful results both for the State and for people and companies within the State. For example:

- In 2018, not including the MVF (which TEDCO began managing in 2015), our portfolio comprised of 289 companies with 1,934 Maryland jobs. If you include MVF, that number jumps to 326 companies with 3,108 Maryland jobs¹;
- “When multiplier effects are included, the five core TEDCO programs generated a total of \$1.6 billion in Maryland economic activity in 2018, supporting a total of 7,746 jobs earning \$600.1 million in labor income and generating estimated state and local government revenues of \$66.6 million”;²
- With more than \$100 million in assets under management, MVF is invested in 37 active Maryland companies, which have a direct Maryland employment of 1,181 workers and estimated revenues of \$330.7 million³; and
- “Including multiplier effects, [MVF portfolio company and supplier company operations] generate \$607.5 million in economic activity in Maryland, support 2,995 jobs earning \$231.1 million in labor income, and have an associated \$25 million in estimated state and local government revenues.”⁴

II. MVF MAKES INVESTMENTS THAT BENEFIT MARYLAND, CAREFULLY DUE-DILIGENCING COMPANIES TO ENSURE THE COMPANIES WILL LEAD TO MARYLAND JOB AND ECONOMIC GROWTH

As part of the first finding that MVF lacked regulations for MVF's direct investments, the Audit tested 10 direct investments in seven MVF portfolio companies, and it concluded that, for six of these investments (related to four of the seven total companies), “each company's principal place

¹ *The Economic and Fiscal Impacts of TEDCO's Five Core Programs*, University of Baltimore Jacob France Institute and Teconomy Partners LLC, 1 (2018).

² *Id.*

³ *Id.* at 11.

⁴ *Id.*

of business was not in Maryland at the time of the investment or did not remain in Maryland after the investment, as required.” (See Audit, p. 8).

The presentation of this finding is misleading and omits critical facts and context about the four companies and the investments, starting with the fact that each of the companies contributes economically to the state, has some form of operations in the State, and, most importantly, has well-paid employees in the State or who reside in the State.

We identify each company below and provide facts and context to correct the record.

- (1) [REDACTED] The Audit presentation is misleading to the public, suggesting that the two identified investments were improper only because MVF knew the company was moving out of the State or had moved out of it. The record shows, however, that (a) these two investments were essential to protect both the State’s equity and a Maryland payroll of 64 employees exceeding \$5 million annually, and (b) these two investments helped ensure that the State would get priority consideration from the company for expanding operations in Maryland, which is in the future plans of the company.
 - MVF, while under the Department of Commerce, first invested in [REDACTED] in 2010, and the two investments the Audit identified were the fourth and fifth in this company, contrary to the incorrect impression left by the Audit.
 - Investments in 2010, 2011, 2012, and 2016 were made while the company’s headquarters was still in the State.
- (2) [REDACTED]: The Audit presentation is again misleading to the public, suggesting this investment was improper only because [REDACTED] is headquartered in a neighboring state, while not providing additional supporting data relative to its positive impact on economic development in Maryland. For example, the Audit failed to note that [REDACTED] (a) paid \$1.2 million in wages to 91 Maryland-based contractors in 2017 and \$1.5 million in 2018, and (b) committed to establishing a non-home-based sales office in Maryland and is currently doing so in Baltimore.
- (3) [REDACTED] Here too, the Audit presentation is misleading to the public about this investment’s propriety and value to Maryland, solely focusing on [REDACTED] principal place of business. When MVF made the original investment in February 2016, it was to support a three-person business whose president/co-founder resided and worked in Maryland. While the company is adding employees in Missouri, the 2018 follow-on investment was essential to protect the State’s original investment, and the president/co-founder continues to reside and operate the finance and administration functions in Maryland.

- (4) [REDACTED] The Audit faulted MVF solely because [REDACTED] principal place of business is outside Maryland. But, at the time of MVF's seventh and eighth follow-on investments in 2017 and 2018, [REDACTED] had a payroll of 12 scientists in Baltimore with plans for future growth there. MVF, while under the Department of Commerce, first invested in [REDACTED] in 2013 and made additional follow-on investments in 2015 and 2016 when the company's headquarters was still in Maryland. The research and development team continues to remain in Baltimore.

III. MVF'S PRIOR ADVISORY COMMITTEE (THE "AC") ALWAYS ACTED PROPERLY

The Audit identified that the AC did not have a conflict-of-interest policy. This was correct and, had MVF continued with the AC, we would have rectified this immediately. Regrettably, the Audit wrongly suggested that the AC's composition or practice was improper, noting that two of the three members were associated with venture capital firms that had received approximately \$21.3 million in funding through MVF.

The Audit, however, failed to include important facts that allay any concerns raised:

- The two venture firms had been awarded those allocations between 2012 and 2015 by the Department of Commerce, which was then advised by [REDACTED]. The Department of Commerce and [REDACTED] selected the venture firm funds, determined specific investment amounts, and allocated the capital to the venture funds;
- The allocations to the investment funds were made in 2012 and 2015 -- before the fund that became known as MVF transferred to TEDCO;
- The three-member AC was formed in 2016, during the year after the allocations were made, with the approval of the Office of the Attorney General;
- No additional allocations have been made to those venture firms since 2015;
- AC members never had decision-making authority for allocations in either venture firms or direct investments in companies; and
- The management fees for each venture firm, which the Audit found were in line with the state law cap of 2.5 percent of the amount invested in each firm, were negotiated and approved by the Office of the Attorney General and executed by the Department of Commerce.

Moving forward, as previously reported in our Initial Response, TEDCO established in 2018 a new investment committee comprised of current TEDCO board directors to provide investment oversight of the MVF. The members will continue to file yearly financial disclosure and statements and will be subject to TEDCO policies regarding potential conflicts of interest.

IV. MVF PROPERLY SUPERVISES THE VENTURE FUNDS THAT RECEIVE MVF INVESTMENTS

The Audit suggests that MVF somehow acted improperly with respect to a venture firm that had received an allocation of \$10 million from MVF's predecessor fund in 2013 but that had not invested in any Maryland companies and had not invested the full amount. MVF has always acted appropriately with respect to this fund. For example:

- The investment terms in the legal documentation precluded MVF from taking any action until five years had elapsed from the date of the closing of the fund; and
- The waiting period ended on January 31, 2019, as we informed you in our Initial Response. Upon that date, MVF immediately began working with the Office of the Attorney General to evaluate options for legal action to address the shortfall.

I hope that you will update your Audit files with this supplemental response, which is aimed at correcting the record and providing clarification of the findings. As always, if you have any questions, please contact me at (410) 715-4163.

Sincerely,



George Davis

Attachment

Auditor's Comment:

Subsequent to the publication of the February 5, 2019 Maryland Technology Development Corporation (TEDCO) audit report, TEDCO submitted this supplemental document related to the report's findings. TEDCO's formal response to the audit report, which is included as an appendix to the published report, indicated general agreement with the audit findings and recommendations. This supplemental document differs from the original published response in that it now characterizes certain audit findings as "misleading" and omitting "critical facts and context," and further indicates that it is important for DLS to understand four foundational facts about TEDCO. After receipt of this document, we re-examined our related audit work and reaffirmed that our published findings and recommendations are appropriate, clearly presented, and properly supported. Briefly, in response to the four foundational facts presented by TEDCO, we note the following:

- I. we did not report that TEDCO did not help create Maryland jobs and growth;
- II. our conclusion that TEDCO invested in four companies whose principal place of business was not in Maryland at the time of the investment or did not remain in Maryland after the investment, as required by State law, is not refuted by TEDCO;
- III. our report did not state or conclude that the three member advisory committee acted improperly; and
- IV. regarding the supervision of venture funds, our report commented on the insufficiency of certain TEDCO policies and practices to ensure that its monitoring of venture firms was as comprehensive as necessary.

Finally, in accordance with our policy, we have redacted the names of any private companies mentioned by TEDCO in this document.