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DATE: March 8, 2001

**HOUSE OF REPRESENTATIVES
COMMITTEE ON INFORMATION TECHNOLOGY
ANALYSIS**

BILL #: CS/HB 293

RELATING TO: Certified Capital Company Act

SPONSOR(S): Representative(s) Crow and Mack

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:

- (1) COMMITTEE ON INFORMATION TECHNOLOGY YEAS 11 NAYS 0
 - (2) FISCAL POLICY AND RESOURCES
 - (3) COUNCIL FOR READY INFRASTRUCTURE
 - (4)
 - (5)
-

I. SUMMARY:

This bill would amend the Certified Capital Company Act, 288.99, F.S. and would expand the pool of tax credits available for investments by a certified capital company ("CAPCO") in qualified businesses (as defined by statute). Among other amendments, the bill would: define the limits for the annual tax credit and the total tax credit; set forth the investment milestones for the second pool of funds; add the requirement for a CAPCO to raise money from two or more certified investors; modify the definition of an early stage technology business; modify the definition of a "Qualified distribution" to exclude the payment of costs or expenses to a certified investor; define and establish "Program One" and "Program Two" to distinguish between the existing funding pool and the new funding pool; establish application and certification deadlines; incorporate offering materials for solicitation of investments in material that has to be provided to the Department of Banking and Finance during certification and allow the Department to make an initial analysis of the CAPCO's business plan prior to its certification; establish a cap on an insurance company's ownership of a CAPCO's equity ownership; set the deadline for application for allocation and set forth the formula for allocation in the event that Program Two is over-subscribed; and allow the Department to levy a fine if an insurance company does not invest the full amount to which it committed during fundraising. This bill would take effect on July 1, 2001.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | | |
|-----------------------------------|---|--|---|---|
| 1. <u>Less Government</u> | Yes <input type="checkbox"/> | No <input checked="" type="checkbox"/> | N/A <input type="checkbox"/> | |
| 2. <u>Lower Taxes</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> | |
| 3. | <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> | |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> | |

For any principle that received a "no" above, please explain:

Because the bill would require the Department of Banking and Finance, the Office of Tourism, Trade and Economic Development and the Department of Revenue to administer the proposed expanded CAPCO program, the bill does not support the principle of "less government."

B. PRESENT SITUATION

Overview of the CAPCO Program

The Certified Capital Company Act, s. 288.99, F.S., was adopted in 1998 to establish a mechanism to provide financing (i.e., venture capital), via certified capital companies ("CAPCO"), for qualified small businesses. The primary purposes of the CAPCO Act are, among others, to increase the number of Florida-based certified venture capitalists, to facilitate access to institutional investors for smaller companies, and to create high-paying high-skilled jobs.

Under current law, corporations, partnerships, or limited liability companies could apply for certification as a CAPCO on or before December 1, 1998. CAPCOs are venture capital firms that provide early-stage capital to other businesses. CAPCOs certified by the Department of Banking and Finance are eligible to receive contributions of capital from insurance companies.

Insurance companies (certified investors), in turn, can receive a credit against state premium taxes for each dollar contributed to a CAPCO, at the rate of 10 percent a year for 10 years, beginning with the premium tax filings for the year 2000. The purpose of this tax credit is to encourage insurance companies to invest in certified capital companies, which, in turn, will make investments in qualified small businesses.

Under the current program, the total amount of tax credits may not exceed \$15 million annually. Further, the tax credits allowed under the program are subject to an aggregate cap of \$150 million.

Three entities are responsible for administration of the CAPCO program. The Department of Banking and Finance is responsible for certification and de-certification. The Department of Revenue oversees the tax credit filings and related requirements. The Office of Tourism, Trade, and Economic Development ("OTTED") was responsible for the initial allocation of premium tax credits and is responsible for preparing an annual report on the CAPCO program.

Certification Requirements

To be certified, a CAPCO must have net capital of at least \$500,000 and at least two of its principals must demonstrate 5 years experience in making venture capital investments.

To remain certified, CAPCOs are required to meet investment benchmarks. By December 31, 2000, at least 20 percent of CAPCO funds must be invested in businesses headquartered in and with their principal business operations in Florida ("qualified businesses") At least 30% of CAPCO funds must be invested in qualified businesses by December 31, 2001. By December 31, 2002, at least 40 percent of CAPCO funds must be invested in qualified businesses. By December 31, 2003, at least 50 percent of CAPCO funds must be invested in qualified businesses. "Qualified business" means a small business (determined by rules of the U.S. Small Business Administration) headquartered in Florida and with its their principal business operations in Florida. A qualified business must certify that it is unable to obtain conventional financing and that it has fewer than 200 employees, at least 75 percent of whom are employed in Florida. A qualified business does not include a business predominantly engaged in retail sales, real estate development, insurance, banking, lending, oil and gas exploration, or engaged in professional services provided by accountants, lawyers, or physicians.

At least 50 percent of the CAPCO's investments in qualified businesses must be in "early stage technology businesses" involved in activities related to developing initial product or service offerings. If those investment benchmarks are not met, the CAPCO would risk decertification. Decertification could result in the forfeiture or recapture of some, or all, of the premium tax credits earned by insurers.

Distributions

Before a CAPCO may make any distribution to its equity holders, other than a "qualified distribution," the CAPCO must have invested 100 percent of its certified capital in qualified investments. A "qualified distribution" of up to 2.5 percent of the CAPCO's certified capital may be made to equity holders for the costs and expenses of forming, managing, and operating the company, plus reasonable and necessary fees for professional services, such as legal and accounting services. Payments of principal and interest to debt holders may be made without restriction.

A CAPCO is required to pay to the Department of Revenue 10 percent of the portion of distributions to all certified investors (insurers) and equity holders that exceeds the sum of the CAPCO's original certified capital (which includes both equity and debt investments) and any additional capital contributions to the CAPCO.

Allocation of Premium Tax Credits

OTTED is responsible for allocating premium tax credits to certified investors who apply and submit specified documentation. A CAPCO must annually file a report with the office and the Department of Banking and Finance detailing the investments the CAPCO has received from insurers and the investments it has made in qualified businesses, including the number of jobs created or retained and the average wages of such jobs. The Department of Banking and Finance must conduct an annual review of each CAPCO to determine if it is abiding by the requirements of certification, and the Department of Revenue may audit and examine the records of CAPCOs and certified investors.

C. EFFECT OF PROPOSED CHANGES:

H.B. 293 amends s. 288.99, F.S. The bill adds the terms "Program One" and "Program Two," and the respective definitions of the terms, to distinguish between the \$150 million in premium tax credits allocated under 288.99, F.S., in 1999 ("Program One") and the proposed additional \$300 million in tax credits that would be allocated under the statute after October 1, 2001 ("Program Two"). The bill establishes the investment milestones for the Program Two pool of funds. To remain certified, a Program Two CAPCO would be required to have invested at least: 20% of its certified capital by December 31, 2003; 30% of its certified capital by December 31, 2004; 40% of its certified capital by December 31, 2005; and 50% of its certified capital by December 31, 2006. The bill establishes a cap of \$300 million on the total tax credits that could be allocated by OTTED under Program Two and a cap of \$30 million per annum on the tax credits that could be earned per annum under Program Two. The proposed changes are discussed in more detail, infra, in the Section-by-Section Analysis.

D. SECTION-BY-SECTION ANALYSIS:

288.99(3)(c) -- Certified Capital Company

The bill adds to the definition of a "Certified capital company" the requirement that the CAPCO receive investments of certified capital from two or more unaffiliated certified investors. This provision is intended to prevent a single certified investor from dominating a CAPCO and to allow a CAPCO to seek funding from multiple sources.

288.99(3)(g) -- Early Stage Technology Business

The bill adds "but is not limited to" language to the definition of "Early stage technology business." With this language, a business that meets all of the other requirements would not be required to be less than 2 years old to be an "Early stage technology business." This change recognizes that some companies, such as research and development companies, may be formally incorporated for a substantial period of time before business is actually transacted. Such companies, which otherwise meet the statutory requirements, will not be precluded from receiving CAPCO funds merely because they have been existence for more than 2 years.

The bill also amends the definition of "early stage technology business" to include four new categories of businesses:

- Businesses involved in certain initial product or service offerings;
- Businesses less than 2 years old with limited revenues;
- The Florida Black Business Investment Board or entities majority-owned or controlled by such boards; and
- any entity defined under Florida's minority business enterprise statute, 288.703, F.S.

288.99(3)(k) -- Qualified Business

The bill would amend Section 288.99(3)(k) to give the Department of Banking and Finance authority to require documentation relating to an entity's status as a "qualified business" under the statute. The bill would also exclude certain businesses, from definition of "qualified business": businesses engaged in retail sales, insurance, banking, oil exploration; professional services by accountants, lawyers, etc.; businesses with no historical revenues and no business plan; and businesses with a strategic plan to acquire similar firms and eliminate Florida-based jobs.

288.99(3)(m) & (n) -- Qualified Distribution / Qualified Investment

The bill would amend Section 288.99(3)(m) to modify the definition of "qualified distribution" to include payment of reasonable costs and expenses, including professional fees, of forming and syndicating the CAPCO, so long as such costs and expenses are not paid to a certified investor. The amount of professional fees permitted to be included in a qualified distribution would be limited to 20% of the certified capital raised. The bill would also limit the ability of costs and expenses to be paid to a certified investor. The section caps reasonable costs of managing and operating a CAPCO to no more than 5% of the certified capital in any one year.

The bill would also amend Section 288.99(3)(n) to exclude three things from the definition of "qualified investment": certain investments with repayment periods of less than 12 months from initial investments; certain follow-on or add-on investments; and investments that exceed 15% of certified capital.

288.99(3)(o) & (p) -- Program One and Program Two

The bill adds the terms "Program One" and "Program Two," and the respective definitions of the terms, to distinguish between the \$150 million in premium tax credits issued under 288.99, F.S., in 1999 ("Program One") and the proposed additional \$250 million in tax credits to be issued under the statute after October 1, 2001 ("Program Two").

288.99(4) -- Certification and Decertification

The bill sets November 1, 2001 as the deadline by which companies seeking certification as a "certified capital company" under Program Two must file a verified application. The bill also adds the requirement that companies seeking certification submit "copies of any offering materials used or proposed to be used by the applicant in soliciting investments of certified capital from certified investors."

The bill sets December 31, 2001 as the deadline on which the Department of Banking and Finance shall grant or deny certification to a Program Two applicant for certification.

As one of the factors that may be considered by the Department in determining whether to certify a company, the bill adds whether "[t]he applicant's proposed method of doing business and raising certified capital as described in its offering materials and other materials submitted to the department conforms with the requirements of this act." This provision allows the Department to make an initial analysis of the CAPCO's business plan prior to its certification to ensure that a CAPCO is likely to be in compliance with the law of Banking and Finance.

The bill deletes the requirement that a certified capital company file a copy of the certification with OTTED.

The bill prohibits an insurance company (or its affiliates) from owning (in any manner) 10% or more of the equity interests in a CAPCO or from having the right to participate in 10% or more of the profits of a CAPCO. This supplements the existing statutory prohibitions on an insurance company's management or control of the direction of a CAPCO's investments.

This bill would also impose a \$5000 late fee for a CAPCO's failure to pay renewal fee by specified deadline.

288.99(5) -- Investments by CAPCOs

The bill establishes the investment milestones for the Program Two pool of funds. To remain certified, a Program Two CAPCO must have invested at least: 20% of its certified capital by December 31, 2003; 30% of its certified capital by December 31, 2004; 40% of its certified capital by December 31, 2005; and 50% of its certified capital by December 31, 2006.

288.99(7) -- Annual Tax Credit; Maximum Amount; Allocation Process

The bill would lower the minimum gross amount that must be raised by a CAPCO to \$15 million.

The bill establishes a cap of \$300 million on the total tax credits that may be allocated by OTTED under Program Two and a cap of \$30 million per annum on the tax credits that can be earned per annum under Program Two. The bill sets the deadlines, respectively, by which each certified CAPCO must apply to OTTED for an allocation of premium tax credits for potential investors and by which OTTED must notify each CAPCO of its share of the total premium tax credits available.

The bill sets forth the formula for calculating the premium tax credits that may be allowed to any one certified investor under Program Two in the event the total amount of capital committed by all certified investors exceeds the aggregate cap on the amount of credits that may be awarded under Program Two.

The bill authorizes the Department of Banking and Finance to levy a fine, not to exceed \$50,000, if a certified investor does not invest the full amount of certified capital allotted it by the Department during the fundraising stage.

288.99(8) -- Annual Tax Credit; Claim Process

The bill establishes January 31 of each year as the deadline for filing with the Department and OTTED the required information (e.g., total dollar amount received by certified capital company, identity of certified investors, amount of certified capital received and invested, jobs created or retained) for the preceding calendar year ending December 31.

III. **FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:**

A. **FISCAL IMPACT ON STATE GOVERNMENT:**

1. **Revenues:**

The fiscal impact of this bill has yet to be reviewed by the Revenue Estimating Conference.

2. **Expenditures:**

The fiscal impact of this bill has yet to be reviewed by the Revenue Estimating Conference.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

N/A

2. Expenditures:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Direct Private Sector Costs

The bill would not impose any additional costs on the private sector. Companies seeking certification as a CAPCO would continue to pay the \$7,500 application fee to the Department of Banking and Finance.

Direct Private Sector Benefits

Qualified businesses, including early stage technology businesses, may have greater opportunity for access to additional sources of venture capital for start-up or expansion.

Certified investors in CAPCOs would receive credits on their premium taxes payable, and CAPCOs, would have a greater opportunity to realize positive returns on their investments.

Effects on Capital Market and Job Creation

Expansion of the CAPCO program could result in additional venture capital investing and high-wage job creation in Florida-based technology businesses.

Florida's CAPCO Program to Date

According to OTTED's April 1, 2000 *Annual Report of the Certified Capital Company Act*

"Between July 1 and December 31, 1999, the first six months of the Florida Certified Capital Company (CAPCO) program, the three companies receiving designation as CAPCOs invested more than \$14.6 million in eight qualified businesses. These investments created 43 jobs and supported the continuation of 222 jobs. The average wage for the jobs created and supported was \$52,200. Most of the companies receiving the CAPCO investments are early stage technology companies and also report receiving \$27 million in additional private venture capital funds from other sources. The investee companies are located in Gainesville, as well as in communities in central and south Florida. In most instances, the average salary paid by these firms is significantly higher than the state average of \$28,189 and the investments in small, high growth, technology based businesses contribute to the diversification of the state and local economies."

PricewaterhouseCoopers *Shaking the Money Tree – Venture Capital Trends in Florida* reports that the CAPCO program has facilitated venture capital investing in Florida.

"Traditionally, almost all of the venture capital invested in Florida-based companies has come from out of state. Venture funds in New York and Boston in particular have been adept at

identifying promising startups in various Florida markets and quietly making their investments. . . This is beginning to change, though. . . . Also spurring this growth was the creation of the Florida "CapCo" (Certified Capital Company) program by the Legislature in 1999."

In its December 28, 2000 Report to OTTED, Advantage Capital Partners, one of the State's 3 CAPCO, reported that it had: raised \$81,862,834 as of December 31,2000 and had invested \$23,325,329 in qualified businesses, of which 82.4% (or \$19,219,446) had been invested in early stage technology businesses.

In a December 28, 2000 report to OTTED, Stonehenge Capital Corporation, another CAPCO, reported that it had invested \$7,120,400 in qualified businesses, of which 89% (or \$6,370,400) had been invested in early stage technology businesses.

Other State's Programs

Currently, five states have CAPCO programs: Florida, Louisiana, Missouri, New York and Wisconsin. In the next 2 years, at least 10 other states are expected to implement CAPCO programs. (See Standard & Poors Bank Ratings Service, *CAPCO Structured Financings Surge*, February 23, 2000).

A study of the 3-year-old Missouri program reported in February 2000 the state's CAPCO program had led to more than \$540 million in capital (\$140 million in certified capital and \$400 million in follow-on capital) for early-stage companies and to the creation of 1600 new jobs. The study concluded that, despite an increasing availability of venture capital funds for start-up companies, the state's CAPCO program should be continued. (See *The Certified Capital Companies Economic Development Innovation: Missouri's Experience to Date*, February 2000).

The Louisiana CAPCO program began in 1988. As of October 31, 2000, \$683 million of certified capital had been raised, and additional follow-on capital of \$563,621,193 had been invested. This capital was invested in 134 qualified businesses that collectively employ 4,841 employees. (See *The CAPCO Program: Creating Growth Capital for Business*). A December 1999 study concluded that Louisiana could not have raised that money without the state's CAPCO program. (See *CAPCO Study prepared for Louisiana Department of Economic Development*, December 31, 1999).

New York's CAPCO program began in May 1998. As of January 30, 2000, it was reported that \$280 million in certified capital had been raised and that qualified investments had been made in 28 mainly high-technology companies. (See *The CAPCO Program: Creating Growth Capital for Business*).

D. FISCAL COMMENTS:

N/A

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

The bill does not require counties or municipalities to expend funds, nor does it require counties or municipalities to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

The bill does not reduce the authority that municipalities or counties have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

The bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

Strike-everything amendment

A strike-everything amendment was adopted by the Committee on Information Technology on February 21, 2001. The following summarizes the strike-everything amendment.

288.99(3)(g) - Early Stage Technology Business

The strike amendment altered the definition of "early stage technology business" to include four additional categories: Businesses involved in certain initial product or service offerings; Businesses less than 2 years old with limited revenues; The Florida Black Business Investment Board or entities majority-owned or controlled by such boards; and any entity defined under Florida's minority business enterprise statute, 288.703, F.S.

288.99(3)(k) - Qualified Business

The strike amendment would give the Department of Banking and Finance authority to require documentation relating to an entity's status as a "qualified business" under the statute. This section would exclude certain businesses, from definition of "qualified business": businesses engaged in retail sales, insurance, banking, oil exploration; professional services by accountants, lawyers, etc.; businesses with no historical revenues and no business plan; and businesses with a strategic plan to acquire similar firms and eliminate Florida-based jobs.

288.99(3)(m) & (n) - Qualified Distribution & Qualified Investment

The strike amendment would amend Section 288.99(3)(m) to define "qualified distribution" to include payment of reasonable costs and expenses, including professional fees, of forming and syndicating the CAPCO, so long as such costs and expenses are not paid to a certified investor. The section caps reasonable costs of managing and operating a CAPCO to no more than 5% of the certified capital in any 1 year.

288.99(3)(n) excludes from the definition of "qualified investment": certain investments with repayment periods of less than 12 months from initial investments; certain follow-on or add-on investments; and investments that exceed 15% of certified capital.

288.99(3)(o) & (p) - Program One/Program Two

Program Two provides for issuance of \$250 million in premium tax credits.

288.99(4)(b) – Application Deadline

The strike amendment would set November 1, 2001 as deadline for a CAPCO's application for certification.

288.99(4)(9) - Late Fee for Renewal

The strike amendment would impose a \$5000 late fee for a CAPCO's failure to pay renewal fee by specified deadline.

288.99(7)(c)– Fundraising Threshold

The strike amendment would lower the minimum gross amount that must be raised by a CAPCO to \$15 million.

Amendment 1a

Amendment 1a eliminated the proposed requirement of 288.99(3)(m) that capped reasonable costs and expenses as a "qualified distribution" to no more than 20% of the certified capital raised.

Amendment 2a

Technical amendment No. 2a made clear that an applicant for CAPCO certification must have a certain net worth prior to applying for certification.

Amendment 3a

Amendment 3a added minority business enterprises, as defined by s. 288.703, F.S., to the definition of an "early stage technology business."

The Committee on Information Technology voted-out the bill as a committee substitute.

VII. SIGNATURES:

COMMITTEE ON COMMITTEE ON INFORMATION TECHNOLOGY:

Prepared by:

Staff Director

Charles M. Davidson

Charles M. Davidson