

Approved 2-4-87
Date

MINUTES OF THE Senate COMMITTEE ON Economic Development

The meeting was called to order by Senator Wint Winter, Jr. at
Chairperson

12:45 ~~xxx~~/p.m. on January 22, 1987 in room 123-S of the Capitol.

All members were present except: Senator Salisbury who was excused.

Committee staff present: Lynne Holt, Research
Arden Ensley, Revisor
Grace Cooper, Secretary

Conferees appearing before the committee:

Ray E. Dillon, III - Kansas Funds Mgt.
Mike Scanlon - Kansas Funds Mgt.
Pat Thompson - Kansas Funds Mgt.
Charles Becker - Campbell Becker Co.
Harold Stones - Kansas Bankers Association

Chairman Winter called the meeting to order at 12:45 p.m.

Senator Winter stated that the Legislative Commission on Economic Development, upon reviewing and approving the Commission's Final Report, requested the drafting and introduction of certain specific Bills. In a meeting yesterday, tentative agreement was reached regarding the split of these Bills between the House and Senate. Since the Commission does not technically have the authority to introduce the Bills, Chairman Winter entertained a motion to authorize this Committee to introduce Bills under the heading of Capital Markets and Taxation -- Bills numbered 10, 11, 12, 13, 14, 15, 16, and 17 -- two of them dealing with Taxation and the rest with Capital Markets.

A motion was made by Senator Burke and seconded by Senator D. Kerr that the Committee authorize the introduction of Bills numbered 10 through 17. There was no discussion or questions and the motion carried.

The purpose of this Committee meeting was to update the progress to date relative to capital funding based on laws passed in the last legislative session. Any clean-up or legislative change requests were being solicited by the Committee.

Vice-Chairman D. Kerr introduced the conferees. The Kansas Funds Management Group, Inc., represented of James C. "Pat" Thompson, Jr., President; Michael Scanlan, Vice President; and Ray E. Dillon, III, Secretary, described their organization and the suggestions for clarifying the law. See Exhibit I.

Harold Stores gave testimony on the Kansas Bankers Association special Task Force on Economic Development and Kansas Venture Capital, Inc. See Exhibit II.

Charles Becker of Campbell-Becker testified that this company was the first venture capital financing company certified in the State of Kansas, and that they have the same tax credit issues as the conferees previously testifying. Senator Kerr asked Mr. Becker whether or not he had any

CONTINUATION SHEET

MINUTES OF THE Senate COMMITTEE ON Economic Development,
room 123-S, Statehouse, at 12:45 ~~xxx~~ p.m. on January 22, 1987

changes to the law to submit, and Mr. Becker replied in the negative.

Chairman Winter thanked the conferees for their testimony and suggested to the Committee that it introduce a Bill addressing revisions to the law.

On motion of Senator Hayden, seconded by Senator Langworthy, the Minutes of the January 15 meeting were accepted with no corrections or additions.

Chairman Winter adjourned the meeting.

Senate Economic Development

Jan. 22, 1987

Guests

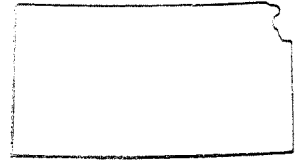
<u>Name</u>	<u>Organization</u>
Dave Ranney	Harris News
Glen Swenson	Ks Board of Agriculture
Kevin Arenal	Ks Assoc for Small Business
M. Hawver	Capital Journal
Pat Thompson	Kansas Funds Management
Ray E. Dillon III	Grey Vins - Hutchinson
Mike Scanlon	

KANSAS FUNDS MANAGEMENT GROUP, INC.

Venture Capital Fund Manager
THE KANSAS CAPITAL DEVELOPMENT FUND

Box 1185 One Compound Drive
Hutchinson, Kansas 67504-1185
Area Code 316-663-1271

Ray E. Dillon III
James H. Galbreath, CFA
Michael J. Scanlan, PhD, CPA
Merle D. Starr
James C. 'Pat' Thompson, Jr.



January 22, 1987

Senate Economic Development Committee

Gentlemen,

We are pleased to provide the following information related to the formation of THE KANSAS CAPITAL DEVELOPMENT FUND, L.P.

We applaud the efforts of the Kansas Legislature to establish an intelligent and comprehensive structure that will encourage economic development in our State of Kansas.

Cordially yours,

KANSAS FUNDS MANAGEMENT GROUP, INC.
James C. "Pat" Thompson, Jr. - President
Michael Scanlan - Vice President
Ray E. Dillon, III - Secretary

ATTACHMENT I
Senate Eco Devo
1/22/87

State of Kansas
Senate Economic Development Committee
Thursday, January 22, 1987

PRESENTATION BY:

Kansas Funds Management Group, Inc.
One Compound Drive
P.O. Box 1185
Hutchinson, Kansas 67502

James C. "Pat" Thompson, Jr., President - Hutchinson, Kansas
Michael J. Scanlan, PhD, Vice President - Denver, Colorado
Ray E. Dillon, III, Secretary - Hutchinson, Kansas

Kansas Funds Management Group, Inc. is the Managing Partner of
THE KANSAS CAPITAL DEVELOPMENT FUND, L.P.

"THE KANSAS CAPITAL DEVELOPMENT FUND L.P." (The Kansas Fund) is being organized as a professionally managed venture capital fund. THE KANSAS FUND, upon formation, will provide a source of funds to smaller businesses in Kansas, and will seek certification from the Kansas Department of Commerce under the guidelines established in the Venture Company Act (Chapter 285) so investors in THE KANSAS FUND will be eligible for Kansas income tax credits. THE KANSAS FUND will invest funds in businesses located in Kansas, or businesses willing to relocate or expand and create jobs in Kansas. A high percentage of THE KANSAS FUND'S investments will be concentrated in the manufacturing sector, as intended under Chapter 285.

THE KANSAS FUND will take an active role with the businesses it invests in including representation on each businesses Board of Directors as necessary.

THE KANSAS FUND began through the association of Ray E. Dillon, III and Michael J. Scanlan, PhD. Mr Dillon attended accounting classes at the University of Denver taught by Mr. Scanlan en route to a Masters in Business, and became interested in the venture capital industry that was beginning in Colorado. Mr. Scanlan's firm, Galbreath Financial Services Corporation, was and is active in the formation and management of The Rockies Fund, Inc., a publicly traded venture capital fund and other venture capital company activities. Galbreath was also selected by the State of Wyoming to develop a state sponsored fund.

During this time there were no private venture capital firms in Kansas, and very limited sources of funds available to Kansas businesses outside the banking industry, particularly to smaller Kansas concerns. Mr. Dillon and Mr. Scanlan felt that a venture capital fund could be successful in Kansas, and with the enactment of the Venture Company Act in 1986, began to take steps to form both a Kansas based management company and venture capital fund.

In October 1986, Mr. James C. "Pat" Thompson, Jr. joined this effort. Mr. Thompson's background included over twelve years with United Missouri Bank of Kansas City's investment department, and seven years as a bank management consultant and chief administrative officer for a group of Kansas bank holding companies located in Hutchinson, Kansas.

The management group that has been formed provides a unique set of abilities and backgrounds that will provide professional management to not only THE KANSAS FUND, but offers portfolio companies, and other Kansas businesses, a new source of advice and counsel. Kansas Funds Management Group, Inc. combines the disciplines of banking, funds management, accounting, securities, investment management, and venture capital fund management in its team of officers and directors.

The development of a management group is the most important - and most expensive - part of the venture capital formation process. Without professional management, both investors and portfolio companies will be subject to extraordinary risk. Assuring compliance with applicable State and Federal security laws, contractual obligations, and high ethical standards requires a commitment from trained and experienced individuals. This is particularly true in Kansas and other states where venture capital funds have not been developed. There is no pool of proven management to draw from.

THE KANSAS FUND will not be formed unless a minimum of \$6,000,000 in capital is raised. Fees adequate to support professional management will be charged to the Fund. Salaries and expenses necessary to adequately supervise the Funds investments, including hands-on time with portfolio companies, will total about \$200,000 annually. Unless the Fund is of adequate size, this level of required management fees becomes excessive.

Once a management team is formed, the development of an offering document is the next step in the process. This document must adequately detail at least the following subjects:

1. The business and purpose of the Venture Capital Fund;
2. Who the managers of the Fund are, their backgrounds, how they are to be compensated, what conflicts of interest may exist;
3. What investor suitability standards apply;
4. What risk factors are present;
5. How the Fund is structured;

6. Compliance with applicable State and Federal security laws and regulations;
7. State and Federal Tax consequences;
8. Glossary of terms
9. Etc., etc., etc.

The preparation of such a document requires a substantial investment, and attorneys with experience and knowledge. The Private Placement Memorandum offering investments in THE KANSAS CAPITAL DEVELOPMENT FUND, L.P. is the third such document that Galbreath Financial has been involved with. The initial document developed for a Colorado based fund required about \$75,000 in attorneys fees. The second document used for a Wyoming fund required another \$45,000. The expenses related to the modification of this documentation for THE KANSAS FUND will total about \$25,000 with a great deal of this expense related to the preparation of a tax opinion dealing with the intent of Chapter 285 related to the 25% tax credit incentives.

After such an exhaustive effort on the part of our attorneys, it is logical that some specific changes to Chapter 285 might be recommended. These are included in the Exhibits attached to this presentation. However, it is also apparent that our Kansas Legislature has done an excellent job of providing specific, workable programs to assist in the economic development efforts needed in Kansas. Galbreath Financial Services, have provided venture capital consulting services in Colorado, Wyoming, North Dakota, South Dakota, Nebraska, and now Kansas. In their opinion, the Kansas Legislature has provided the most integrated, comprehensive economic development package of all these states. They are also impressed with the level of cooperation and understanding evident between the public and private sectors.

Our attorneys have provided specific technical language which they believe will assist the Committee. We also recommend these additional considerations:

1. Allow the tax credit to be assigned to a Kansas tax payer other than the Investor. This will provide an incentive to pension and profit sharing plans, and other funds which pay no Kansas income taxes, to invest in state certified venture capital funds. These types of funds are arguably the largest single source of investment funds available.
2. Allow a tax credit to investors in small, local "Seed Capital Funds." These types of funds are needed at the local level to provide start up ("seed") capital for businesses.
3. Continue to develop incentives to encourage a return of capital to Kansas investments. A great deal of the wealth of Kansas is of course invested in land, factories, and equipment. However, through the years a substantial percentage of cash assets have been institutionalized through estates, pension and profit sharing funds, etc. The professional institutional

managers reinvest these funds in securities and money market instruments. Too often, however, a high percentage of such funds flow out of Kansas. Before significant economic development can occur a return flow of investment capital to Kansas must take place.

The Committees' time and attention is appreciated. We especially want to commend our friend and Senator, Senator David Kerr, for his efforts on behalf of economic development in Kansas.

Respectfully submitted,

KANSAS FUNDS MANAGMENT GROUP, INC.
One Compound Drive
P.O. Box 1185
Hutchinson, Kansas 67502

James C. "Pat" Thompson, Jr.
Michael Scanlan
Ray E. Dillon, III

EXHIBITS

1. Summary of Key Features of the Fund
2. Executive Summary from Memorandum
3. "Proposed legislative changes to Kansas Venture Capital Company Act"

Mr. Timothy P. O'Sullivan
Fleeson, Gooing, Coulson, and Kitch
Wichita, Kansas

KANSAS CAPITAL DEVELOPMENT FUND, L.P.
SUMMARY OF KEY FEATURES

(This summary is limited in its entirety to the Confidential Private Placement Memorandum dated January 2, 1987)

PURPOSE:

Kansas Capital Development Fund L.P. (The Fund) is being organized and capitalized to provide a professionally managed source of funds to be deployed as growth capital for Kansas businesses. As a venture capital fund it is intended that the capital be invested such that it can provide an above average return on investment capital while fostering the key objective of job creation and job maintenance, in the context of the overall economic development program being instituted and conducted throughout Kansas.

INVESTMENT PHILOSOPHY:

The Fund Manager intends to seek portfolio investments which offer opportunities for stability and growth while permitting the Fund to achieve above average returns. It is expected that the Fund will invest in companies that require capital for near term growth; companies that require capital to support leveraged buyouts thus insuring a continuation of successful Kansas businesses; investments which contribute to efforts to obtain new businesses in Kansas; and investments in a limited number of start ups.

TAX INCENTIVE TO INVESTORS:

The State of Kansas has authorized a tax credit against Kansas income taxes in an amount not to exceed 25% of the investment made by an investor. Consequently, the true net investment by an investor could be as low as \$.75 for each dollar invested.

MANAGEMENT:

The Fund will be managed by Kansas Funds Management Group, Inc. (Manager) which is also a general partner in the Fund. Principals of Manager are:

James C. "Pat" Thompson, Jr. - President & Director
Michael J. Scanlan Ph.D, CPA - Executive Vice President,
Secretary, & Director
Ray E. Dillon III - Treasurer & Director
Merle D. Starr - Director
James H. Galbreath, CFA - Director

The principals of the company combine experience in bank management, venture capital management, and funds management with experience in business planning, risk analysis, and business operations such that the processes needed to evaluate, structure and then monitor portfolio investments can be accomplished by a professional management team.

FUND STRUCTURE:

The Fund is organized as a limited partnership which can be capitalized up to a total of \$12,000,000 via a combination of limited partnership interests, participating notes, and general partnership interests. Of the equity capital (partnership interests) the limited partners will provide 99% and the general partners 1%.

The partnership is authorized to issue participating notes in an amount not to exceed \$1 in participating notes for each \$3 of partnership interests.

LIFE OF PARTNERSHIP:

The Partnership is formed with a life of 7 years but with two, one year extensions available to the general partners.

PROFIT/LOSS SHARING:

Income or loss will be shared pro rata by the general and limited partners based on capital contributions (no dilution to limited partners).

MANAGEMENT COMPENSATION:

The Manager will be eligible to earn two forms of compensation for its services.

Annual Management Fee - Manager will be compensated at the maximum annual rate of 2 1/2% of the Net Asset Value of the Fund. The compensation is intended to cover most of the costs of management of the Fund.

Accrued Incentive Fee - Manager will earn an incentive fee equal to 20% of the aggregate net gains on portfolio investments. The incentive fee will be accrued when earned, but will be paid only when aggregate net gains are also distributed to investors, and only after the full return of the investors' invested capital.

COSTS OF FUND RAISING:

The costs to be incurred by the Partnership are limited to 2% of the gross funds raised. Such payment is intended primarily to reimburse Manager for out-of-pocket expenses incurred during the period devoted to formation and fund raising.

DISTRIBUTIONS TO INVESTORS:

As the partnership starts its liquidation process the priority for distributions is as follows:

- 1) Payment of face value of the participating notes.
- 2) Return of initial capital investments to all partners.
- 3) Pro rata to participating notes, partners and manager for any accruals, profits or gains attributed throughout the life of the Partnership.

EXECUTIVE SUMMARY

Introduction

Kansas Capital Development Fund, L.P. ("Kansas Fund" or the "Partnership"), will be formed as a Limited Partnership under the laws of the State of Kansas for the purpose of making investments in privately- and publicly-held businesses which appear to have the potential for growth and appreciation in value.

Kansas Fund is intended to be a venture capital fund eligible for certification by the State of Kansas as a "Certified Kansas Venture Capital Company" as provided by Kansas Laws 1986, Chapter 285. Certification as a Certified Kansas Venture Capital Company provides investors in such a company with certain tax benefits and sets forth certain requirements for the operations and type of investments a certified fund may make. To be eligible for certification, certain minimum requirements exist. Among those requirements are:

1. Information and evidence that the applicant's purpose is to encourage and assist in the creation, development and expansion of Kansas businesses and to provide maximum opportunities for the employment of Kansans.
2. Adequate proof of initial equity capitalization of \$1,500,000. See **EXHIBIT III - KANSAS VENTURE CAPITAL COMPANY ACT**

Kansas Fund will invest primarily in businesses located in Kansas or businesses willing to relocate or expand and create jobs in Kansas. Companies in which Kansas Fund makes and continues to hold an investment are referred to in this Private Placement Memorandum (the "Memorandum") as "Portfolio Companies". Investments will be made in selected start-up, post start-up and later-stage expansion capital opportunities. The dollar weighted emphasis will be on later-stage expansion opportunities that have the potential to add or maintain jobs throughout the State of Kansas.

As a later-stage investor, it could be expected that Kansas Fund will hold debt instruments with warrants or conversion features as a major part of its portfolio. Many of these debt instruments, while perhaps subordinated to other debt, will be collateralized with some of the assets of the investee company. The later-stage philosophy of investment, when coupled with debt instruments as the evidence of the investment, should bring stability to the Partnership's investment portfolio while ensuring an adequate stream of revenue to support the expenses of the Partnership while continuing to add to the Net Asset Value.

Kansas Funds Management Group, Inc., will be the Managing General Partner ("Managing General Partner"). It and two individual General Partners (James C. Thompson, Jr. and Michael J. Scanlan), the Limited Partners and Participating Noteholders will be the Investors (the "Investors") in Kansas Fund. Kansas Fund will have a stated term of approximately seven years, subject to the right of the Managing General Partner to extend the term for two renewal periods not to exceed one year each. The minimum investment per Limited Partner and Participating Noteholder is two units of \$25,000 each (\$50,000); however, Managing General Partner may, in its sole discretion, admit Investors, who are Accredited Investors, with a lesser minimum investment.

The Managing General Partner is a Kansas corporation which was formed in 1986 and the stockholders of which are Galbreath Financial Services Corporation ("GFSC"); Michael J. Scanlan; James C. ("Pat") Thompson, Jr.; Merle D. Starr; and Ray E. Dillon, III. It was organized for the purpose of serving as a venture capital investment management, consulting and financial services company. Manager will contract with Galbreath Financial Services Corporation to provide certain services relating to analysis, review and management of Portfolio Companies. Mr. Scanlan is a principal in GFSC.

The Managing General Partner will establish an office in Hutchinson, Kansas, for Kansas Fund for purposes of evaluating, developing, assisting and monitoring Portfolio Companies. Mr. Thompson will be responsible for day-to-day operation of the office, and will be President of Managing General Partner.

Structure

The Limited Partners, Participating Noteholders and the General Partners will share gains, losses and income, pro rata in the ratio of their respective Committed Capital to the total Committed Capital, except as impacted by the terms for Participating Interest for the Participating Noteholders and Accrued Incentive Fee for the Managing General Partner. Partnership Expenses will be shared pro rata by the Limited Partners and the General Partners.

The Participating Notes will bear interest on the outstanding balance at the fixed rate of 8% per annum payable June 30, 1987 and each December 31 and June 30 thereafter until maturity ("Fixed Interest Expense"). The Participating Noteholders will also receive distributions of Participating Interest from time to time as distributions are made to the General and Limited Partners and in any event upon dissolution of the Partnership or at maturity of the Notes. Participating Interest will be credited to a Participating Interest Account in the defined amounts. See **SUMMARY OF THE PARTNERSHIP AGREEMENT** and **SUMMARY OF PARTICIPATING NOTES**.

Investment by General Partners

The General Partners will make a Capital Contribution to Kansas Fund equal to 1% of the aggregate Capital Contribution Commitments of the Limited Partners and Participating Noteholders to Kansas Fund. See **SUMMARY OF THE PARTNERSHIP AGREEMENT - Initial Capital**.

Subscription Terms

Investments in Kansas Fund are being offered principally by the Managing General Partner to Accredited Investors (as defined in Regulation D of the Securities and Exchange Commission). The Managing General Partner may enlist the assistance of broker-dealers and may share its non-accountable offering expense allowance with them. Each Limited Partner or Participating Noteholder must commit for a minimum of two units of either Limited Partnership Interests or Participating Notes of \$25,000 each (\$50,000), except that the Managing General Partner has the discretion to accept a limited number of Investors with commitments of a lesser amount. In either case, one-half of the commitment must be paid at subscription or by a note to be paid seven days after notice of demand for payment and prior to closing of the organization of Kansas Fund. A second payment in the amount of 50% of the commitment is due no later than the

first anniversary date of Kansas Fund's Partnership effective date. The Managing General Partner may defer the due date for payment of the second installment by up to twelve months by written notice to the Investors. The ratio of investments in Limited Partnership Interests to investments in Participating Notes may not be less than three-to-one (3:1). See **SUBSCRIPTION PROCEDURE** and **SUMMARY OF THE PARTNERSHIP AGREEMENT - Initial Capital**.

Allocation of Partnership Income, Gains, Expenses, and Losses

As described in the Limited Partnership Agreement of Kansas Fund (the "Partnership Agreement"), Net Operating Income or Net Operating Losses will be allocated pro rata to the Capital Accounts of the General and Limited Partners and then, pro rata, to the individual Capital Accounts of each General and Limited Partner in proportion to his percentage interest in Kansas Fund.

Net Gains in excess of any Loss Carryforwards will be allocated pro rata to the Investor Accounts. Net Losses in excess of any Gain Carryforward will be allocated pro rata to the Investor Accounts. The Limited Partners' Capital Accounts will be credited in proportion to their percentage interests in Kansas Fund with Net Gains and Net Losses credited to the Investor Accounts after deduction of the Participating Interest.

The foregoing is a general statement of the allocations that may normally occur over the term of the Partnership. There are further exceptions to these general statements that are applicable in unusual circumstances or at various intervals during the term of the Partnership. (See **SUMMARY OF THE PARTNERSHIP AGREEMENT - Allocation of Income, Gains, Expenses and Losses**.)

Distributions

Distributions may be made at the discretion of the Managing General Partner, but the amount of distributions and the timing of distributions, if any, cannot be predicted. If Kansas Fund's Net Asset Value is less than 125% of the Committed Capital, distributions generally will not be made. If Net Asset Value is 125% or greater of the Committed Capital, the Managing General Partner may choose to make distributions to the extent necessary to provide funds for Limited Partners to pay income taxes of the Partners attributable to each Partner's interest in Kansas Fund. However, no distribution of Accrued Incentive Fees to which the the Managing General Partner will be entitled will be made to the Managing General Partner until the Investors have received distributions equal to 100% of their Capital Contributions; thereafter, distributions may be made to the Accrued Incentive Fee account of the Managing General Partner; and thereafter additional distributions may be made pro rata 80% to the Investors, and 20% to the Managing General Partner as long as the Net Asset Value remains greater than 125% of the Committed Capital after the distributions. (See **SUMMARY OF THE PARTNERSHIP AGREEMENT - Distributions**.)

Annual Management Fee

Kansas Fund will pay to the Managing General Partner an annual Management Fee, payable semi-annually in advance, on the following schedule, with dollar amounts based on Net Asset Value:

- 2.5% on the first \$10 million or less of Net Asset Value,
- 2.35% on the portion of Net Asset Value in excess of \$10 million but less than \$12 million,
- 2.2% on Net Asset Value of \$12 million or more.

In no event will the management fee for the first four full years of Kansas Fund be less than \$200,000 per year (\$100,000 semi-annually).

The first semi-annual payment will be due at the inception of the Partnership and shall be based pro rata from the date of inception to the regular dates of payment - June 30 or December 31, whichever shall apply.

The Managing General Partner will pay the following expenses: fixed and day-to-day operating expenses of Kansas Fund, including office space, management service contract to GFSC, salaries for employees, telephone, personnel, clerical and bookkeeping services; semi-annual accounting statements and reports to Investors; normal communication with Partners and Noteholders; travel between GFSC's Colorado and the Managing General Partner's Kansas offices, except when such travel relates to a Portfolio Company or potential Portfolio Company.

Accrued Incentive Fee

In addition to the annual Management Fee, Kansas Fund will accrue a fee payable to the Managing General Partner based on 20% of the Aggregate Net Gains realized by Kansas Fund ("Accrued Incentive Fee").

On a semi-annual basis, the Accrued Incentive Fee will be increased to reflect an amount equal to 20% of the amount by which Net Gains exceeds Net Losses. In the event in any one semi-annual period Net Loss for the period exceeds Net Gain for that period, the Accrued Incentive Fee will be reduced by 20% of the net difference between Net Loss and Net Gain. In no instance will the Accrued Incentive Fee be less than zero.

Although this fee will be accrued throughout the life of the Fund, no payments will be made to Managing General Partner until all Committed Capital has been returned to the General and Limited Partners and to the Participating Noteholders. (See **SUMMARY OF THE PARTNERSHIP AGREEMENT - Compensation of Managing General Partner** for a more complete description of the process for calculating the Accrued Incentive Fees as well as the timing and method of distribution of the Accrued Incentive Fee.)

Other Expenses

Partnership Expenses to be paid by Kansas Fund and charged against the Capital Accounts of the General and Limited Partners include the following: the Management Fee, the Accrued Incentive Fee, fees for preparation of annual audited financial statements and tax returns, fees for legal services incurred after formation, consulting fees when such fees are part of the review of

potential investments in prospective Portfolio Companies, fees for fidelity bonds and/or errors and omissions insurance for General Partners, a non-accountable expense allowance of 2% of initial Capital Contribution Commitments, travel from the Colorado offices of GFSC and Kansas offices of the Managing General Partner relating to specific investment opportunities and existing Portfolio Companies, as well as all other expenses relating to Portfolio Investments or potential Portfolio Investments. See **GLOSSARY OF TERMS - Partnership Expenses**.

To the extent not paid by the issuer or seller of securities in Portfolio Companies or potential Portfolio Companies, Kansas Fund will bear its own expenses for commissions for brokers, costs of registration of securities and finders fees, as well as premiums for insurance protecting Kansas Fund and the Partners, employees and agents of the General Partners from liabilities to third parties in connection with Kansas Fund affairs, litigation expenses and interest on borrowed money. See **SUMMARY OF THE PARTNERSHIP AGREEMENT - Allocation of Income, Gains, Expenses, and Losses**.

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WAYNE COULSON
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JAMES R. BOYD
OF COUNSEL

January 13, 1987

Senator Dave Kerr
State Capital Building
Topeka, Kansas 66612

Re: Proposed 1987 Legislative Changes to Kansas Venture
Capital Company Act

Dear Dave:

As per my earlier phone conversation with you, please find enclosed proposed changes to the above-referenced law. As I do not have Senate Bill No. 757 as incorporated in the Kansas Statutes Annotated, these suggested changes correspond to the sections of the Kansas Venture Capital Company Act itself.

The first change is found in Section 3, where I have added a definition of the term "cash investment," such term being found in Section 4(a) as a requirement to be eligible for the State income tax credit. I have split this definition into two parts. The first part defines cash investment in terms of equity, and such definition corresponds to the type of equity defined in Section 3(b) required to be made by Kansas venture capital companies in order to meet the investment level requirements under the Act. It is my feeling that a "cash investment" required to be made in an equity investment should not have a different meaning than that required by Kansas venture capital companies in order to meet the investment requirements under the Act. The second part of the definition allows for cash investments in debt instruments, as long as these debt instruments are unsecured, subordinated to general creditors, and require no principal payments other than those required to be paid out of profits for at least a seven year term following commencement of the debt instrument. This additional category was made for two reasons. First of all, the term "investment" is often legally construed to include debt obligations. However, in order to

exclude normal debtor-creditor relationships, and only include those types of cash investments put to some risk of the business enterprise, the additional definitional requirements were made. The type of debt instrument included within the term "cash investment" approximates the point at which such debt instruments would be arguably "securities" entitled to be distributed tax-free along with stock in an incorporation under the Internal Revenue Code.

The next section which is proposed to be revised is Section 4(a), which I feel is the most confusing provision under the Act. I have included three alternative provisions in addressing these ambiguities. In looking at the submitted changes, you will note that the first document includes an alternative "A" and "B" in Section 4(a), while the second document is titled Alternative "C". The first document, with the inclusion of alternative "A", corresponds to my understanding of how the Department of Revenue currently interprets the Act. It allows for a three year carry back of tax credits to the extent that a cash investor is limited by the Tax Liability Limitation, and thus is not able to realize 25% of the credit (Tax Credit Limitation) in any one year. That is, such cash investor can carry back three years the difference between the Tax Credit Limitation and the Tax Liability Limitation for three years in order to hopefully place such cash investor in the same plane as another cash investor who is limited by the Tax Credit Limitation. Alternative "A" thus only allows a limited carry back in such instance. Any remaining unused credit is allowed to be carried over to subsequent years until utilized in full.

The first document, with the incorporation of alternative "B", comports with your understanding (or hoped for interpretation) of the Act. Alternative "B" allows the same three year carry back per the Department of Revenue's interpretation, but additionally would allow any further carry back that did not go back prior to tax year 1986. Thus, to the extent cash investments did not exceed the total allowable State-wide credit in 1986, which has in fact been the case, the carry back of a cash investment in 1987 to tax year 1986 would provide additional incentive for such investments, while not causing the fiscal note for such credits to exceed the \$1.5 million per year which you had indicated to me was the maximum cost per year the State wished to bear in providing this credit. This additional carry back provision is the only substantive change to alternative "A", as alternative "B" also allows any remaining unused credit to be carried over until used in full.

Alternative "C" is my proposed simplification measure. This proposal would eliminate the Tax Liability Limitation, and thus the limited three year carry back provision, while maintaining the other elements of alternative "B". It appears to me that the effect of the Tax Liability Limitation has already been ameliorated by the Act allowing a three year carry back provision. Further, if the Act is truly to provide the same incentive for all investors, irrespective of tax liability levels, there is no need for the Tax Liability Limitation. As the Act would still require a tax liability at least equal to the allowable credit, there is no possibility that the State would be required to issue a refund check equal to the excess of the allowable credit over actual tax liability. Moreover, the elimination of the Tax Liability Limitation, as you will note from the language of alternative "C", greatly simplifies the credit provision. The bottom line here is that a given cash investor would only be limited in taking the allowable credit to his actual tax liability in an applicable year, not 25% thereof, and would be able to carry back any unused credit over the Tax Credit Limitation to prior years commencing in 1986, with any unused credit still remaining to be carried forward until utilized in full.

The next change is in Section 4(b). I feel this submitted language gives the Secretary of the Department of Commerce some direction in the allocation of credits. There is currently a "chicken and egg" problem in the Act. A given investor would not wish to invest in a venture capital company prior to certification, whereas a minimum level of capitalization of \$1.5 million is necessary in order to obtain certification. The language in Section 4(b) is now designed to avoid this problem. It would allow a venture capital company to be certified based upon cash investments yet to be made, provided such cash investments are committed to be made with the only allowable contingency being that of certification. Additionally, as the current Act provides for an applicant to specify the level of "expected capitalization," the Secretary should be given some guidelines as to how expected capitalization is to be certified. In this regard, Section 4(b) allows expected future cash investments to be allocated credit, so long as such cash investments are committed within a 90 day period after certification and the Secretary is notified within 100 days of certification that such expected cash investments have in fact been made. Further, you will note from the language that there is a provision for allocation

Senator Dave Kerr
January 13, 1987
Page 4

of additional credits after certification, but such allocation can only be made as to actual committed cash investments at such time and priority as to such additional cash investments will only be determined as of the time of such later application.

The suggested language to Section 4(d) will eliminate another ambiguity in the Act. By using the phrase "applicable to all taxable years," a question arises whether the tax credit is only available in such years. It is my understanding from talking with the Department of Revenue and you that it was not intended that the credit be limited necessarily to an applicable year. Consequently, I felt it was more appropriate to make the provisions of Section 4 applicable to cash investments made in such years, thereby eliminating this ambiguity. The result would be that any carry back and carry over would be available in any tax year to which such credit was otherwise allowed to be carried back or carried forward, as long as the cash investment was made in a tax year commencing after December 31, 1985, and prior to January 1, 1993.

The final suggested change is in Section 6(a). Although this section is retyped in full, the only change therein is the deletion of the term "capitalization" in the middle of such paragraph, and the substitution of the term "cash investment." This substitution of terms makes the language in Section 6(a) comport with the language in Section 4(a) with respect to qualification for the credit. Otherwise, one is left with the issue of whether a "cash investment" in Section 4(a) is to be limited by the term "capitalization" in Section 6(a). This creates an additional ambiguity, particularly as the term "capitalization," like the term "investment," can lead to a variety of legal interpretations. This ambiguity is eliminated by conforming terms and defining "cash investment" in Section 3.

I have no pride of authorship with respect to the language necessary to accomplish the foregoing results, as I am aware the Revisor of Statutes Office may need to alter the language and/or structure in order to comport with its own format. However, if such changes become necessary, please ensure that the new language addresses the above substantive issues. As much as possible, these changes should be "technical corrections" and retroactive.

Senator Dave Kerr
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Thank you for your cooperation and willingness to support
legislation to correct the current ambiguities in the Act.

Sincerely,

FLEESON, GOOING, COULSON & KITCH

By 
Timothy P. O'Sullivan

TPO/rl
Enclosures

CHAPTER 285

Sec. 3. (a) "Cash investment" means money or its equivalent in consideration for

(1) an equity interest, such as a general or limited partnership interest, common or preferred stock with or without voting rights and without regard to seniority position, forms of subordinate or convertible debt, or both, with warrants or other means of equity conversion attached; or

(2) a debt instrument, such as a note or debenture, which is unsecured, subordinated to the general creditors of the debtor, and requires no payments of principal (other than principal payments required to be made out of any future profits of such debtor) for at least a seven year period after commencement of its term.

Sec. 4. (a) There shall be allowed as a credit against the tax imposed by the Kansas income tax act on the Kansas taxable income of a taxpayer for a cash investment in a certified Kansas venture capital company in an amount equal to 25% of such taxpayer's cash investment in any such company ["Total Credit"]. In any one taxable year, the amount of Total Credit allowable for deduction from the taxpayer's tax liability shall be limited to the lesser of 25% of such total credit ["Total Credit Limitation"], and 25% of the taxpayer's tax liability in such year ["Tax Liability Limitation"]. ("A" or "B")

"A" Subject to the foregoing limitations in any one taxable year:

(1) such credit is allowable in the taxable year in which such cash investment is made;

(2) unused Total Credit may be carried over to subsequent taxable years after such cash investment year until the Total Credit is used in full; and

(3) to the extent the otherwise allowable credit is limited by the Tax Liability Limitation in any taxable year, the difference between the Total Credit Limitation and the Tax Liability Limitation in such taxable year may be carried back three taxable years (to be applied to the earliest such carry back year first).

"B" Subject to the foregoing limitations in any one taxable year:

(1) such credit is allowable in the taxable year in which such cash investment is made;

(2) to the extent the otherwise allowable credit is limited by Tax Liability Limitation in any taxable year, the difference between the Tax Credit Limitation and the Tax Liability Limitation in such taxable year may be carried back three taxable years (to be applied to the earliest such carry back year first);

(3) after application of subsection (2) above, any remaining unused Total Credit may be carried back to taxable years commencing after December 31, 1985 (to be applied to the earliest such carry back year first); and

(4) after application of subsections (2) and (3) above, any remaining unused Total Credit may be carried over to subsequent taxable years until such Total Credit is used in full.

(b) The secretary of revenue shall allow credits that are attributable to not more than \$24,000,000 of cash investments in certified Kansas venture capital companies, which shall include not more than \$10,000,000 for Kansas Venture Capital, Inc. The credits shall be allocated by the secretary for cash investments in certified Kansas venture capital companies in the order that completed applications for designation as Kansas venture capital companies are received by the secretary. Allocations by the secretary of such credit shall be made based upon committed future cash investments, including those contingent solely upon certification, as well as uncommitted cash investments expected to be committed or made within ninety days of certification. Any such expected uncommitted cash investments which are not in fact made or committed within such ninety day period and with respect to which the certified Kansas venture capital company has not so demonstrated to the secretary in writing to have been made within 100 days of certification, shall forfeit their allocation of such credit. Any certified Kansas venture capital company may apply to the secretary at any time for additional allocation of such credit based upon then committed cash investments, but priority as to such additional allocation shall be determined at the time of such subsequent application. Notwithstanding the provisions of subsection (c), investors in Kansas venture capital companies established after July 1, 1984, which otherwise meet the requirements specified in this act, shall be, upon certification of the Kansas venture capital company, entitled to the tax credit provided in subsection (a) in the calendar year in which the investment was made.

(d) The provisions of this section shall be applicable to cash investments made in any taxable year commencing after December 31, 1985, and prior to January 1, 1993.

Sec. 6. (a) The secretary shall promulgate rules and regulations for making an application for certification of a Kansas venture capital company and shall specify the information that must be submitted at the time of application. No Kansas

venture capital company shall be certified until the secretary has adopted rules and regulations as required in section 5. A company seeking to be certified as a Kansas venture capital company must specify the level of cash investment that the company expects to qualify for the tax credits provided for in this act. The application must show that the applicant's purpose is to encourage and assist in the creation, development and expansion of Kansas businesses and to provide maximum opportunities for the employment of Kansans by making venture capital available to Kansas businesses as described and defined in section 3.

CHAPTER 285

Alternative "C"

Sec. 4. (a) There shall be allowed as a credit against the tax imposed by the Kansas income tax act on the Kansas taxable income of a taxpayer for a cash investment in a certified Kansas venture capital company in an amount equal to 25% of such taxpayer's cash investment in any such company ["Total Credit"]. In any one taxable year, the amount of Total Credit allowable for deduction from the taxpayer's tax liability shall be limited to 25% of such Total Credit. Subject to the foregoing limitation in any one taxable year:

(1) such credit is allowable in the taxable year in which such cash investment is made;

(2) any remaining unused Total Credit may be carried back to taxable years commencing after December 31, 1985 (to be applied to the earliest such carry back year first); and

(3) after application of subsection (2) above, any remaining unused Total Credit may be carried over to subsequent taxable years until such Total Credit is used in full.

A PRESENTATION TO

THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

FROM

THE KANSAS BANKERS ASSOCIATION

JANUARY 22, 1986

EXHIBIT II
Senate Eco Devo
1/22/87

TESTIMONY FROM THE KANSAS BANKERS ASSOCIATION TO THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

Economic development is the Kansas Bankers Association's Number One Priority. Eighteen months ago, then-President Deryl Schuster asked Overland Park banker, Ben Craig, to head up a special Task Force on Economic Development. Ag bankers told us this was one of their highest-priority needs at the outset of this disinflation cycle.

1. The KBA Task Force on Economic Development invited key players in Kansas, including, Gov. John Carlin, legislative leaders, Consultant Belden Daniels, KU and KSU economists, KDED officials, SBA officials, Community Development Company officials, Small Business Development Center officials, and other trade groups to meet with us, and attempt to develop a coordinated approach to stabilize and rebuild our Kansas communities.
2. The idea for Kansas Venture Capital, Inc. was born jointly by many of the key groups in Kansas. The majority share of credit deserves to reside in our forward-thinking legislative leaders for such an innovative, creative public-private partnership.
3. This resulted in the passage of Senate Bill 756 by the 1986 Legislature. KBA strongly supported all nine economic development initiatives during the 1986 Session, But SB 756 was our main focus.
 - a. S. B. 756 proposed for \$10 million to be raised from the private sector in common stock. In turn, the state would invest \$10 million in preferred, non-voting stock. This \$20 million capital could then be leveraged through the SBA, to create a pool of venture capital unmatched in the history of this state.
4. Kansas Venture Capital, Inc., is designed to supply \$50

million in venture capital to retain and create a jobs base in our state. The purpose of this corporation is outlined in the bill to : ". . . lead to further growth, diversification and improvement of the Kansas economy *in all geographic regions* in a diversified range of primary sectors concerned with products, processes and services that create jobs, wealth and income for the benefit of Kansas and Kansans *especially in nonmetropolitan areas of the state.*" (emphasis added.)

5. The KBA has invested considerable time and money meeting and working with with the Small Business Administration, Securities and Exchange Commission, and numerous agencies and officials at both the state and national level in order to get this enterprise up and operating as soon as possible. We are pleased to report positive results.

a. SBA has given our concept the green light to proceed as a Small Business Investment Co., which will allow our private stock to be leveraged on a 3-1 basis.

b. SEC has extended an "exemption from registration" letter to allow us to now actively solicit common stock from the private sector.

c. We have explained this program, with careful restraint because of SEC limitations, to some 300 Kansas banks.

Over 200 of them have now signed voluntary, non-binding "Expressions of Support" which will total some \$7.5 million in common stock. Early in 1987, all Kansas banks will be solicited by KVCI urging that each bank subscribe .65% of their capital, surplus and undivided profits in this corporation. We are optimistic that the \$10 million will be a reality at the end of this offering. If not, we will solicit other Kansas financial institutions and corporations.

6. This is an aggressive effort to restore health back to as many Kansas communities as possible. We must create a jobs

base in these communities if they are to survive. Non-farm jobs for those who may leave farming, and off-farm income for some of those who remain are not considered to be a magic or all-encompassing solution to our agricultural problems, but it is one very positive action for our future. And this is something the Kansas Bankers Assn. is proud to help bring about.

1/1/87

Unemployment falls in Topeka

Unemployment falls in Topeka, across Kansas

By ROGER MYERS
Capital-Journal Statehouse writer

Statewide in November, 1.17 million people were employed in November and 66,653 were not.

Although the unemployment picture brightened somewhat during November, it did not match that of November 1985, when the jobless rate was 4.8 percent.

The department said that manufacturing in Kansas had lost 2,400 jobs during 1986 and that there were employment losses in machinery manufacturing and food products.

Ketchum said that although employment statisticians were not alarmed about the employment rate in Kansas during the year, they did not see a growth pattern in employment.

"Generally the state is lagging behind last year in employment," she

said. "It's about the same as the state's generally sluggish economy."

That sluggish economy has led to a shortfall in collection of state revenues and has led Gov.-elect Mike Hayden to impose a 3.8 percent cut in state agency spending through the remainder of this fiscal year.

The oil and gas industry has been the hardest-hit sector of the Kansas economy in 1986, losing 4,700 jobs during the year.

In Lawrence, the unemployment rate fell to 3.3 percent during November, compared with 3.5 percent in October.

In Wichita, the unemployment rate was 5.9 percent in November, compared with 6.3 percent in October.

Jewell County, which lost a food products manufacturing employer in November, had the highest unemployment rate in the state last month. The jobless rate there was 12.8 percent in November, compared with 6.1 percent in October.

Clay County, which suffered layoffs in manufacturing, had an unemployment rate of 8.3 percent in November, compared with 5.9 percent in October.

SUMMARY OF SENATE BILL 756

Passed in the 1986 Kansas Legislative Session
effective on May 22, 1986

Section 1 states the purpose of the act is to create a statewide risk capital system (Kansas Venture Capital, Inc.), to invest \$10 million of state funds, to create "further growth, diversification and improvement of the Kansas economy in all geographic regions . . . concerned with products, processes and services that create jobs, wealth and income for the benefit of Kansas and Kansans especially in nonmetropolitan areas of the state."

Section 2 defines various technical terms.

Section 3 outlines the requirements for the Secretary of Commerce to authorize the Pooled Money Investment Board to invest \$10 million in non-voting, preferred stock. The following conditions must be met:

A. Banks, S&I's, individuals, corporations or "other entities" must have invested \$10 million in new, common stock in KVCI.

B. The preferred stock must receive the same rate of dividend and capital appreciation as common stock.

C. Every share of preferred stock is to be repaid before any common stock. In the event of "capital impairment" which compromises the ability of KVCI to repay fully the \$10 million preferred stock, the Pooled Money Investment Board has power to convert its shares to voting stock to protect its investment.

D. Common stock investment must meet the terms of SB 757, the Kansas Venture Capital Co. Act.

E. Common and preferred stock investments must not compromise KVCI's Small Business Investment Co. license.

F. KVCI may invest in other Kansas venture capital companies located in Kansas, which meet requirements under SB 757. Such investments are not subject to tax credits.

G. Fifteen board of directors are to be elected by common stockholders, as follows:

1. Eight are from Kansas financial institutions, representing a reasonable balance of the common stock investments.

2. Two are venture capitalists or investment counselors

familiar with types of investmets in which KVCI will invest its funds.

3. Five are from the business sectors of special importance to the KS economy in which KVCI shall be expected to invest its funds.

H. The board has conducted a national search, and has seected a president for KVCI who meets "a national standard of experience, ability and initiative for similar chief executive positions for venture capital corporations investing high risk equity in firms which meet the purpose of this act."

Section 4 requires KVCI to prepare an annual report for the governor, legislative committees on economic development, Kansas, Inc., and the public, accounting for:

- A. Manner in which the purpose of the Act has been carried out;
- B. Total investments made in KS businesses;
- C. An estimate of jobs created and jobs preserved;
- D. An estimate of the multiplier effect on the KS economy.
- E. An analysis of resource targeting by size, sector and location of enterprises .

Section 5 excludes KVCI common stock dividends from state privilege tax for life insurance companies.

Section 6 excludes KVCI common stock dividends from state privilege tax for domestic fire and casualty insurance companies.

Section 7 excludes KVCI common stock dividends from state privilege tax for banks and s&ls.

Section 8 authorizes the Pooled Money Investment Board to invest, subject to Section 3, up to \$10 million in preferred stock in KVCI.

Section 9 increases a state bank's authority to own stock in one or more small business investment companies from 3% to 5% of capital and surplus.

Section 10 allows banks, s&l's and insurance companies a tax credit

*amended by
House Finance
Committee
1-22-87*

on the Kansas privilege tax equal to 25% of common stock investment, with no more than 25% of ~~such~~^{some} credit to be taken in any one tax year. Credit may be carried back three years or forward until total credit is used. Applicable to investments made in all tax years commencing after December 31, 1985 and before January 1, 1993.

Section 11 allows the same investment tax credit to state income taxpayers (individuals and corporations) on the same terms and conditions as found in Section 10.

Section 12 sets a limit of \$10 million investment subject to such income and privilege tax credits.

Section 13 excludes dividends from KVCI from individual income tax for tax years commencing after December 31, 1986.

Section 14 excludes the state from liability for any damages to any investor in KVCI.

Section 15 subjects KVCI to an audit by the Legislative Division of Post Audit.

Section 16 exempts the offer or sale of a security, issued by KVCI, or its successors from the Kansas Securities Commission requirements, except those statutes dealing with fraud.

Section 17 severs any section found unconstitutional from the remainder of the act.

Section 18 is a repealer section.

Section 19 states effective date.

COMPARISON OF BANK AND S and L 5 YEAR GROWTH

1981 LIST OF LARGEST TEN FINANCIAL INSTITUTIONS IN KANSAS				
INSTITUTION	ASSETS IN \$000	TYPE		
Topeka, Capitol Federal	1,428,538	S&L		
WICHITA, FOURTH NTL	861,143	BANK		
WICHITA, FIRST NTL	467,636	BANK		
Kansas City, Anchor	420,667	S&L		
Wichita, Mid Kansas	353,235	S&L		
Wichita, American Savings	332,964	S&L		
TOPEKA, FIRST NTL	325,280	BANK		
KANSAS CITY, COMMERCIAL NT	285,638	BANK		
Newton, Railroad	268,369	S&L		
TOPEKA, MERCHANTS NTL	248,287	BANK		
5 of top ten are Banks, 5 are S & L's				

1986 LIST OF LARGEST TEN FINANCIAL INSTITUTIONS IN KANSAS				
INSTITUTION	ASSETS IN \$000	TYPE	% 5-YEAR GROWTH	OUT-OF-CITY BRANCHES
Ottawa, Franklin Savings	3,481,398	S&L	1744%	8
Topeka, Capitol Federal Savings	2,483,192	S&L	74%	15
Salina, Peoples Heritage	1,489,966	S&L	1173%	17
WICHITA, BANK IV	1,424,108	BANK	65%	0
Wichita, Mid Kansas	870,464	S&L	146%	8
Kansas City, Anchor	838,228	S&L	99%	17
Wichita, American	734,647	S&L	121%	18
WICHITA, FIRST NTL	704,035	BANK	51%	0
Emporia, Columbia	474,230	S&L	420%	11
KANSAS CITY, SECURITY BANK	469,277	BANK	101%	0
3 of top 10 are Banks; 7 are S & L's				