

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT.

The meeting was called to order by Chairman William G. Mason at 3:35 p.m. on January 27, 2000 in Room 522-S of the Capitol.

All members were present except: Representative Bonnie Sharp - E
Representative Galen Weiland - E

Committee staff present: April Holman, Legislative Research Department
Bob Nugent, Revisor of Statutes
Lynne Holt, Legislative Research Department
Rose Marie Glatt, Committee Secretary

Conferees appearing before the committee: Charles Ranson, President, Kansas, Inc.
Larry Williams, Halstead Bank & Private Sector Co-Chair
Janet Gardner, Communications Workers, Local 6407
Mitch Woolery, Partner, Polsonelli, White, Vardeman & Shalton
David Frankland, Pres/CEO, Digital Archeology of Lenexa
John Fowler, President, Kansas Chamber of Commerce & Industry.
Phil Thomas, Growth Capital Alliance & Advantage Capital

Others attending: See Attached List

Representative Kuether moved, seconded by Representative Vickrey that the minutes from the January 20 meeting be approved. The motion carried.

Chairman Mason directed the committee's attention to the Joint Committee on Economic Development Report on the background of **SB 315**, heard during the interim committee session(Attachment 1).

He opened the hearing on **HB 2688**, an act on Venture Capital.

Charles Ranson, President, Kansas, Inc. reviewed the history of venture capital in Kansas. He referred to the *Best Practices Study of State-Sponsored Seed and Venture Capital* (Research Report, dated December 1998, on file at Kansas, Inc.). That report formed the basis for a discussion of the needs of entrepreneurial businesses in the state.

Mr. Ranson presented an overview on **HB 2688**, outlining the intent of the bill, which included facts about seed capital in Kansas, lost opportunities, future development of Capcos, oversight and administration of the program and timeliness of the bill. In addition he provided supplemental information on (a) key points, (b) missed opportunities and (c) commonly asked questions on the bill (Attachment 2). He answered questions on: limitations and definitions of companies allowed to invest in Capcos and value added agricultural products.

The Chairman asked Bob Nugent, Revisor of Statutes, to explain the agriculture limitations language. Lynne Holt, Legislative Research Department called the committee's attention to the Joint Committee on Economic Development report, page 6, last paragraph, which recommends *that the introduced version of the bill would allow CapCos to invest in businesses engaged in traditional agricultural endeavors, assuming those businesses meet other specified conditions.*

Discussion followed regarding the importance of inclusion of agricultural value added products/companies in the program, criteria required for Capco investments, quality Capco managers and the financial cost of program.

Larry Williams, President, Halstead Bank spoke as a member of the Kansas, Inc. Board of Directors, stating that they support the policies and mechanisms incorporated in **HB 2688** and believe that the bill is an essential element of Kansas' future economic strength (Attachment 3).

Janet Gardner, Kansas, Inc. Board Member and President of Local 6407 Communication Workers of America spoke in support of the bill stating that Kansas must focus on creating adequate seed and venture capital resulting in new and higher paying jobs for today's and tomorrow's workers (Attachment 4).

Mitchell Woolery, Partner, Polsonelli, White, Vardeman & Shalton, testified on his own behalf and not as a representative of the Firm or any of its clients. He reviewed the securities laws and the types of persons who are eligible to invest in Capco's as outlined in a general overview of regulation and specific types of exemptions (Attachment 5). Discussion followed regarding the success of venture capital projects in Colorado.

David Frankland, President, Digital Archaeology spoke about his companies need for venture capital, which was secured through a Capco Program in Missouri, resulting in the company's relocation to that state. He stated that unless the Legislature acts now to provide venture seed capital, there will be an exodus of companies that together have the potential to revolutionize the economy of Kansas and prepare it to compete successfully in the 21st Century (Attachment 6). Chairman Mason congratulated him on the success of his company and thanked him for his testimony and support for venture capital legislation.

John Fowler, President, KCCI spoke in support of **HB 2688**. The Chamber of Commerce believes the state's commitment to improving venture capital opportunities can be the difference in a vision becoming reality in Kansas, a viable enterprise leaving Kansas for another state, or never being more than a vision (Attachment 7).

Phil Thomas, an attorney in private practice, representing over 12 existing Capcos on a nationwide basis presented an overview on Certified Capital Companies including the history, mechanics, typical investment schedules and key differences between CAPCO and **HB 2866**. He presented his conclusions as well as data pertaining to Capco experience in five states, Louisiana, Missouri, New York, Wisconsin and Florida (Attachment 8). Discussion followed regarding the size of qualified business, the inclusion of a variety of investors and the time frame of fund raising.

Chairman Mason closed the hearing on **HB 2688**. He recommended that those committee members with questions, suggestions or changes, concerning the bill, contact, Charles Ranson and the revisor.

Discussion followed about the Louisiana Law. Mr. Nugent has a copy of that law in his office for those interested..

The next meeting is Tuesday, February 1.

Chairman Mason adjourned the meeting at 5:30 p.m.

**HOUSE ECONOMIC DEVELOPMENT COMMITTEE
COMMITTEE GUEST LIST**

DATE: January 27, 2000

NAME	REPRESENTING
Susan Swan	KDOT + H
Charles T. Zimson	KS INC.
DAVID FRANKLAND	DIGITAL ARCHAEOLOGY
Larry K. Williams	KS INC.
Janet Gardner	K2 INC
Mike Miller	Kansas Inc.
Bill Denny	KS Government Consultancy
Phil Thomas	GROWTH CAPITAL ALLIANCE
Bob Corant	KCCI
Reger Traudle	KGS
Kevin Carr	KTEC
James J. Sproesser	KDOT + H
Allen Kattus	KANSAS, Inc.
John Fowler	KCCI
Mitch Woolery	self (atty in private practice)

JOINT COMMITTEE ON ECONOMIC DEVELOPMENT

KANSAS CERTIFIED CAPITAL COMPANY ACT (SB 315)

CONCLUSIONS AND RECOMMENDATIONS

The Joint Committee on Economic Development recommends a proposed substitute version of SB 315 be referred favorably to the Senate Commerce Committee for its consideration.

BACKGROUND

Legislation Which is the Subject of Joint Committee Review. The Joint Committee on Economic Development reviewed a proposed Substitute for SB 315. The substitute bill would enact the Kansas Certified Capital Company Act. The purpose of the Act is to make seed capital more available in Kansas and to promote development of intermediate and later stage venture capital resources. The bill authorizes the establishment in Kansas of certified capital companies (referred to in the bill as CapCos), which are for-profit, privately managed, privately funded investment companies. CapCos would invest in qualified Kansas businesses that meet certain criteria set forth in the bill. Among other conditions, businesses would lack ability to obtain conventional financing for further development and future operations; would have been in existence for five years or less; and would not have realized revenues of more than \$1 million. To encourage investments in CapCos, the bill authorizes tax credits equal to 100 percent to be used against individual income tax, corporate income tax, premium tax, or privilege tax or fees. Based on the criteria of an "accredited investor" developed by the U.S. Securities and Exchange

Commission (SEC), an investor must have a net worth of \$1 million. If lacking sufficient Kansas tax liability, an investor may claim a refund. Kansas taxpayers not subject to Kansas income, privilege, or premium taxes may sell the tax credits to a taxpayer with Kansas tax liability. Total tax credits are capped at \$50 million, but no more than \$5 million of that amount may be claimed each fiscal year. The state also is authorized to receive 10 percent of a CapCo's profits. Finally, the bill includes provisions for regulatory oversight and accountability.

Kansas, Inc.'s Study. SB 315 is largely a work product of Kansas, Inc.—the state's economic development strategic planning organization. The introduced version of the bill had its origin in a best practices study the Board of Kansas Inc. directed its staff to conduct. Work on the study culminated with a report *Best Practices of State Sponsored Seed and Venture Capital Programs and Alternatives to Direct State Funding* (December 1998). This report was prepared by Economic Innovation International, Inc., with guidance from Kansas, Inc. staff and from a 20-member technical advisory committee appointed by Kansas, Inc. This report identifies various alternatives to direct public funding of seed and venture

capital, including the CapCo concept found in laws of Louisiana, Missouri, Wisconsin, Florida, and New York and applied to insurance companies. After considering the funding models outlined in the report, the Kansas, Inc. Board of Directors asked the staff to consider the CapCo concept in developing proposed legislation to be introduced during the 1999 Legislature.

Legislative Action Prior to Interim Study. SB 315 was referred to the Senate Commerce Committee which had hearings on the bill rather late in the 1999 Session. The Chairman of the Senate Commerce Committee requested the Legislative Coordinating Council refer the bill to the Joint Committee for further review and amendments. She attributed the reasons for that request to the complexity of the bill and the lack of remaining time during the 1999 Session to adequately address Committee members' questions and concerns. In the course of the Senate Committee's hearing and deliberations on the introduced version of SB 315, several questions were raised. Overarching policy questions included the need for seed capital and this legislation. Implementation questions focused on: the nature of the tax credits which may be claimed; who may receive the tax credits; who may make investment decisions; the types of companies in which the CapCos may invest; the criteria governing the companies receiving those investments; and the optimal method of assessing program costs and benefits to the state. At the hearing, several conferees and staff presented amendments to the bill. These amendments, coupled with others, were subsequently incorporated by Kansas, Inc. staff into a proposed substitute bill for the Joint Committee's consideration.

COMMITTEE ACTIVITIES

The Joint Committee on Economic Development devoted a large portion of its November meeting to consideration of SB 315. The Committee heard presentations on the market need for seed capital in Kansas, received an explanation by Kansas, Inc. staff of a proposed substitute bill for SB 315, and discussed and made recommendations on the proposed substitute bill.

Market Need for Seed Capital. The Committee heard from the following conferees: Charles Ranson, President, Kansas, Inc.; Harold Stones, the Kansas Special Director for U.S. Senator Pat Roberts; Bob Rosander, President, NANTEK (Manhattan); and Ralph Lagergren, President, Rimfire Corporation and inventor of the Bi-Rotor Combine (Winfield). Mr. Ranson read written testimony submitted by David Frankland, President and Chief Executive Officer, Digital Archeology (Lenexa).

Mr. Ranson explained that the United States is losing its competitive edge with respect to innovation (the United States is projected to slip to sixth place in 2005 from third place in 1999 and first place in 1995 in terms of investments in long-term innovative capacity). On a more local level, Kansas' economic future is at risk. Mr. Ranson cited examples of various corporate headquarters which have left or are planning to move from Kansas and the region, and the impact of past or planned relocation activities on the state's economy and image. He observed that Kansas needed to build on its strengths and shore up its weaknesses, such as the paucity in seed capital. The proposed legislation, together with other proposals, should help reverse the state's image problem. Mr. Ranson had four observations about seed capital in Kansas:

- Seed capital is essential to the develop-

ment of high-growth early stage companies.

- Seed capital needs cannot be met by banks and other traditional institutions.
- Seed capital does not flow far from its source. Therefore, Kansas companies must leave to access essential seed capital.
- Seed capital is virtually nonexistent in Kansas.

The other conferees supported the need for seed capital. Their presentations cited examples of businesses that either face pressure to relocate or have relocated:

- Knowledge Communication produces software that creates simulation-learning models. The company received seed capital moneys from Ad Astra but could only secure follow-on moneys in Dallas and agreed to relocate the company's marketing group to Dallas in exchange for \$1.5 million from a Dallas investment group.
- Digital Archeology develops and markets software that enables companies to identify, maintain, and improve customer relationships across e-commerce and traditional distribution channels for purposes of marketing analyses. The company raised \$8.5 million in the Midwest and currently has 50 employees. The company's president wants to add another 50 employees within the next year but fears that funding presently accessible only from outside the region will impose conditions that could result in relocation.
- NANTEK, Inc., a spin-off of Kansas State University, is an advanced materials

company founded in 1995 to develop and commercialize reactive nanoparticles and other related technologies. Nanoparticles are extremely small particles of matter having extraordinary physical and chemical properties that could be used for military applications, such as the safe and efficient destruction of chemical weapon stockpiles and protective systems against chemical weapon stockpiles. Potential civilian applications include decontamination foggers and kits for industrial and laboratory accidents and acid gas scrubbing for industrial emissions. However, NANTEK lacks the capital to grow rapidly and a competitor in Chicago just raised \$30 million. The President of NANTEK would like to keep the company in Kansas.

- Rimfire Management Corporation helps Kansas inventors and creators develop concepts into products, market those products, and create jobs in Kansas. Rimfire is currently working with three start-up companies: a manufacturer of an automated interior finishing system that will blow acoustic-enhancing material on ceilings and plaster on drywall, a manufacturer of a pivotal finger retainer for pens, and a producer of a video series *Four Fish Fly Free* aimed at teaching musical concepts to children. Rimfire encounters problems with finding money in Kansas to follow initial seed investments.

Federal, State, and Contractual Oversight of CapCos. The Committee invited P. Mitchell Woolery, Attorney, Polsinelli, White, Vardeman and Shalton, to explain and respond to questions about government and contractual oversight of CapCos. Mr. Woolery noted that he has spent 12 years practicing in the area of corporate finance and security laws. His law firm represents a

wide variety of companies that are seeking capital, as well as companies, such as Kansas Venture Capital, Inc., that are seeking to make investments. Mr. Woolery noted that he was representing himself and not a client in appearing before the Committee in support of the proposed bill. He stressed that seed capital investments are hard to secure. If companies do not get investors, they tend to leave the state. He cited as an example a client who wanted to create 30-40 jobs in Kansas but was unable to raise seed capital in Kansas and raised it immediately in Colorado. A summary of Mr. Woolery's main points follows:

- **Federal Oversight.** Both federal and state securities laws set the outside limit as to what can and cannot be done and who can and cannot make particular investments. Federal oversight of CapCos comes from the Securities Act of 1933, which establishes the types of investors who can invest in a CapCo, as well as other federal securities laws. Any CapCo investment contemplated in SB 315 would generally be exempt from registering with the SEC because the dollars and participants involved are sufficiently small that such an investment would not be a public offering. Instead, it would be a private placement, generally to high net worth sophisticated investors. If an investment is exempt, the CapCo making the investment is not required to file anything about that investment with the SEC (other than possibly a one-page notice of investment.) With respect to federal tax law, the application with the proposed bill is that most of the investments will be made for people who are seeking to pass through tax treatment so that taxation is not imposed at the fund level but rather at the individual investor's level. By definition, the Internal Revenue Service has a "safe harbor" that there be less than 100 investors in a particular fund. As a practical matter, that number may be, and probably will be, significantly less because fund managers prefer to deal with smaller numbers. Finally, federal securities laws and, by extension, so-called "anti-fraud" rules, require disclosure of the nature of the investment and the risks of the investment as a means of protecting the investor.
- **State Oversight.** Kansas invented securities regulation in 1911. Like federal oversight, state oversight concerns limiting the number of investors in a fund and requiring disclosure. Kansas has Merit Regulation which allows the state to impose restrictions on securities investments that extend beyond federal regulations.
- **Private Contract.** In addition to minimum standards set forth in statutes, a fund also will be governed by the contract setting up the fund. That contract will determine, among other provisions, who the investors are, how much they invest, and the rights and authority of the fund manager. Contractual terms may vary from industry to industry and investor to investor. In general, these contracts will authorize high net worth individuals to invest in a CapCo. In general, these investors will be passive investors who will not be involved in ongoing day-to-day management but will negotiate a fund manager's fee.

Testimony on Certain Provisions of Proposed Substitute for SB 315. The Committee received testimony from the Kansas Securities Commissioner who took a neutral position on the bill but recommended that either the Kansas Department of Commerce and Housing or the Kansas Development Finance Authority but not the Securities

Commissioner administer the CapCo program. The Securities Commissioner cited that most of the administrative requirements assigned the Commission in the bill would conflict with its primary regulatory responsibility of protecting and informing Kansas investors. The Securities Commissioner observed that the proposed program would "cross the line" into economic development and promotion of venture capital. However, the Securities Commissioner indicated the Commission could handle the responsibilities concerning background checks of specified CapCo personnel. In response to a question, staff of the Kansas Development Finance Authority indicated the proposed bill is a good piece of legislation; however, the Finance Authority is not a regulatory agency, nor is it eager to become one. In response to questions, staff of the Kansas Department of Commerce and Housing explained that the administrative oversight responsibilities outlined in the bill did not conflict with the Department's mission. However, the agency has concerns about the staff expertise and funding necessary to administer the program effectively so that investors and taxpayers are protected and companies funded by CapCo investments can be assured of good program implementation.

CONCLUSIONS AND RECOMMENDATIONS

The Joint Committee on Economic Development recommends, by a majority vote, a proposed substitute version of SB 315, including certain amendments discussed below, be referred favorably to the Senate Commerce Committee for its consideration. (The Joint Committee used as the basis for its discussion a proposed substitute bill submitted by Kansas, Inc. Committee deliberations resulted in recommendations for additional amendatory language.)

The Committee recommends the follow-

ing amendments be considered by the Senate Commerce Committee:

- The Secretary of Commerce and Housing would certify and decertify Kansas capital companies (CapCos), monitor CapCos to ensure they comply with statutory requirements, and review documentation regarding the qualifications of prospective CapCo managers. The introduced version of the bill provides for the Kansas Securities Commissioner to assume those responsibilities. The suggested amendment to switch these responsibilities to the Secretary of Commerce and Housing acknowledges the Securities Commissioner's concern that the duties proposed in SB 315 depart from the Commission's primary regulatory mission to protect and inform Kansas investors. The Kansas Department of Commerce and Housing already administers other tax credit programs, including the Kansas Venture Capital Company Act. Moreover, three of five states with CapCo programs (Missouri, New York, and Wisconsin) assign certification responsibility in whole or in part to their respective economic development agencies. The Committee recommends retaining the provision in the bill that the Securities Commissioner be responsible for conducting background checks on specified personnel who have decision-making responsibilities for a CapCo's operations and investments because the Securities Commission has expertise in that type of activity.
- A CapCo would be required to register with the Kansas Securities Commission all offers or sales of any security issued by the CapCo. The introduced version of the bill would exempt such transactions from registration.
- The definition of "qualified Kansas busi-

ness" in which a CapCo could invest would be further amended to require the business to have no more than \$1 million in revenues in any fiscal year prior to making the investment. The substitute version of the bill considered by the Joint Committee reflected several amendments to the definition of "qualified Kansas business," including a requirement that the business have gross sales during its most recent complete year of not more than \$1 million. The Committee's recommendation would apply the \$1 million threshold to each fiscal year of the business' operations. The intro-

duced version of the bill does not include any revenue threshold.

- The definition of "qualified Kansas business" would not include traditional agricultural endeavors, such as farming and ranching, livestock and hog production. However, it would include agriculture value-added companies. The introduced version of the bill would allow CapCos to invest in businesses engaged in traditional agricultural endeavors, assuming those businesses meet other specified conditions.

House Bill 2688

Presented to
House Economic Development Committee

January 27, 2000

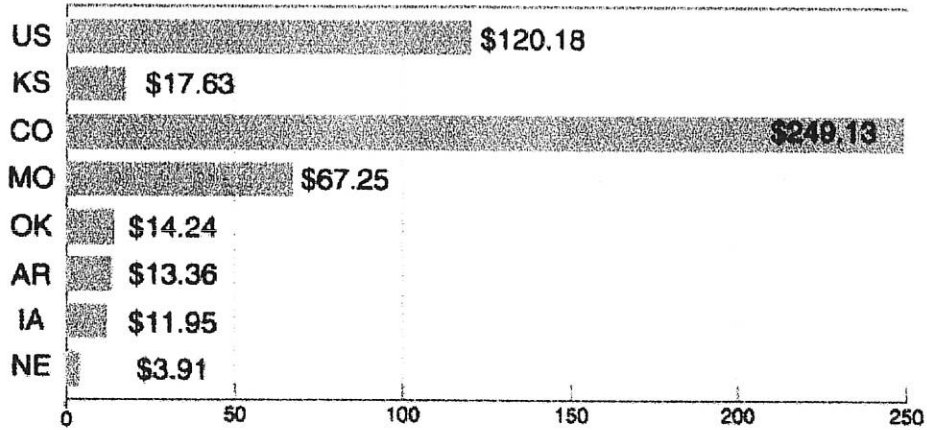
By
Charles Ranson, President
Kansas, Inc.

Established Facts about Seed Capital in Kansas

- Seed capital is essential to the development of high-growth early stage companies.
- Seed capital needs cannot be met by banks or other traditional institutions.
- Seed capital does not flow far from its source therefore Kansas companies must leave to access essential seed capital.
- Seed capital is virtually non-existent in Kansas

2

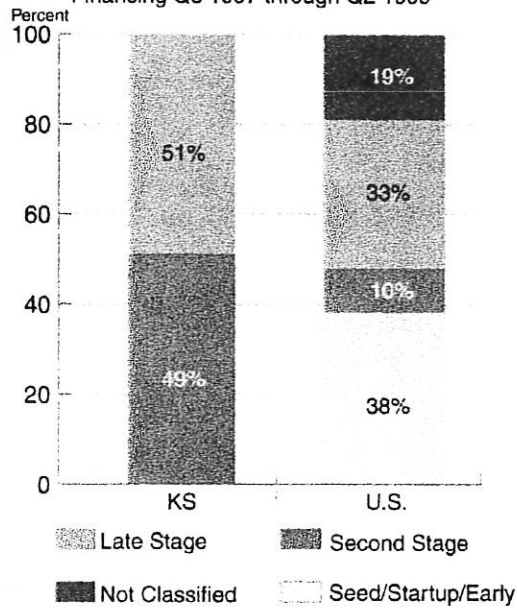
Per Capita Venture Capital Funding Q3 1997 through Q2 1999



Source: Price WaterhouseCoopers Money Tree™ Survey

3

Venture Capital Funding by Stage of Financing Q3 1997 through Q2 1999



Source: Price WaterhouseCoopers Money Tree™ Survey

4

Kansas stakeholders invest millions to develop these early stage companies only to lose them later due to a lack of seed capital in their home state.

These losses represents untold missed opportunities for Kansas.

- New industry development
- Thousands of new jobs
- New tax revenues
- New employment opportunities for Kansas' best and brightest
- Entrepreneurial infrastructure losses

6

Kansas can reverse these losses and begin building the economy of tomorrow by developing a seed capital infrastructure in Kansas.

HB 2688 is the necessary catalyst.

7

HB 2688 will overcome this barrier to Kansas' future development by creating a network of Kansas Capital Companies or CapCo's.

What is a Kansas Capital Company (CapCo)?

CapCo's are investment companies

- For profit
- Privately managed
- Privately owned
- Privately funded
- Publicly regulated

9

CapCo's invest in early stage Kansas companies

- Less than 5 years old
- With less than \$1 million in revenues

10

What are some examples of early stage businesses a CapCo might invest in?

- The developers of a product that renders biological warfare agents harmless?
- The value added agriculture application the farming industry has been waiting for?
- The pharmaceutical company that develops a cure for epilepsy?
- The inventor of a revolutionary new tool for spreading drywall mud?

11

CapCo's don't just invest in high-tech firms - they invest in companies with high potential for growth and profitability.

12

The only industries HB 2688 excludes from CapCo investment are

- Real Estate/Insurance Companies
- Retail/Personal Services
- Financial Services (i.e. Banks or S&L's)
- Oil & Gas Exploration
- Ag. Commodities (i.e. Livestock production)

13

CapCo's are funded by private sector investors.

- Risk is balanced by state tax credits.

14

Investors receive a 100% tax credit
against their investment.

- Individual income tax
- Corporate income tax
- Premium tax
- Privilege tax or fees

15

HB 2688 imports out of state investment

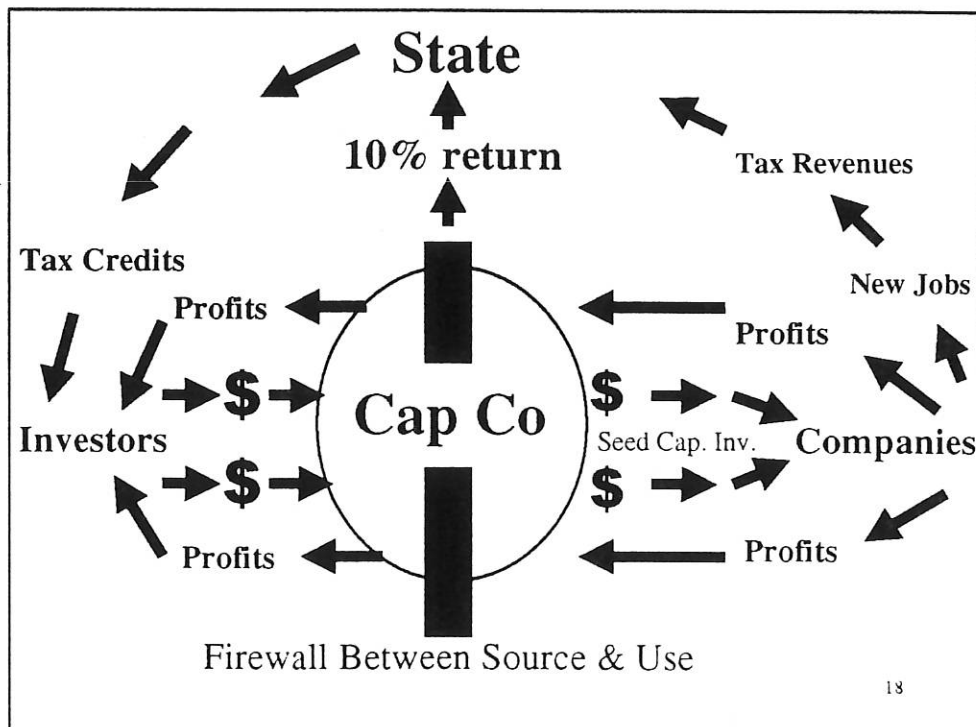
- Tax credits can be transferred or sold
to a Kansas taxpayer

16

Who can invest in a CapCo?

- Individuals
- Corporations
- Limited liability companies
- Financial institutions
- Insurance companies
- Partnerships
- Trusts

17



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Kansas CapCo Infrastructure

- 5 to 10 CapCo's
- Minimum size of \$5 million
- No maximum size, although only first \$10 million will earn tax credits

19

Multiple CapCo's are encouraged to

- Create healthy competition among funds
- Encourage risk-sharing and cooperative ventures
- Allow entrepreneurs to shop their "best deal"

20

Critical Mass - \$50 million

- Fiscal impact is spread over 10 years
 - Only \$5 million per year can be claimed
- Kansas gets use of full \$50 million up-front
- Actual cost of credits - approx. \$32 million

21

To remain compliant, CapCo's must invest

- 25% within 3 yrs
- 40% within 4 yrs
- 50% within 5 yrs
- 70% within 7 yrs

No distributions allowed until 100% investment
has been achieved.

22

What does the state receive in return?

- 10% of CapCo's returns
- Increased competitiveness
- Job creation
- Diversification in economy
- New tax revenues
- Sustainable seed capital infrastructure

23

CapCo Oversight

Kansas Dept. of Commerce & Housing

24

Kansas Dept. of Commerce & Housing's Role

- Administer certification process
- Approve or Disapprove Fund Managers
 - experience
 - character
- Background checks on principals
- Annual audits

25

Kansas Dept. of Commerce & Housing's Role (Continued)

- Annual review of each CapCo
- Annual report to Governor and Legislature
- Authority to revoke CapCo's charter if statute is violated

26

Safeguards

- Separation of source of funds from use of funds
- Investors are not involved in investment decisions
- CapCo managers are screened for competency and quality of character
- All principals are screened for quality of character

27

Safeguards (Continued)

- Strict prohibitions against self dealing
- Strict conflict of interest provisions
- Oversight by Kansas Dept. of Commerce & Housing
- Revocation of CapCo status and forfeiture of tax credits for violations

28

The Kansas CapCo Model

- The "Kansas CapCo model" (HB 2688) reflects lessons learned by other states and our own.

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Downfall of Past Efforts

- Insufficient incentive for investors
 - Undercapitalized funds
 - Inability to sustain companies to next stage
- Lack of public confidence
 - Unwarranted media attention
 - Insufficient oversight
 - Confidentiality for entrepreneurs

30

The Kansas CapCo model provides

- Strict public accountability and transparency;
- Sufficient incentive to attract private investment;
- Effective targeting of investment to early stage Kansas businesses;
- Professionally managed, multiple funds;
- Safeguards against conflict of interest and self-dealing;
- Confidentiality standards based on established industry practice; and
- Separation of source of funds from use of funds. ³¹

Both Missouri and Oklahoma recently passed legislation to encourage investment in early-stage companies.

The Kansas Legislature ensure that
we have a balanced economic
development portfolio...

- Create
- Retain
- Recruit

33

swiftly and definitively.

34

HB 2688
Leadership
Courage
Vision

35

HB 2688 - Commonly Asked Questions Concerning Operation of Kansas CapCos

What is a CapCo?

In concept, a Kansas Capital Company (or CapCo) is a privately managed, privately funded investment company that focuses its investment portfolio on Kansas companies less than 5 years old with less than \$1 million in revenues.

Why does Kansas need CapCos?

While Kansas has no shortage of entrepreneurs with innovative ideas and great potential to create wealth and new jobs in Kansas, those same entrepreneurs are finding they must look elsewhere for the seed and venture capital they need to develop their companies.

Didn't we try something like this in the past?

Only in the most general sense. The state made \$4.8 million in direct investments in two seed capital funds between '93 and '95. However, two factors limited their success.

First, the 25% tax credit offered investors was too low to attract sufficient investment to sustain their portfolio companies' needs for follow-on seed investment. Second, in 1997, the funds received unwarranted media attention which included scrutiny of portfolio investments causing potential investors, and entrepreneurs concern.

Legislators made it clear they could no longer support direct investment in private seed and venture capital funds. An alternative to direct public funding that would win the support of the Legislature would have to offer public accountability, confidentiality for entrepreneurs, safeguards against conflicts of interest, and widespread private sector support.

How is private investment attracted to the funds?

Investors in a Kansas CapCo receive a 100% tax credit that can be used against Kansas individual income tax, corporate income tax, premium tax, or privilege tax or fees. Investment from outside the state is encouraged as well. Out of state investors and other non-Kansas taxpayers can sell investment credits to a Kansas taxpayer.

Who can invest?

Any natural person or entity, including a corporation, limited liability company, partnerships, or trust.

As an investor safeguard, HB 2688 requires that if the investor is an individual, he or she must have a net worth of at least \$1 million and that the investment will be limited to no more than 10% of his or her net worth.

The program also imports out-of-state investment as well by allowing out-of-state investors to sell their tax credits to a Kansas taxpayers.

What does this mean to state revenues?

The tax credits are capped at \$50 million, but only \$5 million in tax credits can be claimed each year. By spreading the tax credits over a period of 10 years, the state receives the benefit up front, while minimizing fiscal impact. Considering the time value of money and that only 10% of the credits may be taken per year, the true cost to the state is approximately \$32 million.

The state also receives 10% of a CapCos returns.

How many CapCos will there be?

Because each CapCo must be a minimum of \$5 million, and tax credits will not be issued for investment of more than \$10 million in any one CapCo, a fully implemented program should result in at least 5 CapCos and possibly as many as 10. Having multiple CapCos encourages competitive, risk-sharing and provides a better environment for entrepreneurs to shop their best deal.

How can we be sure fund managers are qualified?

HB 2688 requires the Secretary of Commerce & Housing to determine whether a prospective fund manager is qualified based on professional experience and knowledge in the field of seed and venture capital and deny certification to any fund whose manager applicant is deemed unqualified.

Are there other safeguards offered by this program?

Yes, one very important one. The source of funds is separated from the use of funds. Investors in CapCos have no control over which companies their funds invest in.

HB 2688 also clearly defines and penalizes violations of conflict of interest standards or self-dealing. In addition, principals in a CapCo must meet strict standards as to the quality of their character and to business dealings in their past.

How is accountability and confidentiality achieved?

HB 2688 gives the Secretary of Commerce & Housing regulatory authority over CapCos. This includes approving fund managers on the basis of experience and character; performing background checks on principals; requiring annual audits; conducting an annual review of each CapCo; and preparing an annual report to the Governor and Legislature.

HB 2688 also provides for the confidentiality of trade secrets and gives the Secretary of Commerce & Housing the authority to deem certain materials to be closed records where proprietary or confidential information is involved.

Why was the Secretary of Commerce & Housing chosen to oversee the CapCos?

Success of the CapCo program will depend in large measure on the designated regulator's ability to inspire public confidence that the program is being objectively managed to guarantee separation of the source and use of funds. Confidence in the CapCo program will be weakened if it is perceived that political influence determines who runs the CapCos and where the investments are made.

Review of CapCo laws in other states reveals an even split between chief economic development officers and state securities regulators as designated overseers of CapCo programs. At its hearings in November 1999, the Interim Joint Economic Development Committee recommended amending SB 315, the counterpart to HB 2688, to designate the Secretary of Commerce & Housing the program regulator. This draft accedes to that recommendation.

Can just anybody start a CapCo if they have the \$500,000 required to become certified?

All CapCos principals or promoters must meet strict tests as to the quality of their character and to the business dealings in their past. HB 2688 requires the Secretary of Commerce & Housing to determine whether a prospective fund manager is qualified based on professional experience and knowledge in the venture capital field and deny CapCo certification to any fund manager not deemed qualified.

How will this program balance confidentiality of the entrepreneurs with the public's desire for accountability for the tax credits?

Since the CapCos will be privately held companies, they have certain rights to keep their business dealings confidential (just as you would in your own business.) In addition, the statute give the Secretary of Commerce & Housing the ability to treat any information he receives from the CapCos as closed records if he determines that its disclosure would compromise trade secrets or the privacy of an investor.

On the other hand, the statute requires that each CapCo undergo an annual audit performed by an independent auditor to determine whether the CapCo is operating in compliance with the statute.

In addition, the Secretary of Commerce & Housing is required to conduct an annual review of each CapCo to ensure that no investment in a CapCo or investment by a CapCo has been made in violation of the statute.

The Secretary of Commerce & Housing is also required to prepare an annual report to the Governor and to the Legislature which will report the total investment in CapCos in the state, the amount invested by each CapCo, the identity of the businesses in which they invested, the amount of the investment, and the job creation associated with the investment.

Why are CapCos restricted from investing in certain industries?

Seed capital should be targeted to firms which offer the promise of high growth, the creation of high paying jobs and which, at the seed stage, do not meet criteria necessary to qualify for bank financing.

Kansas lawmakers have long used "the basic industry theory" when determining which types of businesses to offer its economic development tax incentives. This theory justifies targeting incentives to the manufacturing sector and other industries that bring "new dollars" into the state through the sale of Kansas products and services. The basic industry theory is complemented by the "locations decision theory" which holds that businesses that locate based on the location of their market (or customers as in the case of retail firms) should not receive incentives. This would be the case for several industries which are excluded from CapCo investment, i.e.,

personal services, insurance, real estate, retail, and others. There are, however, provisions in the statute for CapCo investment in service sector firms which sell primarily to customers outside the state.

Is investment by a CapCo limited to technology companies?

No, but seed and venture capital funds, by nature of the industry, seek only investment opportunities which have high growth potential and a clear exit strategy. These opportunities are most frequently, but not exclusively, found in technology companies.

Could a CapCo invest all its money in a single company?

No. HB 2688 restricts a CapCos investment in a single company to no more than 20% of the fund. This provision ensures diversification within the CapCo portfolio.

Could a company receive investment from more than one fund... thereby beating the 20% restriction?

Yes. However, such partnering by CapCos should not cause alarm. Each CapCo would still have to maintain its portfolio diversification and evaluate the risk-reward potential. Chances are that if opinions as to the quality of investment opportunity are shared among multiple funds, it is a wise investment which would ultimately benefit the state.

What happens if a CapCo violates the provisions of the statute?

The Secretary of Commerce & Housing has the right (after due process) to revoke a CapCos certification. If a CapCo is decertified before it has reached certain investment thresholds, the result can be the recapture of all tax credits already taken in connection with the CapCo, and the forfeiture of all tax credits still unclaimed.

###

HB 2688 - Key Points

- + Seed capital is virtually non-existent in Kansas today.
- + HB 2688 is catalyst for formation of a permanent, private seed capital industry in Kansas.
- + CapCos would invest only in Kansas companies with less than \$1 million in revenue and less than five years old.
- + Not just a technology company bill. Only real estate, retail, and financial and personal services, passive business activities, ag commodities, and oil & gas exploration, are excluded.
- + Businesses in all 105 counties are eligible for investments.
- + 100% tax credit to accredited investor in CapCo, with suggested minimum investment of \$25,000.
- + \$50 million maximum credits available with no more than \$5 million (10%) to be claimed per year. Considering the time value of money and that only 10% of the credits may be taken per year, the true cost to the state is approximately \$32 million.
- + Total tax credits will not exceed \$10 million to investors in any single CapCo.
- + A minimum of \$5 million investment in each CapCo is required.
- + Bill is designed to attract out-of-state capital to Kansas through transferrable tax credits.
- + CapCos are regulated by the Secretary of Commerce & Housing.
- + CapCo managers are screened for competency to ensure success of CapCo and positive economic benefits to the state in return for tax credits.
- + The Secretary of Commerce & Housing has audit authority and other oversight powers.
- + Department of Revenue would administer tax credits.
- + State shares in financial success of CapCos: 10% of distributions.
- + HB 2688 reflects lessons learned from other states' CapCos and Kansas' 1986 tax credits.

**Missed Opportunities
Due to
Lack of Seed and Venture Capital in Kansas**

Knowledge Communications - Wichita

Texas financiers required that headquarters re-locate to Dallas. Since acquired by Harcourt General, a Connecticut company

Digital Archaeology - Lenexa

Has raised several million dollars out-of-state, including Missouri CapCo money and has been required to relocate to Missouri.

Agri-Technologies - Winfield

Acquired by John Deere. Production will be out-of-state.

FoodLabs - Manhattan

Acquired by Steris Corporation, Ohio. Transfer of local operations will always be an option.

HELP Innovations - Lawrence

Being acquired by out-of-state company. Local presence expected to remain in the state.

Newteck - Topeka

Moved to Texas for several reasons, one of which was access to venture capital

Brite Voice Systems - Wichita

Moved to Florida for several reasons, one of which was access to venture capital.

Practically every KTEC client company is currently seeking growth capital, usually in the form of equity-based venture capital. The companies listed above are examples. Lack of seed and venture capital for growth in rapidly developing markets is a severe hindrance for even those companies which do survive and remain in Kansas.

TESTIMONY OF LARRY WILLIAMS
President, The Halstead Bank
Co-Chairman, Kansas, Inc. Board of Directors
Presented to
House Economic Development Committee
January 27, 2000

Thank you for allowing me to appear before your committee relating to HB 2688. I am not here today to explain to you the intricacies of seed and venture capital, or to discuss the fine points of law incorporated in this legislation.

However, I am here today to tell you that by unanimous vote of the members attending its most recent meeting on December 16, the Kansas, Inc. Board of Directors reaffirmed its support of the legislation being considered. We are convinced, based on research and analysis conducted by our staff and consultants, that the policies and mechanisms incorporated in HB 2688 are an essential element of our states future economic strength.

Also, I am here as a citizen who is a community banker in a small town. I have been involved in lending to agriculture, businesses, and small manufacturing for nearly forty years. I would love to take each of you to our town of 2,000 and show you the jobs that have been created by entrepreneurial people and a bank that has been interested in creating jobs in our community. I think it's impressive. But over the past fifteen years, following the bank failures of the mid 80's (some 60 banks in Kansas alone failed) bank regulations have tightened. Thus it has become very difficult for banks and any other conventional lending institutions to met the needs of any request that even hints of venture capital. I feel a void has been created.

The opportunities are real. They are in small towns as well as the cities. In many respects, I have come to believe that the calculated risk-taking, creative entrepreneurs are our future. In our community, as in most towns, what we accept as the economic backbone of our communities today were venture capital risks of yesteryear.

Today we simply are not meeting the need. I fear our Kansas entrepreneurs, ultimately, are tempted to move to states where venture capital is more readily available. We can no longer ignore the problem. Competition is intense. We cannot ignore the efforts our neighboring states such as Missouri and Oklahoma have set in motion to address the issue. House Bill 2688 addresses the problem.

I urge your favorable consideration of HB 2688 and I, again, thank you for your courtesy and attention.

Testimony of Janet Gardner
Communication Workers of America
Kansas, Inc. Board of Directors
Before the Economic Development Committee of the
Kansas House of Representatives
on January 27, 2000

Greetings, Mr. Chairman and Members of the Committee.

I am Janet Gardner, president of Local 6407 Communication Workers of America. In this position, I am a chief advocate for the interests of our 170 employees.

I am also the member of the board of directors of Kansas, Inc. appointed by the Governor to represent the interests and concerns of the working men and women of Kansas.

Having worked in the labor force for 32 years, I am dedicated to insuring that there are good paying jobs to offer future generations of Kansans. Training and retraining are necessary to insure skilled workers, however, all the training and retraining are for naught if we are not creating, retaining and attracting companies to Kansas. We must focus on creating adequate seed and venture capital in Kansas where it does not exist today. This investment in our state's future will enable companies to start up, survive and grow in Kansas. As a result, new and higher-paying jobs will be created for today's and tomorrow's workers.

I urge you to vote in favor of HB 2688.

Thank you.

Testimony of P. Mitchell Woolery¹

Before: Committee on Economic Development, House of Representatives,
State of Kansas

Date: January 27, 2000

Re: H.B. No. 2688 (Kansas certified capital company act) and Discussion
of Federal Securities Laws

Introduction. This memorandum will discuss the federal securities laws which are likely to apply to the venture capital funds ("capco's") to be set up by H.B. No. 2688. In particular, I will discuss the types of persons who are eligible to invest in a capco. The federal securities laws are complex and this report greatly oversimplifies and generalizes the application of these laws. Should the Committee desire greater depth or coverage, I am happy to provide it.

Capco's. Capco's are a type of venture capital fund specifically established by a state statute. All venture capital funds and persons associated with them, whether they are capco's or are private investment funds, are regulated by the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act, as well as other federal securities laws and regulations. Capco's also will be regulated by the securities commissioner of each state in which potential investors in the fund are located. In addition, H.B. 2688 provides some regulatory oversight by the Kansas Department of Commerce.

General Overview of Regulation. Securities regulation usually takes the following forms:

1. Exempt offerings. Offer and sales of investments in the capco need to be exempt from registration. Generally these exemptions will focus on the type of investors and the amount of total money sought by the capco within a specified period.
2. Disclosure. Adequate disclosure of all material facts about the capco must be provided in writing to potential investors. This serves to satisfy the anti-fraud requirements of the securities laws (for example, Rule 10b-5).
3. Not more than 99 investors in the capco. To comply with the Investment Company Act, venture capital funds generally limit their investors to not more than 99 direct or indirect investors.

Please note that the securities laws regulate the process by which investors become part of a venture capital fund and, to a lesser extent, how they exit the fund; generally, they do not regulate the fund itself or its operations. Once the fund is established, it is unlikely the SEC or any state securities commissioners will have ongoing contact with the fund, although either may investigate complaints of fraud. Most of the regulation of a fund is by the contract setting up the

¹ Mr. Woolery is a partner with the Kansas City, Missouri-based law firm of Polsinelli, White, Vardeman & Shalton, P.C. He is testifying on his own behalf and not as a representative of the Firm or any of its clients. The views expressed in his testimony do not necessarily reflect the views of the Firm or its client

fund, the corporate/LLC laws governing the fund and general laws of fraud, fiduciary duty, etc. H.B. 2688 will provide ongoing oversight of capco's by the Kansas Department of Commerce.

Specific types of exemptions. There are dozens of exemptions from securities laws registration requirements; however, only five are likely to be used in setting up a venture capital fund like a capco.

- Rules 504, 505 or 506 under Regulation D.
 - Rule 504. This rule, when combined with a state SCOR offering, basically allows the capco to seek up to \$1 million from "retail" investors. The term "retail investor" is not a legal term of art but is generally used to describe investors who are not "accredited" or "sophisticated."
 - Rule 505. This rule allows the capco to seek up to \$5 million from an unlimited amount of accredited investors or up to 35 "retail" investors.
 - Rule 506. This rule allows the capco to seek an unlimited amount of money from an unlimited amount of accredited investors or up to 35 "sophisticated" investors.
 - An "accredited investor" includes (1) a natural person with a \$1 million net worth, (2) a natural person with an individual annual income of \$200,000 (\$300,000 with his or her spouse) for this year and the past two years, or (3) an entity like a corporation with total assets of more than \$5 million.
 - There is not an objective definition for a "sophisticated" investor but it includes persons who are able to have access to all material information, who are able to "fend for themselves" and bear the risk of total loss of their investment.
- Section 4(2) of the Securities Act. This exemption, together with U.S. Supreme Court interpretations, allows an unlimited amount of money to be raised from "sophisticated" investors.
- The Intrastate Offering Exemption (Section 3(a)(11) and Rule 147 of the Securities Act). This exemption allows an unlimited amount of money to be raised by the capco from accredited, sophisticated or retail investors. The capco, the investors and the businesses invested in would all need to be based in Kansas.

* * *

This memorandum has attempted to synthesize a vast amount of information about the securities laws to make them readable and understandable to the Committee. Please let me know if you have need for further amplification.

Respectfully submitted,

P. Mitchell Woolery



**Testimony of
David Frankland
President and CEO
Digital Archaeology**

before

**House Economic Development Committee
January 27, 2000**

I am David Frankland, President and Chief Executive Officer of Digital Archaeology, a technology start-up company now in its 5th year of existence.

Our Kansas-based company was founded by a group of software industry veterans seeking to commercialize a new software architecture we call X-Set. X-Set radically simplifies the process of transforming data into usable customer knowledge. Since its beginning Digital Archaeology has enjoyed considerable success in developing this new technology that enables businesses to implement flexible "just in time" decision support systems. In simple terms, we help businesses better understand and manage their customers thereby adding to their bottom line profitability.

Beginning in 1998, I had the pleasure to serve as one of 20 Kansans on Kansas, Inc.'s technical advisory group. As you know this group was created to guide a best practices study of seed and venture capital and to develop alternatives to direct state equity investment in high risk, high reward companies such as ours.

Last year, I was pleased to present testimony before the Senate Commerce Committee in support of SB 315, the companion measure to this bill. And, in November 1999, I once again had the pleasure of submitting written testimony in support of SB 315 to the Interim Joint Economic Development Committee. I would have gladly presented that testimony in person had I not just returned from attending a technology fair in Osaka, Japan as one of a small group of companies chosen worldwide to demonstrate and discuss their technology and business plan to a select group of Japanese investors. I passionately support HB 2688 and its counterpart (SB 315) as essential to the long-term success and competitiveness of the Kansas economy.

Need for Capital

Digital Archaeology would not and could not exist without venture capital. When my written testimony was presented in November, we had raised \$8.5 million in equity investments from groups including Kansas City Equity Partners, Gateway Associates (out of St, Louis) and other private investors. While this may seem like a substantial sum of money, it pales in comparison to our competitors, some having raised in excess of \$30 million when they were at our stage of development.

You may remember my earlier testimony. At that time we were seeking additional equity funding to support ongoing operations. To our continuing dismay, our hopes of securing adequate financing have rested almost entirely on entities outside the state of Kansas. As a result I have spent the bulk of my time traveling outside the State making presentations to potential investors

when I should be managing and growing our business. In Osaka, Japan, through the help of KTEC, we presented our investment proposition to a number of large Japanese companies. This was a terrific opportunity and we are very grateful to KTEC for their assistance, but I think you will all agree that 6,600 miles is too far to travel for investment capital.

I am here today to tell you that we have been successful in achieving our goal of raising \$15 million in new venture capital to enable Digital Archaeology to continue to grow.

I am also here to tell you that because the Kansas Legislature did not enact SB 315 in 1999, and did not establish the mechanism that could have met my company's pressing need, Digital Archaeology was forced to find capital where it was available. The State of Missouri made the final piece of our \$15 million financing package available through its CapCo program. To obtain the nearly \$2 million in equity investment that is tied to this program, Digital Archaeology has agreed to relocate the company from Kansas to Missouri. The move will be effective no later than June of this year.

Digital Archaeology presently employs over 50 people at an average salary well in excess of \$70,000. With new funding we will add at least another 50 people in the next 6-12 months, and that we hope will only be the beginning of our growth. When I spoke to you before, I mentioned that the single greatest fear I had as a CEO of a high technology company in Kansas was the lack of available local capital to fuel our growth. In that testimony, I posed to you the critical question: will Digital Archaeology be able to remain a Kansas company or, will the financial terms and conditions of an outside investor force the company and its large and growing number of high paying jobs to move elsewhere?

The answer to that question is now clear, at least for Digital Archaeology. Unfortunately, we will not be able to remain a Kansas company. But our example is not unique. There are many other companies going through the same process that we have gone through - searching for capital, trying to survive and grow, trying to create more and higher paying jobs and, as a result, strengthening the image and the revenue base of this state.

Unless this Legislature acts now, in this session, to meet the need of companies like Digital Archaeology, ours will not be the last company to pull up stakes and move to where the money is. We will simply be the next in a continuing exodus of companies that together have the potential to revolutionize the economy of Kansas and to prepare it to compete successfully in the 21st Century.

Thank you Mr. Chairman.

LEGISLATIVE TESTIMONY

HB 2688

January 27, 2000

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

House Committee on Economic Development

by

John Fowler, President
Kansas Chamber of Commerce and Industry

Mr. Chairman and members of the Committee:

I am John Fowler, President of the Kansas Chamber of Commerce and Industry. On behalf of the businesses that comprise the membership of the Kansas Chamber, thank you for this opportunity to express our support for the concept of improving the venture capital opportunities in our state.

Somewhere in Kansas right now, an entrepreneurial vision may be forming that could be the next technological marvel. However, that vision, that seed of an idea, cannot grow on its own.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 2,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 48% of KCCI's members having less than 25 employees, and 78% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

Product development, market research, a production structure, product marketing, and many more hurdles stand as challenges in growing that vision into a viable commercial venture. Each hurdle can have a significant cost. As a result, our state's commitment to improving venture capital opportunities can be the difference in a vision becoming reality in Kansas, a viable enterprise leaving Kansas for another state, or never being more than a vision.

KCCI's Economic Development Committee and the segment of our membership that works in the area of economic and industrial development have made improving Kansas' venture capital opportunities an important component in business recruitment and development. In recognition of Kansas' lack of venture capital investment relative to the U.S. and surrounding states, enhancing the environment for venture capital was among the economic development priorities identified by our members at KCCI's Business Congress.

The Chamber applauds this Committee's review of HB 2688 with the hope you can craft a legislative frame that will encourage private investment, and enable more entrepreneurs to turn ideas into vital businesses and industries. Thank you for considering our comments. I would be happy to respond to questions.



Growth Capital Alliance

CAPCO

Certified Capital Companies

HB 2688

Phil Thomas
1-800-261-9755

January 27, 2000
Topeka, KS

History

- **Started in Louisiana in 1988** - over \$300 million in funds
 - Ammended significantly in mid 90's
- **Missouri 1997** - \$140 million of funds
- **New York 1998** - \$100 million of funds
- **Florida 1998** - \$150 million of funds
- **Wisconsin 1998** - \$50million of funds
- **Several other states now considering**

Mechanics

- **Insurance Companies receive 10% per year tax credit**
 - **Good long term investors**
 - **Large pools of capital available**
 - **Because insurance companies regulated at the State Level**
 - **Allows program to target “in-State” businesses**
 - **Alleviates “Commerce Clause” legal risk**
 - **Fewer Investors**
 - **More sophisticated Investors**

• Investment schedule

- **Typical**
 - **20% within 2 years**
 - **30% within 3 years**
 - **40% within 4 years**
 - **50% within 5 years**
 - **100% before any distributions**

Example -Missouri in first 30 months.

- \$140 million raised**
- A total of 19 qualified businesses have received \$40,370,789**
- State tax reductions to date \$15 million**
- Follow-on capital of over \$387 million**

Investments - Missouri

- **18 companies have received funding**
- **1,750 Direct jobs created**
- **4,000 Indirect jobs created**

Investments - Nationwide

- **Rapid Investment - in New York about 50% of funds placed in first 18 months**
- **Over 60 companies funded nationwide**
- **In every State actual investments are occurring quicker than projected**
- **Every CAPCO dollar is bringing in over 8x additional follow on capital**

Summary of CAPCO

- CAPCO has created over a Billion Dollars in capital for small Businesses.
- Over 60 Companies have received funding
- Thousands of jobs created
- No risk to the State that program rules will not be followed
- Only venture capital program that targets small businesses and keeps the \$ in state
- Every State that has passed the program is seeking renewal

Key differences between CAPCO and HB 2866

8-9

- Program allows individual investors instead on Insurance Companies
- \$ 1million dollars size for “qualified business” definition is too small
- Investment schedule is different than all other states
- 365 days of fund raising is significantly different than the 30-60 days in other states
- Limiting or favoring applicants who are existing innovation and commercialization corporations or affiliates is not the way to attract capital or Venture Capitalists
- Many other provisions differ from CAPCO

Program allows individual investors instead on Insurance Companies

01-10

- Timing of taxes different
- Potential SEC problems
- Nightmare for Revenue department to track credits for thousands of individuals versus 5-20 insurance companies.
- Political disaster if a CAPCO defaults and an individuals have to amend 10 years of tax returns
- Insurance Companies are better able to judge which CAPCO managers are qualified to manage the money. If they are wrong they can afford it.
- Individuals will have no idea which fund manager is better qualified to meet these complicated statutory provisions or to predict which fund managers are the best qualified Venture Capitalists.
- Since the State Shares in the returns both through tax revenues and participation it should also want professional investors picking the money managers

\$ 1million dollars size for “qualified business” definition is too small

100

–Louisiana \$ 9 million

–Missouri \$3-\$4 million

–Wisconsin \$2 million of Gross Profit

–Florida

- SBA definition of small business

- 50% “early stage technology companies”, < 2yrs old and < \$2 million revenues

–New York

- Rest is \$5 million of revenue

- 50% - Early Stage Technology Companies; < \$2 million in Revenues

- Portfolio diversification

- If limit is low all investments will be made at the limit

- If you want more small you need some larger investments to spread the risks

Investment schedule is different ^{1/2}₀₀ than all other states

- HB 2688 requires 70% investment before tax credits are vested**
- Sophisticated investors would not invest in the program at 70%**
- Individuals probably would not invest if they understood that their tax returns will not be final until 70% is invested.**
- The 50% requirement for vesting and 100% requirement before distribution as used in all other programs is a balanced approach.**

Many other differences

- 365 days of fund raising is significantly different than the 30-60 days in other states
- Limiting or favoring applicants who are existing innovation and commercialization corporations or affiliates is not the way to attract capital or Venture Capitalists
 - 20% investment in any one company
 - \$1 million funds size
- Many other provisions differ from CAPCO

Conclusion

8-14

-
- Applaud the efforts and hard work of persons involved to recognize a serious issue and attempt to address that issue
 - The generic CAPCO program has proven to be highly successful and has provided over a Billion Dollars of capital to small businesses in 5 states and created thousands of high paying jobs.
 - HB 2688 differs so significantly that the current industry participants do not consider this bill to be a CAPCO bill.
 - HB 2688 would be an experiment that would be significantly different than any other CAPCO program
 - It could take years to determine the success or failure of the program
 - If this version with these major differences were to pass we would wish you luck on the experiment but would respectfully request that it be called something other than CAPCO so as not to create confusion.
 - If Kansas wants a generic program that is guaranteed to work we would welcome the opportunity to work on changes to HB 2688

Certified Capital Company - State Experience

Louisiana

Program began in 1988

As of 11/1/99:

- 24 Certified "Capital Companies"
- \$347 million of certified capital raised
- Capital has been invested in 66 qualified businesses that collectively employ 4,200 employees
- Additional follow-on capital invested as a result of CAPCO investment: \$98,991,193 of equity and \$464,630,000 of debt

Demand:

- \$3.8 billion requested in 862 transactions.

Missouri

As of 11/1/99:

- 8 Certified "Capital Companies"
- \$140,000,000 of certified capital raised
- Capital has been invested in 18 qualified Missouri businesses
- Additional follow-on capital as a result of CAPCO investment: \$113,450,000 of equity and \$112,250,000 of debt

Demand:

- \$1.2 billion requested in 506 transactions through the end of 1998.

New York CAPCO

CAPCO Program began in May 1998

As of 11/1/99:

- Five Certified "Capital Companies"
- \$100 million of certified capital raised
- Capital invested in 13 qualified New York businesses
- Over \$13 million invested in the first operating year

Demand

- \$470 million requested in 168 transactions.

Wisconsin CAPCO

CAPCO Program began in October, 1999

As of 11/1/99:

- Three Certified "Capital Companies"
- \$50 million of certified capital raised

Florida CAPCO

Program began April 1999

As of 11/1/99:

- Three Certified "Capital Companies"
- \$150 million of certified capital raised
- Capital has been invested in eight qualified Florida businesses within the first eight months

Demand

- \$718 million requested by 245 companies