

**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: 2/28/02  
BILL NO. 284 & 579  
OR  
SUBJECT \_\_\_\_\_

**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: 2-2  
BILL NO. 284/579  
OR  
SUBJECT \_\_\_\_\_

**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: 2-28-02  
BILL NO. 5284 A 579  
OR  
SUBJECT \_\_\_\_\_

(NAME) Hector De Luca  
(Street Address or Route Number) 415 Service Dr.

City and Zip Code Madison 53711

(Representing) Deltaoid Pharmaceuticals, Inc.

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

Registering Against:

but not speaking:

Speaking for information only; Neither for nor against:

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State Capitol - B35 South  
P.O.Box 7882  
Madison, WI 53707-7882

(NAME) Charles Kerns  
(Street Address or Route Number) 1330 W. Towne Sq. Rd.

City and Zip Code Mequon, WI 53092

(Representing) Western Weapons LLC

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

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(NAME) Ron Kueh  
(Street Address or Route Number) 2 E. Mill Ln #600

City and Zip Code Madison

(Representing) 411 Biotech Assoc.

Speaking in Favor:

Speaking Against:

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but not speaking:

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**SENATE HEARING SLIP**

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BILL NO. SB 284/ABS 579

SUBJECT \_\_\_\_\_

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SUBJECT \_\_\_\_\_

**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: 2-28-02

BILL NO. SB-284

SUBJECT AB-579

Michael Korengold

(NAME)

Enhanced Capital Partners

(Street Address or Route Number)

201 St. Charles Ave  
New Orleans, LA 70170

(City and Zip Code)

Enhanced Capital

(Representing)

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

Registering Against:

but not speaking:

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Pete Christianson

(NAME)

S. Pinckney Suite 600

(Street Address or Route Number)

MSU, WI 53701-2112

(City and Zip Code)

Enhanced Capital Partners

(Representing)

Speaking in Favor:

Speaking Against:

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but not speaking:

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but not speaking:

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Madison, WI 53707-7882

Tom Springer

(NAME)

1 E Main St Ste 300

(Street Address or Route Number)

Madison WI

(City and Zip Code)

Facilitator Capital Fund

(Representing)

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

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but not speaking:

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**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: 2-28

BILL NO. SB-284, AB-579

OR  
SUBJECT \_\_\_\_\_

Darryl Lund  
(NAME)  
455 County Road M Ste. 101  
(Street Address or Route Number)

Madison 53719  
(City and Zip Code)

Community Bankers of WI  
(Representing)

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

Registering Against:

but not speaking:

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Madison, WI 53707-7882

**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: \_\_\_\_\_

BILL NO. Bill 284 Bill 579

OR  
SUBJECT Certified Request

Pent Velds  
(NAME)  
3424 N. Shepard Ave  
(Street Address or Route Number)

Milwaukee WI 53211  
(City and Zip Code)

Wisconsin Growth Fund, LLC  
(Representing)

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

Registering Against:

but not speaking:

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**SENATE HEARING SLIP**

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DATE: 2/28/02

BILL NO. SB 284; AB 579

OR  
SUBJECT \_\_\_\_\_

State Rep. David Ward  
(NAME)  
P.O. Box 8953  
(Street Address or Route Number)

Madison WI 53708  
(City and Zip Code)

Self - Author of the legislation  
(Representing)

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

Registering Against:

but not speaking:

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Madison, WI 53707-7882

**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: ~~Feb 28~~ Feb 28 2002  
BILL NO. HB 204  
OR  
SUBJECT ABS 79

(NAME) Senator Owen Morse  
~~Sen. Owen Morse~~  
(Street Address or Route Number)

(City and Zip Code) ~~Madison, WI 53707~~  
(Representing)

Speaking in Favor:   
Speaking Against:   
Registering in Favor:   
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Registering Against:   
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**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: 2/28/02  
BILL NO. 284 & 579  
OR  
SUBJECT

(NAME) Deepak Dhan  
(Street Address or Route Number) 8155 Forsythia St

(City and Zip Code) Middleton, WI 53562  
(Representing) Soft Switching Technologies, Inc

Speaking in Favor:   
Speaking Against:   
Registering in Favor:   
but not speaking:   
Registering Against:   
but not speaking:   
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DATE: 2/28/02  
BILL NO. 284 & 579  
OR  
SUBJECT

(NAME) Paul Weiss  
(Street Address or Route Number) 8137 Forsythia St

(City and Zip Code) Middleton, WI 53562  
(Representing) Gala Design, Inc

Speaking in Favor:   
Speaking Against:   
Registering in Favor:   
but not speaking:   
Registering Against:   
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BILL NO. 284 & 579

OR  
SUBJECT \_\_\_\_\_

(NAME) John Barri  
(Street Address or Route Number) 2228 Evergreen Rd.

(City and Zip Code) Middleton 53562

(Representing) Temel Therapy, Inc.

Speaking in Favor:

Speaking Against:

Registering in Favor:  
but not speaking:

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BILL NO. 284 & 579

OR  
SUBJECT \_\_\_\_\_

(NAME) Eric Apfelbach  
(Street Address or Route Number) 1832 Wight St

(City and Zip Code) Madison 53704

(Representing) Alfahart, Inc.

Speaking in Favor:

Speaking Against:

Registering in Favor:  
but not speaking:

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**SENATE HEARING SLIP**

(Please Print Plainly)

DATE: 2.28.02

BILL NO. \_\_\_\_\_

OR  
SUBJECT CRPEO LEGISLATION

(NAME) PAUL J. RAAB  
(Street Address or Route Number) 5133 W. Terrace Dr.

(City and Zip Code) MADISON, WI 53018

(Representing) FACILITATOR CAPITAL FUND

Speaking in Favor:

Speaking Against:

Registering in Favor:  
but not speaking:

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(Please Print Plainly)

DATE: 2/28

BILL NO. SB 284/AB 579

OR  
SUBJECT \_\_\_\_\_

(NAME) Rep. Thompson Lippert

(Street Address or Route Number) \_\_\_\_\_

(City and Zip Code) \_\_\_\_\_

(Representing) 70th Assembly District

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

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BILL NO. SB 284

OR  
SUBJECT AB 579

(NAME) Tim Elvermen

(Street Address or Route Number) \_\_\_\_\_

(City and Zip Code) \_\_\_\_\_

(Representing) Stonehenge Capital

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

Registering Against:

but not speaking:

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BILL NO. SB 284 & 579

OR  
SUBJECT \_\_\_\_\_

(NAME) John Neis (niced)

(Street Address or Route Number) \_\_\_\_\_

(City and Zip Code) Madison 53719

(Representing) Venture Investors & Advantage Capital

Speaking in Favor:

Speaking Against:

Registering in Favor:

but not speaking:

Registering Against:

but not speaking:

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(Please Print Plainly)

DATE: 2-28-02

BILL NO. SB 284

OR  
SUBJECT \_\_\_\_\_

Red Heller  
(NAME)

6414 Coppes Ave  
(Street Address or Route Number)

Madison WI 53716  
(City and Zip Code)

Myself  
(Representing)

Speaking in Favor:

Speaking Against:

Registering in Favor:  
but not speaking:

Registering Against:  
but not speaking:

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Madison, WI 53707-7882



## WISCONSIN LEGISLATIVE COUNCIL

*Terry C. Anderson, Director  
Laura D. Rose, Deputy Director*

TO: SENATOR ROBERT JAUCH

FROM: Nicholas Zavos, Staff Attorney

RE: Senate Bill 284

DATE: February 27, 2002

This memorandum, prepared at the request of your aide Dave Jahr, gives a brief summary of the provisions of Senate Bill 284 (the bill) and of Assembly Substitute Amendment 1 to Assembly Bill 579. Both bills make a number of changes in the Certified Capital Company (CAPCO) program.

### **INTRODUCTION**

The goal of the CAPCO program is to create venture capital. The CAPCO program allows certain insurance companies to earn tax credits for investments the insurance company makes in certified capital companies. The certified capital companies are then required to use the funds to provide capital to certain small businesses. The program is administered by the Department of Commerce (the department).

### **SENATE BILL 284**

#### **Amount of Credits**

Current law limits the total amount of certified investments the department may certify to \$50 million. In addition, each investor is limited to \$10 million of certified investments. [s. 560.31 (2), Stats.] The Senate bill would increase both these limits. The Senate bill authorizes the department to certify another \$100 million in certified capital investments. In addition, the bill would limit individual investors to the greater of \$10 million or 15% of the total certified investments the department may certify.

#### **Requirements for Qualified Businesses**

To qualify as a business in which a capital company may invest (qualified business), a business must meet a number of requirements. One of the requirements is that at least 75% of the employees of a



qualified business must be employed in the state. [s. 560.33 (1) (b), Stats.] The Senate bill provides an alternative to this requirement. Instead, a business may qualify if 75% of the total payroll of the qualified business is paid to employees who are employed in this state.

A second requirement to become a qualified business is that the business had, in the two most recent fiscal years, an average annual net income, after taxes and excluding any carryover losses, of not more than \$2 million. [s. 560.33 (1) (c), Stats.] The Senate bill provides that, for purposes of satisfying this requirement, a partnership, limited liability company, or tax option corporation must calculate its net annual income based on the income of its partners, members, or shareholders that is related to the economic activity of the partnership, limited liability company, or tax option corporation.

Finally, the bill specifies how an investment will be treated if a qualified company violates certain provisions required as a condition of receiving the investment. Examples of these conditions include not relocating the company headquarters outside of this state, and maintaining at least 75% of the company's employees or 75% of the payroll in this state. [s. 560.34 (1), Stats.] If the qualified company violates a required provision, the investment will be valued at 1/2 the amount invested.

### **Reporting Requirements**

The Senate bill also changes one of the reporting requirements. Under current law, a certified capital company must have its financial statements audited annually by a certified public accountant to ensure statutory compliance. The Senate bill would allow a review of financial statements instead of an audit.

### **ASSEMBLY BILL 579**

Assembly Bill 579 is a companion bill to Senate Bill 284. The substitute amendment to Assembly Bill 579 made substantial changes to the bill. Assembly Substitute Amendment 1 (the substitute amendment) eliminates the change in the reporting requirement which would allow a review instead of an audit of a capital company's financial statements. In addition, the substitute amendment makes a number of additional changes to the CAPCO program that are not included in the Senate bill.

### **Expanded Eligibility**

The substitute amendment expands the eligibility for credits under the certified capital company program to insurance companies that pay income taxes under subch. VII of ch. 71, Stats. According to the Department of Commerce, the practical effect of the amendment is to significantly expand the ability of insurance companies domiciled in Wisconsin to participate in the program. A report from the department states that as of October 29, 2001, there were 32 insurance companies participating in the program; two of these companies were domiciled in Wisconsin. [SECTIONS 1, 2, 3, 4, 30, and 31.]

### **Qualified Distribution**

Current law authorizes a certified capital company to make specific distributions if certain conditions are met. The substitute amendment makes the following alterations:

- a. Current law provides that a qualified distribution may be made by a certified capital company to its equity holders for the costs of forming, syndicating, managing, or operating the company. The substitute amendment limits the distribution for forming and syndicating the company to an amount not to exceed 5% of the company's total certified capital.
- b. Current law authorizes a distribution for the reasonable and necessary fees paid to its equity holders for professional services related to the operation of the certified capital company. The substitute amendment limits these fees to an amount not to exceed 5% of the company's total certified capital, unless approved by the Department of Commerce.
- c. Current law authorizes a qualified distribution for a projected increase in federal or state taxes, including penalties and interest on those taxes, of the equity owners. The substitute amendment eliminates the authorization to make a qualified distribution for penalties and interest on projected increases in federal or state taxes.
- d. The substitute amendment authorizes a qualified distribution for the reasonable costs associated with applying for qualified federal funding programs, as determined by the Department of Commerce.

[SECTIONS 5 to 8.]

### **Certification**

Current law provides that the Department of Commerce must certify a person as a certified capital company if, in part, the person has, at the time of application, a net worth of at least \$500,000 and at least \$500,000 in cash, cash equivalents, and marketable securities. The substitute amendment clarifies that these monetary requirements must exist both at the time of application for certification and on the date on which the person is certified. Further, the certified capital company may not return to investors any investments made in the company prior to its certification for the purpose of enabling the company to meet these monetary requirements. Finally, the substitute amendment also provides that a person seeking certification must agree to maintain in Wisconsin an investment office and staff actively engaged in making investments. [SECTIONS 9, 10, and 15.]

### **Required Investment**

Under current law, a certified capital company must ensure that within three years after the investment date for a particular investment pool, at least 30% of the investment pool must be placed in qualified investments. The percentage increases to 50% within five years. The substitute amendment increases these requirements to 70% and 100% within seven and 10 years, respectively. [SECTIONS 21 and 22.]

### **Reporting**

The substitute amendment increases the reporting requirements of a certified capital company. For example, information that must be reported on an annual basis under current law will be required to be reported semi-annually under the substitute amendment. [SECTIONS 23 and 26 to 29.]

**Audit**

The substitute amendment authorizes the Joint Legislative Audit Committee to direct the Legislative Audit Bureau to perform a performance evaluation audit of the certified capital company program, which must include evaluating the overall effectiveness of the program. [SECTION 32.]

I hope the information in this memorandum is helpful. If I can be of any further help, please contact me at the Legislative Council Staff offices.

NZ:rv;jal

Testimony of Sen. Gwen Moore  
Before the Senate Economic Development Committee  
Regarding Senate Bill 284 and Assembly Bill 579  
February 28, 2002

Chairman Jauch and other members of the Economic Development Committee, I am pleased to appear before you today to discuss SB 284 and its companion bill in the Assembly, AB 579.

It is a pleasure to join with my cosponsor and friend in the Assembly, Rep. David Ward, in strongly endorsing SB 284 and AB 579, and in asking for your support for them as well.

Rep. Ward and I enjoyed working together during the 1997-1998 legislative session when we introduced the Certified Capital Company (CAPCO) program to Wisconsin. During that session, we learned that there was a program operating in Louisiana, Missouri and Florida which had been successful in raising hundreds of millions of dollars in venture capital for small businesses in those states. We modeled our legislation after those successful programs, and our legislature approved the Wisconsin CAPCO program in the spring of 1998.

Our original CAPCO program raised \$50 million in venture capital for small Wisconsin businesses. This money was raised by offering tax credits to insurance companies willing to invest in the CAPCO program.

As Representative Ward and I are proud to note, this is the *only* venture capital fund which requires, by law, that every investment of dollars from the fund *must* be in a small Wisconsin business. Specifically, the law requires that in order for a business to receive money from the CAPCO funds, the business must:

- Be located and headquartered in Wisconsin,
- Be in need of venture capital and unable to obtain conventional financing
- Have no more than 100 employees, and at least 75% of those employees must be in Wisconsin
- Have no more than \$2 million in net income per year and a net worth not exceeding \$5 million.

This legislation was advanced four years ago because we realized that there were many small businesses and entrepreneurs who were not able to find any venture capital in Wisconsin. Therefore, these businesses and people left the state. We also realized that

the lack of venture capital contributed to the number of college and university graduates who left the state each year looking for opportunities elsewhere in the country.

The CAPCO program became law in Wisconsin in July of 1999, and the first CAPCOs were certified by the Wisconsin Department of Commerce late that year. Those CAPCOs then raised the \$50 million in venture capital funds and began talking to prospective recipients in the first quarter of 2000.

We are pleased that these CAPCO funds appear to be accomplishing some of our major goals. The CAPCO investments are:

- Leveraging other venture capital investments from both inside and outside Wisconsin.
- Increasing employment *in Wisconsin* at the companies receiving funds
- Helping small Wisconsin companies that are paying their Wisconsin employees very good annual wages (More than \$50,000 annually, on average)
- Generating tax revenue for the state through the income, property and payroll taxes paid by these companies and their employees.

Although we are pleased with this initial success, we are also painfully aware that Wisconsin remains starved for additional venture capital. During 2000, while the venture capital industry had \$225 billion under management nationally, Wisconsin had only \$145 million under management. That is less than one percent of the national total!

From conversations with the CAPCO representatives in the state I have learned that they are reviewing hundreds of applications for these limited funds. Therefore, it is obvious that our initial \$50 million will not satisfy the state's hunger for additional venture capital. With this in mind, the discussion and the need for additional CAPCO funds even before the tragic events of September 11<sup>th</sup>. However, those events, and the resulting effects on our national and Wisconsin economies, added an element of urgency which did not exist before that date. Therefore, we are pleased to note that 17 other Senate colleagues and 44 other Assembly colleagues, Democrat and Republican, shared this same sense of urgency and signed on as original cosponsors of this legislation.

If approved, an additional \$100 million in CAPCO funds will be invested in small Wisconsin companies. No other venture capital fund, either in Wisconsin or outside of Wisconsin, can make that guarantee.

We can also feel confident that these dollars will create good paying jobs in Wisconsin companies that will contribute additional tax revenue at a time when these resources are critical to the state's well being. That fact has become even more critical since Rep. Ward and I introduced these bills last October.

The Assembly has already acted on AB 579. During deliberations on the bill, several amendments were offered and added to the bill before its passage by a vote of 69 to 29 on November 6<sup>th</sup>. Rep. Ward and I have discussed and studied these amendments and other proposals since November, and appreciate the good input we have had from the program's administrator, (the Department of Commerce,) as well as from others, including the existing CAPCOs and some recipients of the first CAPCO funds.

As we appear before you today, we are offering for your consideration Substitute Amendments for our bills which incorporate many of these good ideas. The Substitute Amendments would further enhance and strengthen the CAPCO program by:

- Requiring all the CAPCOs to have Wisconsin offices and staff (this requirement is currently in the Rules for the program, but not in the statutes)
- Requiring more timely filing of reports with the Department of Commerce
- Requiring the CAPCOs to have Department of Commerce approval before they make their investments in individual small Wisconsin businesses.
- Adding a provision which says that the Joint Legislative Audit Committee may direct the Legislative Audit Bureau to perform a performance evaluation audit of the program
- Deleting a provision in the current law which allows a CAPCO to be "decertified" (not regulated by the state) after 10 years. This change will ONLY allow CAPCOs to be "decertified" after they have invested 100% of their certified capital.
- Clarifying that there will be a new certification process for CAPCOs if these new funds are approved. This will allow new CAPCOs to be part of the program.
- Changing the effective date for the tax credits to July 1, 2003, thereby ensuring that there will be NO fiscal impact on this biennial budget if the legislation is approved.
- Making the tax credits available to ALL Wisconsin insurance companies, not just those that pay the premium tax.

Further, you will hear comments from some of the CAPCOs concerning the good things that are being done at some of the companies that have already benefited from our current CAPCO program. The result is retention of entrepreneurs and Wisconsin college graduates in the state, as well as, creating good paying jobs. At the same time, we are leveraging other venture capital investments in the state, while generating new tax revenue for the state at the same time. I am sure you will enjoy hearing this good news as much as I have.

Thank you for the opportunity to appear before you today concerning this important legislation. I hope you will support this legislation and, thereby, support Wisconsin businesses, Wisconsin employees, and Wisconsin's economy.

## CAPCO Program Achievements

February 27, 2002

The early accomplishments of the specialized venture capital firms that were formed under Wisconsin's Certified Capital Company (CAPCO) program already have begun to demonstrate the potential economic impact of the program. The establishment of the CAPCO program has accelerated the formation of pools of venture capital, it helped attract unprecedented amounts of venture capital into Wisconsin from out-of-state investors, it has accelerated the growth of high paying jobs in Wisconsin, and it is generating new wealth in our state. However, the current CAPCO program in Wisconsin is by far the smallest of the six CAPCO programs in the country. The small capacity of the three funds has limited their ability to respond to the needs of the market. Despite this limitation, two of the three of the current CAPCOs face the prospect of being fully invested, including reserves, until investments are exited and funds are available for reinvestment, or until additional tax credits are made available. As manager of Advantage Capital's CAPCO, we can provide the most complete picture of our accomplishments and status, and then supplement that with data from all three firms.

### **What has the State of Wisconsin received in exchange for the \$5 million in tax credits issued thus far to the investors in Advantage Capital Wisconsin Partners I L.P. (ACWP I)?**

1. An investment of \$5,603,771 by ACWP I in five Wisconsin companies.
2. Participating investment in Wisconsin companies of \$62,833,987 from other venture capital and angel investors, including \$44,305,119 invested from out-of-state sources. The CAPCO program helped make us a credible lead investor. A strong local lead is critical to attracting out of state venture capital into developing high tech and biotech companies. Investors want to know that one their of peers is actively involved locally to assist the managers and monitor the investment. This net inflow of investment capital is principally spent on salaries, facilities, supplies, and services in Wisconsin. This adds to tax revenues through in income tax, property tax, and sales tax.
3. A new venture capital fund with \$42 million under management, Venture Investors Early Stage Fund III L.P. (VIESF III), was raised with the assistance of the CAPCO program because of a promise to provide 10% of the gains from the ACWP I to investors in VIESF III. Investors in VIESF III included the State of Wisconsin Investment Board (the largest investor with a \$20 million total commitment), Wisconsin Alumni Research Foundation, University of Wisconsin Foundation, Madison Gas and Electric, Baird Venture Partners and others.
4. A growth of employment in Wisconsin from 101 to 185 employees in these businesses with an average salary of \$64,409. These companies had a total annualized payroll of \$11,915,733 at the end of 2001. These companies are creating high paying jobs of the future and adding to the income tax revenue for the State of Wisconsin.
5. Specialized facilities have been constructed or are under construction for four of these companies. A total of \$19.3 million is being invested to construct and equip these facilities. These companies are planting firm roots in Wisconsin and adding to the property tax base.
6. Since the time of the first investment, these firms have a net unrealized gain in shareholder value of \$65,515,147 (based on arm's length investments by new investors in subsequent rounds of financing). This is adding to the wealth in Wisconsin, and as these gains are eventually realized, it will contribute to the capital gain tax revenue for the State of Wisconsin.

Three of the current portfolio companies are in various stages of discussion with investors about term sheets for new rounds of funding. In aggregate, ACWP I expects to invest an additional \$442,000 in rounds that are expected to total between \$31 million and \$41 million, the majority of which is expected to come from outside Wisconsin. These rounds are targeted for closing before the end of the second quarter.

**With only \$13 million out of \$50 million invested, why is new funding needed now?**

The CAPCO Program participants are required to invest an amount equal to 100% of the tax credits over time, and the current funds are committed to doing this. However, all venture capital funds, including CAPCOs, face practical limitations in how aggressively they can prudently deploy the capital:

1. It is critical for a venture capital fund to keep money in reserve for follow-on investment in existing portfolio companies. This can be a planned future financing, or unplanned. In a planned financing, it is expected that an existing investor will participate as a display of continued confidence in the company and to demonstrate a belief that the proposed investment terms are reasonable. Sometimes it is necessary to have the ability to decline financing and internally fund it because proposed terms are unreasonable. Unplanned financings can be because a company is ahead of projections and needs funding to grow faster, or because it is behind projections and it takes longer to meet objectives and build value. The ability to respond to these situations internally is often critical to the survival and success of the company.
2. All venture capital funds incur operating expenses (salaries, rent, consultants and advisors, legal and accounting fees, etc.), which reduce the net dollars available. All venture capital funds, and CAPCOs are no exception, rely on the successful exit of one or more early investments to provide the dollars needed to invest an amount equal to 100% of commitments. The CAPCOs comfortably have the net resources to pass the threshold of investing an amount equal to 50% of the tax credits as required in the legislation (which is why there is a statutory time line). However, since they rely on the successful exit of one or more of their investments to reach the 100% threshold, approximately \$25 million to \$30 million is effectively available initially. (No statutory timeline is imposed on the second 50%. These investments are high risk, illiquid, and the exit date is uncertain. Imposition of a statutory timeline would require lower risk investments with greater certainty of exit date and amount, which is contrary to the intent of the legislation.)

In the case of ACWP I, here is what has been earmarked:

Amount Invested:	\$5,603,771
Committed to follow-on	\$442,000
New investment proposal outstanding	\$1,250,000
Second additional investment	\$750,000
Reserve for follow-on investment	<u>\$954,229</u>
Total	\$9,000,000

All remaining investment will be accomplished with proceeds from the successful exit of the first seven investments. As a result, we are able to propose only one additional investment unless we exit an investment or receive new funding under the program. While ACWP I has only invested 34% of total required over the life of the fund, the total of investments, commitments, current proposals, and reserves represent 92% of the amount immediately available for investment. A second CAPCO, Wilshire Investors faces a similar predicament. Without new funding, we will have to soon suspend our investment activity until an exit event.

This has been accomplished despite the small size of the program, which has limited the ability of all three of the existing CAPCOs to respond to many opportunities. Despite being the home to the nation's second largest research institution, and having above average per capita spending on Research and development at our universities, we lag in our capacity to commercialize our discoveries. According to the National Venture Capital Association, the venture capital industry



has \$210 billion under management<sup>1</sup>, while Wisconsin has \$163 million under management, or *only 0.08% of the national total*. The average venture capital firm in the U.S. in 2000 has \$302.8 million under management, more than double that all Wisconsin based funds that venture capitalists have raised in the last eight years combined. Venture capitalists that invest in companies that are in the later stages of development will invest nationally, so Wisconsin companies can potentially access the capital that is managed outside of the state. However, venture capitalists need to be more actively involved with an early stage company, which typically requires the presence of a local lead investor. Without the adequate availability of venture capital at the earliest stages, few companies will develop to the stage where they can compete for capital nationally. As a result, Wisconsin based venture capital is an essential ingredient to building companies and attracting investment capital from outside of Wisconsin.

Venture capital is viewed as critical to the development of a robust high technology sector. To be competitive on an international basis, these companies must make enormous investments in research and development and specialized facilities. In the biotech and medical device sectors, where Wisconsin's universities are research leaders, these companies face the added burden of regulatory approval. As a result, Wisconsin not only needs venture capitalists so more companies can obtain financing, it needs venture capitalists whose investment capacity fits the financing requirements of the most qualified opportunities. Nationally, a firm receiving its first round of venture capital had an average round of funding of \$11.52 million in 2000. Wisconsin's three CAPCOs each have \$16.7 million under management and are limited to investments of \$2.5 million per firm. Since venture capital funds want to maintain reserve investment capacity, rarely will one of the CAPCOs be able to prudently consider an investment of more than \$1 million at the time of the initial investment. This modest capacity makes it extraordinarily difficult to take a lead role and attract sufficient co-investors for a first round of funding that would be typical at the national level.

The expansion of the program will broaden the scope of opportunities that the CAPCOs can consider, and will strengthen our ability to be a credible lead investor in significant rounds of financing.

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<sup>1</sup> National Venture Capital Association 2001 Yearbook, & NVCA presentation at the Governor's Summit on Venture Capital

<sup>2</sup> National Venture Capital Association 2001 Yearbook

## Case Study #1: AlfaLight, Inc.

AlfaLight, Inc. will be the subject of a white paper that was commissioned by InvestWisconsin. The story will be presented at the Governor's Summit on Capital on March 22. The following is an excerpt of the white paper written by Stephanie Essex Elkins:

It all started at the urging of one of the four founders, Tom Earles. While taking a technical writing class as an undergrad, Earles developed a strong interest in optical logic devices. During his master's work in electrical engineering at the UW, he learned that there was a group on campus specializing in optical devices. He decided to pursue a Ph.D. under the auspices of UW Professors Dan Botez and Luke Mawst, both of whom would become co-founders of AlfaLight. Well-known in the field of high-power semiconductor lasers, Botez is a theoretician, and Mawst is an experimentalist, complementing each others' skills nicely. The products the pair developed were aluminum-free, high-power semiconductor pump diode lasers. These lasers can be used to amplify digital signals in fiberoptic networks, saving telecommunications companies big bucks.

AlfaLight was started and its founders, who had already patented their UW research through the Wisconsin Alumni Research Foundation (WARF), were able to license back that technology for the new business. WARF eventually became a part-owner of AlfaLight, starting with a 5% stake in return for licensing the technology. They also invested cash in both venture rounds, the first time WARF had ever invested in one of its licensees.

The founders also spent a lot of time during the first year trying to find someone with business experience, avoiding a classic pitfall that can plague technology-driven entrepreneurs – the inability to let someone else run the show. The fledgling company found that person in Eric Apfelbach, a proven leader with a track record in global technology management, having worked with companies such as IBM, Applied Materials, Texas Instruments, Motorola, and National Semiconductor. It didn't hurt that he had a BS in Chemical Engineering.

Apfelbach was raised in Janesville and educated at the UW-Madison, but his career took him all over the globe as he worked his way up the management chain. Enormously successful at sales and management – while at Applied Materials, he helped grow sales from \$175 million to \$4.5 billion in six years. Apfelbach relocated regularly, calling Texas, Vermont, and New York home at one time or another. But the husband and father of two decided to move back to Wisconsin for a better quality of life, even if it meant sacrificing income and career options. Apfelbach started researching opportunities in Wisconsin, and eventually found himself at the WARF offices. Former WARF Director Dick Leazer told him about AlfaLight, and Apfelbach contacted Earles. Apfelbach came on board as the fourth founder. By December of 1999, they had written the initial business plan and arranged for the first round of angel financing, which totaled \$380,000.

The year 2000 was huge for AlfaLight. In January, they used some of the proceeds from the angel round to purchase a computer and rent about 800 square feet of office space in the MGE Innovation Center (a high-tech business incubator) on Madison's Rosa Road. The telecom industry was booming and there was a six-month lead time for the big-dollar equipment that the start-up needed. They decided to go for it, ordering what they needed on sheer faith that additional funding would be in place by the time the invoices came due. In the interim, the group was able to rent lab space and equipment from the UW. Not only were there risks involved, but the team was willing to put their own resources on the line. As Apfelbach put it, "The whole thing is a gamble. In essence, you're committing to spend money that you don't have yet.

Apfelbach began raising the first round of venture capital, doing the "dog & pony show" to investors all over the country. There was tremendous interest in their proprietary technology, especially on the part of Silicon Valley venture firms, but those firms had a caveat: Taking West Coast money would have meant moving AlfaLight's operations from Wisconsin to California, where investors maintained huge networks of support, recruiting, and expertise available to nurture young companies.

The Alfalight team considered the possibility, but declined. "We were all Wisconsin flag-wavers," said Charlie Hoke, an angel investor and Board member, "and we wanted to make it work here." Virtually every member of the company had left the state and come back because they appreciated what Wisconsin had to offer in terms of family lives, outdoor interests, and values. They decided against moving, and sought support closer to home. Venture Investors LLC (the manager of ACWP I) was, quite literally, right down the road.

It was a perfect match. "We specialize in seed and early stage funding for companies with proprietary technology that can serve large markets," acknowledges Scott Button. "They had the ideal scenario – a tremendous market opportunity, licensed technology out of the UW, Dr. Dan Botez, a nationally known expert in the field, and a great partner in WARF," he continued. "And the added benefit was Eric Apfelbach, a world-class manager. It was really a luxury to have someone like that leading the charge in the community. They had all the pieces."

The other major investors in the first venture round were also from the Midwest: Chicago-based Arch Venture Partners, and Enterprise Development of Michigan, both referred by Venture Investors. The first round closed in May of 2000, and Alfalight received \$6.1 million. The value of the company was pegged at \$9.6 million going into the round, and \$15.7 million post-money.

In October of 2000, the burgeoning company moved out of its start-up digs and into a 20,000 square-foot facility (expanded later to 36,000) on Madison's East Side near Madison Area Technical College's Truax campus. Finding a new home was not an easy task – manufacturing lasers necessitates the use of poisonous and volatile gases, substantial capital equipment, and a demanding cleanroom.

As the new facility was being planned, Apfelbach knew they would need significantly more cash for the capital-intensive enterprise. InterWest was one of several top-tier companies that Alfalight considered as their lead investor for the second round, but in the end, InterWest ceded their lead position to Advanced Technology Ventures of Palo Alto (ATV), to whom Alfalight had been introduced by Madison's Venture Investors (manager of ACWP I). The other major investors in the round were the Infrastructure Fund (California) and Centerpoint Ventures of Texas.

Alfalight had a pre-money valuation of \$75 million at this point, up from \$10 million for the angel round, and a post-money valuation of \$15 million for the first venture round only months earlier. In December 2000, they raised \$28 million, just in the nick of time. Between the new facility, foreign subsidiary, equipment, and staff, they certainly needed the resources. In April 2001, the company was able to secure \$9 million in debt funding earmarked for capital equipment for both facilities. Participants in that round of financing included Silicon Valley Bank, GATX, Third Coast Capital, and Transamerica.

Alfalight currently employs 82 people between its Madison and Canada operations. Most of them are highly educated professionals, and many of those in the Wisconsin facility were recruited back to the Midwest by a management team determined to make their high-tech company work in a state to which they are fiercely loyal.

Loyalty wasn't the only reason to keep the company in Wisconsin. According to Charlie Hoke, Wisconsin taxpayers support the university system year after year: "We [taxpayers] ought to get a return on our investment. Capturing the technologies that come out of the UW and keeping them resident in the state of Wisconsin is one way to do that."

## Case Study #2: TomoTherapy, Inc.

TomoTherapy, Inc.'s history extends back more than 10 years, when researchers at the University of Wisconsin-Madison, exploring ways to deliver intensity-modulated radiotherapy (IMRT), developed the concept of helical tomotherapy in 1990. In 1992, the TomoTherapy founders, Thomas Rockwell Mackie and Paul Reckwerdt, and two other partners founded Geometrics Corporation, which developed a three dimensional radiation therapy treatment planning package. In 1996, following FDA approval of that product, the company was sold to ADAC and it is still a leading 3-D treatment planning system.

Radiation is one of the most effective cancer treatments available. It works by damaging the cells it strikes: when the cancer cells are damaged enough, they will die. But what happens to healthy cells that are struck by the radiation beam? A limiting factor in radiation therapy is a lack of accurate knowledge of the tumor location on any given day and the inability to precisely deliver radiation to a location. Even though normal tissue can recover from exposure to radiation, there are often side effects, and of course too much radiation can damage normal tissue beyond repair. Until recently, it was very difficult for doctors to deliver enough radiation to kill a tumor without causing painful or debilitating side effects. Some side effects might go away once the treatment is complete, but others could continue to affect quality of life for years. In other cases, no further treatment is possible because ancillary damage to vital organs becomes life threatening.

Intensity Modulated Radiation Therapy (IMRT) is one of the most important recent advances in radiation therapy. The goal of IMRT is to change (modulate) the size, shape, and strength of the radiation beam in order to focus enough dose on the tumor to kill the cancer cells, while sparing as much as possible the surrounding healthy tissue. A multileaf collimator, or MLC, which is a device that is attached to the linear accelerator consists of many individual fingers or leaves, which move across the beam in a specified pattern to block or allow the passage of radiation, shaping the beam as it is emitted. Still, without precise information of the tumor location at the time of treatment, a safety margin has to be created, sacrificing healthy tissue in attacking the cancer.

The TomoTherapy concept was to integrate CT imaging with a very sophisticated MLC with a unique helical delivery pattern in order to deliver precise radiation at the target. Instead of delivering radiation from just a few directions, the system delivers radiation from every point on the helix—in about the same amount of time as conventional IMRT. By accurately identifying tumor location, precisely delivering treatment, and avoiding vital healthy tissue and organs, it was believed that patient outcomes could be greatly improved.

The Tomotherapy Research Group was officially established at the University of Wisconsin-Madison in 1994, and in 1995, the University of Wisconsin and WARF entered into a research contract with GE Medical Systems. After two years of productive research, GE closed their radiotherapy division, which ended their interest in the TomoTherapy project.

In 1997, two members of the research group founded TomoTherapy, Inc.: Professor Thomas Rockwell Mackie, a leading medical physicist, and Paul J. Reckwerdt, an accomplished mathematician and software engineer. TomoTherapy Inc. licensed over 100 patents from WARF issued worldwide. Buoyed by a previous successful venture in the field, they began a national search for venture capital. However, they were rejected as being too early, too small in a market of giants, as needing too much money, and for being in a location that was viewed as a disadvantage.

Venture Investors (manager of ACWP I) saw a different story. We had a scientific team that had worldwide recognition, they had previous entrepreneurial experience in the field, their concept had potential life saving advantages, and we recognized that with companies like GE Medical Systems, Lunar, and the UW Medical Physics Department, medical imaging and medical physics

was one of the core industry clusters in which Wisconsin excels. Madison was an ideal location for this business.

In 1998, Venture Investors identified another Midwestern venture capital firm, Avalon Investments, to put together a \$3 million round of financing to enable the company to spin out of the university, to build their management team, and to complete a working prototype. They attracted a world-class management team, including John Barni as CEO, the former General Manager of Marconi Medical Systems' \$500 million global CT business. Other key recruits came from GE Medical Systems, Lunar, ADAC, and Marconi. With the successful completion of the prototype and the assembly of this stellar team, they expected the second round of capital to be easier to secure.

Despite the success, venture capitalists on the coasts continued to pass on the opportunity. Again, the size of the competitors, the unique challenges of the large capital equipment markets, the uncertainty of the FDA approval process, and the location of the company were common reasons for the lack of interest. The company projected a need for \$8.5 million to reach FDA approval. A smaller round wouldn't work because it wouldn't enable the company to reach the milestones that increased its value. There are a limited number of investors in the Midwest that have the capacity to lead a round of this size, even though it is commonplace on the coasts.

The original investment by Venture Investors was out of a \$15.8 fund (VIESF II) that had capacity to invest up to \$1.5 million per deal. It was fully invested. Without the CAPCO program, we would have been dead in the water. The CAPCO Program enabled Venture Investors to raise a companion fund, Venture Investors Early Stage Fund III L.P. (VIESF III) by offering a portion of the CAPCO gains as a sweetener to the returns for VIESF III. This resulted in the formation of a \$37.1 million fund, plus access to an additional \$5 million from the State of Wisconsin Investment Board. When combined with the CAPCO, this gave us \$58.1 million to deploy and enabled us to be a credible lead investor for this second round of funding. VIESF III invested \$2 million and ACWP I invested \$1 million in an \$8.9 million round that closed in the second quarter of 2001. Other investors included Baird Venture Partners, Open Prairie Ventures (Champaign, IL), Mayo Medical Ventures, and Avalon Investments.

The prototype was installed at the University of Wisconsin-Madison Hospital and researchers there received a \$7.5 million grant from the National Cancer Institute to research the opportunity for improved patient outcomes with the device. In November 2001, the company submitted its application for FDA approval and unveiled the product at two major industry trade shows. Several major comprehensive cancer centers in North America signed up as a part of the company's Centers of Excellence program and committed to research using the device to be in a position to be one of the first to get a device after FDA approval. In early February, the company received regulatory clearance from the FDA.

TomoTherapy is now preparing to launch into the market later this year. This spring, the company will move into a dedicated headquarters facility, which is being constructed on the west side of Madison for research, manufacturing, and customer training. Employment is expected to grow from 54 to 106 during 2002. The company is planning on raising an additional \$12-20 million to aggressively pursue the market. Now that the company has attained the required critical mass of achievements that were financed with local and regional sources, this last round of capital will be raised in a different environment. Strategic and venture capital investors are already expressing an interest in investing in the company. We are expecting a competitive environment for the right to invest in the company and will likely have to turn investors away. Without the CAPCO program, we would have not been able to raise enough money to get to this point.

**Aggregate data for Wisconsin's Certified Capital Companies**

	Advantage Capital	Bank One Stonehenge	Wilshire Investors	Total <sup>1</sup>
Number of companies financed	5	3	5	12
Amount Invested by CAPCO	\$ 5,603,771	\$ 2,300,000	\$5,150,000	\$ 13,053,771
Co-investment by other Wisconsin investors	\$19,528,868	\$ 9,408,711	\$1,272,519	\$ 22,251,387
Co-investment by out of state investors	\$44,305,119	\$ 2,500,000	\$ 75,000	\$ 46,880,119
Total Invested in Wisconsin Companies	\$69,437,759	\$14,208,711	\$6,497,519	\$ 81,285,408
Outstanding commitments & proposals to invest	\$ 1,692,000	\$ 1,250,000	0	\$ 2,942,000
Commitments to side-by-side venture funds	\$42,075,758	0	\$7,000,000	\$ 49,075,758
Tax Credits Issued	\$ 5,000,000	\$ 5,000,000	\$5,000,000	\$ 15,000,000
Wisconsin employees as of December 31, 2001	185	111	25	288
Average Salary	\$ 64,409	\$ 49,888	\$ 31,604	\$ 56,921
Total Annualized Wisconsin Payroll	\$ 11,915,733	\$ 5,537,592	\$ 790,100	\$ 16,393,313

<sup>1</sup> Does not equal the total of the individual firms because of a common investment of ACWP I and Bank One Stonehenge.