WISCONSIN STATE LEGISLATURE COMMITTEE HEARING RECORDS

2003-04
(session year)

Assembly
(Assembly, Senate or Joint)

Committee on Insurance (AC-In)

File Naming Example:

Record of Comm. Proceedings ... RCP

- 05hr_AC-Ed_RCP_pt01a
- 05hr_AC-Ed_RCP_pt01b
- 05hr_AC-Ed_RCP_pt02

COMMITTEE NOTICES ...

- Committee Hearings ... CH (Public Hearing Announcements)
- **

- Committee Reports ... CR
- **

- Executive Sessions ... ES
- **

- Record of Comm. Proceedings ... RCP
- **

INFORMATION COLLECTED BY COMMITTEE CLERK FOR AND AGAINST PROPOSAL

- Appointments ... Appt
- **

Name:

- Clearinghouse Rules ... CRule
- **

- Hearing Records ... HR (bills and resolutions)
- **03hr_ab0524_AC-In_pt01**

- Miscellaneous ... Misc
- **

Rosenak, Mary Jan

From: Shepherd, Jeremey
Sent: Monday, October 27, 2003 9:11 AM
To: Rosenak, Mary Jan
Subject: Commerce plan for Venture Capital

Mary Jan,

Here's a document and diagram of what Commerce is thinking in regards to our bill AB 538/SB 261 and McCormick's bill, AB 524. Take a look at this and let me know what you think...

vc allocation 10-26-03[2].doc

VC Diagram 1[1].doc

Venture Capital Allocation
$185 Million

I. Traditional Venture Capital (VC) Funds — $75 Million in Tax Credits

Modified Assembly Bill 524
Governor's Grow Wisconsin Initiative

- Support the expansion of traditional VC funds in Wisconsin
  - Authorize Commerce to allocate $75 million in tax credits to individuals that invest in qualified Wisconsin Venture Capital firms
  - The credit would be 15% of funds invested not to exceed $300,000. As such, the maximum eligible investment would be $2 million.
  - No more than 10% of credits allocated could be taken in any given year. Therefore, the budget impact would not exceed $7.5 million in any given year.
  - The credits would result in an additional $500 million being invested in Wisconsin VC firms ($500 million increased investment x 15% = $75 million in tax credits)
  - The credits would be allocated in two rounds, 50% in first round (year 1) and 50% in the second round (year 3)
  - Credits can only be taken in tax years beginning on or after 01/01/05
  - VC firms will be required to invest in Wisconsin companies in direct proportion to the amount of the fund that received tax credits, e.g., if the capitalization of Fund A is $100 million and tax credits were provided on only $60 million of that amount, then Fund A would be required to invest 60% of its funds in WI businesses.
  - Note:
    - 1.) The tax credit for traditional VC firms is less than the credit provided angel investors because the VC risk is spread over a portfolio of companies rather than just a single company.
    - 2.) No VC fund would be certified if its total capitalization would be less than $20 million
    - 3.) No single VC fund would receive an allocation of more than $11.25 million in tax credits.

II. Early Stage & Seed Venture Capital Funds — $25 Million in Tax Credits

Modified Assembly Bill 524
Governor's Grow Wisconsin Initiative

- Support the creation of early stage seed funds in Wisconsin
  - Authorize Commerce to allocate $25 million in tax credits to individuals that invest in qualified Wisconsin Seed Funds
  - The credit would be 25% of funds invested not to exceed $125,000. As such, the maximum eligible investment would be $500,000.
  - No more than 10% of the credits allocated could be taken in any given year. Therefore, the budget impact would not exceed $2.5 million in any given year.
  - The credits would result in an additional $100 million being invested in Wisconsin seed funds ($100 million investment x 25% = $25 million in tax credits)
  - The credits would be allocated in two rounds, 50% in first round (year 1) and 50% in the second round (year 3)
  - Credits can only be taken in tax years beginning on or after 01/01/05

- VC firms will be required to invest in Wisconsin companies in direct proportion to the amount of the fund that received tax credits, e.g., if the capitalization of Seed Fund B is $20 million and tax credits were provided on only $16 million of that amount, then Seed Fund B would be required to invest 80% of its funds in WI businesses.
- Notes:
  - 1.) No seed fund would be certified if its total capitalization was less than $10 million.
  - 2.) No more than $5 million in tax credits would be provided to any single seed fund.

III. Community Based Seed Funds — $5 million in Tax Credits

Modified Assembly Bill 524
Governor's Grow Wisconsin Initiative

- Support the creation of community based seed funds in Wisconsin
  - Authorize Commerce to allocate $5 million in tax credits to individuals that invest in qualified Wisconsin community based seed funds
  - The credit would be 25% of funds invested not to exceed $125,000 per investor. As such, the maximum eligible investment would be $500,000.
  - No more than 10% of the credits allocated could be taken in any given year. Therefore, the budgetary impact would not exceed $500,000 per year.
  - The credits would result in an additional $20 million being invested in Wisconsin community based seed funds ($20 million investment x 25% = $5 million in tax credits)
  - The credits would be allocated on an ongoing basis as eligible applications are received
  - Credits can only be taken in tax years beginning on or after 01/01/05
  - Notes:
    - 1.) No community based seed fund would be certified if its total capitalization was less than $1 million.
    - 2.) No more than $1 million in tax credits would be provided to any single community based seed fund

IV. Angel Investors — $25 Million in Tax Credits

Modified Assembly Bill 538

- Support Angel Investors
  - Authorize Commerce to allocate $ 25 million in tax credits to individuals that invest in qualified Wisconsin businesses.
  - The credit would be 25% of the funds invested not to exceed $125,000. As such, the maximum eligible investment would be $500,000.
  - No more than 10% of the credits allocated could be taken in any given year. Therefore, the budget impact would not exceed $2.5 million in any given year.
  - The credits would assist, at a minimum, 20 early stage companies per year and result in an additional investment of $100 million over the 10 year life of the program
  - Credits can be earned any time but can only be taken in tax years that begin on or after 01/01/05.

V. Increased Federal Research Spending — $50 million in GPR funds

Governor's Grow Wisconsin Initiative

- Implement the Governor's Technology Commercialization Grant and Loan Program
- Create a set of new programs at Commerce designed to stimulate increased federal spending on R&D in WI as well as provide equity matching grants to assist w/proof of concept type projects.
  - Early Planning Grants — 75% up to $15,000
  - Federal Matching Grants — 20% up to $250,000
  - Bridge Grants — 75% up to $100,000
  - Equity Matching Grants — 50% up to $250,000
  - $4.8 million available on an annual basis.
  - Includes authorization for 2 Commerce positions

VI. Technology Transfer — $5 million in GPR funds

Governor's Grow Wisconsin Initiative

- Implement the Technology Transfer program which is a collaboration between Commerce, WARF, WiSys and the Small Business Development Center.
- The program is needed to offset the fact that Wisconsin lacks both formal and informal networks to assist emerging new economy businesses.
- The Technology Transfer program is designed to provide a coordinated approach to assisting technology start-ups at their nascent stage.
- Services would include IP review, technology searches, patent, trademark and copyright information, feasibility assessments, referrals (atty's, accountants, angel network, VC firms, etc.), training, etc.
- Program involves establishing three new entrepreneurial centers at SBDC offices in northwest, northeast and southeast Wisconsin.
- Implementation of this program will result in state-wide availability of services.

VII. Patients Compensation Fund and SWIB

Governor's Grow Wisconsin Initiative

- Commerce would continue to encourage SWIB & PCF to focus a portion of their respective investment pools on Wisconsin businesses.

Assembly Bill 538
Credits for Investments in Qualified Businesses
by Angel Investors

Introduced By:

Rep.'s: Nischke, McCormick, Ladwig, Musser, Montgomery, Towns, Owens, Lehman, Weber, Van Roy, Krawczyk, Olsen and Ott.

Sen.'s: Kanavas, Stepp, Leibham, Welch, Darling, Zien and Lassa

Issues & Concerns:

- The bill has a stepped-down credit - 20% of the first $100,000 and 10% of the investment in excess of $100,000.
  - *For the sake of simplicity and consistency, Commerce would prefer a fixed credit of 25%.*

- The bill does not cap the level of investment for which a tax credit can be received.
  - *Commerce would prefer to limit the credit to the first $250,000 invested by an individual.* ok

- The bill does not limit the amount of credits that can be taken on an annual basis or cap the maximum amount of credits that will be provided.
  - *Commerce would limit the tax credits available under the program to $25 million and limit the amount of credits that can be taken in any single year to no more than $2.5 million.*

- The bill includes a provision that would allow individuals to defer tax liability on gains from the sale of assets provided they notify DOR and then reinvest the gain in either a qualified venture capital firm or qualified technology businesses.
  - The argument in favor of this is that investors are not sitting on liquid assets to invest. Instead, in order to make the desired investment in new businesses, the investor will have to liquidate assets, pay tax on the gain, and then reinvest the remainder. The concern is that the tax credit provided on the new investment may not off-set the taxes paid on the gain. As such, the investor may choose not to participate in the program.
  - *Commerce's position is that this provision adds an unnecessary level of complexity to the program and clouds the program benefit, i.e., are we providing tax credits on deferred taxes that are owed to the state. Paying tax on the capital gain is the status quo. We are trying to compete against the plethora of options that individuals have as to where to place their liquid assets or after-tax gains. The proposed tax credit should be an attractive incentive.*

- The bill includes a provision that would treat gains from the sale of an asset that is a technology business different from the gains from the sale of other assets. Specifically, the bill would allow gains realized on the sale of investments in technology businesses to be tax-free.
  - *Commerce's position is that this provision is unnecessary given the 25% tax credit. Commerce is also concerned about the precedent of making certain gains tax-free. This issue could negatively impact the broader based goals of the initiative.*

- The bill includes a finders fee of up to $50,000 for broker-dealers whose clients invest in businesses are eligible to receive the tax credit.
  - *Commerce does not believe that a finders fee is appropriate and is convinced that professional broker-dealers will make their clients aware of the tax credit program. Commerce does not want to get into the debate about commission vs. fee-for-service financial services.*

- The bill requires Commerce to prepare an annual report on business start-ups and impediments to growth.
  - *Commerce supports this provision but feels that a biennial report will allow for a better presentation of the data.*

- The bill defines eligible businesses as: 1.) Headquartered in WI - 2.) 51% of employees in WI - 3.) Avg net income less than $20 million - 4.) Net worth less than $75 million - 5.) Not professional services (acct., atty's, physicians, trade, leisure, hospitality, banking or real estate) - 6.) Has been in business for at least one year but less than ten years.
  - *Commerce believes that the definition should be modified to target small businesses and include start-ups. Specific language to follow.*

Assembly Bill 524
Credits for Investments in Qualified
Venture Capital Funds

Introduced By:

Rep.'s: McCormick, Seratti, Hahn, Albers, Krawczyk, Friske, Gronemus, Weber, Gielow and Ott.

Sen.'s: Kanavas, Stepp, Lassa, Reynolds and Roessler

Issues and Concerns:

- The bill provides a 6% credit on investments in qualified venture capital (VC) funds up to $60,000 per claimant and a 20% credit for investments in community-based VC funds.
  - *Commerce believes that three types of qualifying funds should be recognized. Namely, traditional VC funds, early stage seed funds and community-based seed funds.*
  - *Commerce also believes that the credit percentage and dollar amount of credits available should take into consideration the differences between the three types of funds. Specifically Commerce recommends:*
    - *Traditional VC funds - A 15% credit of up to $300,000 per individual investor with the total credits allocated not to exceed $75 million.*
    - *Early stage seed funds - A 25% credit of up to $125,000 per individual investor with the total credits allocated not to exceed $25 million/*
    - *Community-based seed funds - a 25% credit of up to $125,000 per investor with the total credits allocated not to exceed $5 million.*

- The bill does not require VC firms to invest in WI businesses but asks that they make a commitment to consider making investments in WI businesses.
  - *Commerce believes that the VC firms should be required to invest in WI businesses in proportion to the % of the fund that is receiving tax credits.*
  - *Any negative impact associated with such a geographical limitation should be mitigated by the increased size of the tax credit.*
  - *Also, the individual investors and fund managers can decide the % that they want the fund targeted to WI businesses by having investors forgo tax credits on a portion of their investment or investing more than the maximum eligible for the credit.*

- The bill creates a Capital Investment Board with 3 members appointed by the Governor and 1 member appointed by the Speaker and 1 member appointed by the Senate Majority Leader. The bill also directs the Board to promulgate rules, accept applications, issue notices, certify funds and hire staff.
  - *Commerce supports the establishment of a Capital Investment Board and is generally comfortable with the make-up of the Board. However, Commerce believes that the Board should act in a fashion similar to other Commerce boards and/or councils such as the Wisconsin Development Finance Board and the Industrial Revenue Bond Council. Under this model, the Capital Investment Board would be responsible for certifying funds while the administrative functions, including staffing, would be carried out by Commerce.*

- The bill includes language that would allow tax credits to be provided to individuals that invest in qualified businesses.
    - *Commerce believes this language should be eliminated since investments into qualified businesses is addressed in Assembly Bill 538.*

- The bill allows the tax credits to be carried for a period of 5 years.
    - *Commerce believes the carry-forward provision should be 15 years which is consistent with what is allowed under Commerce's other tax credit programs.*

ISSUES AND PROCESS

1. What could this mean with regard to impact

Fund Type	Minimum Size		Maximum Size		No. of Funds	
	Cash	Credits	Cash	Credits	Min	Max
Traditional	$20 mil.	$3 mil.	$75 mil.	$11.25 mil.	6.7	25
Seed	$10 mil.	$2.5 mil.	$20 mil.	$5 mil	5	10

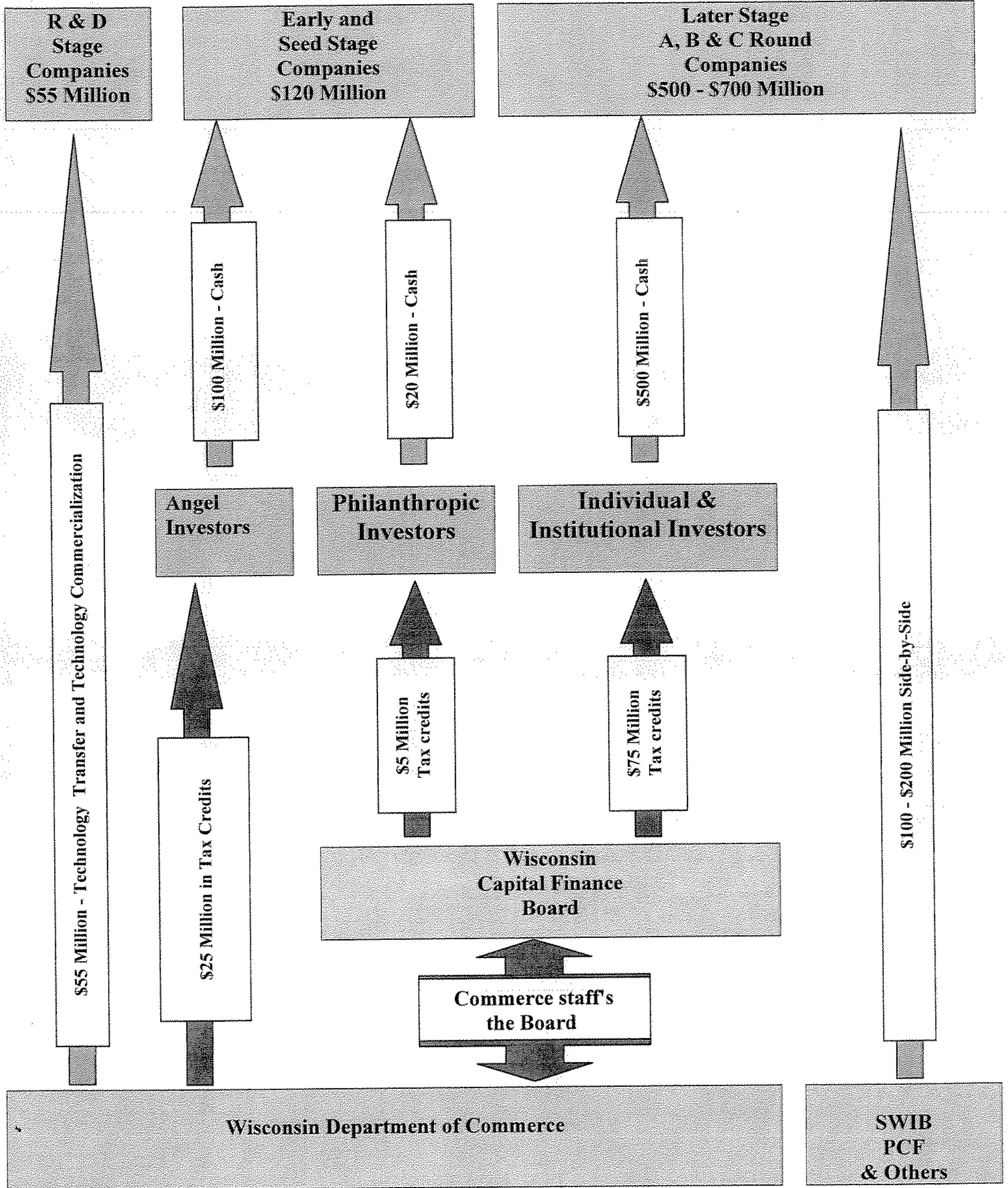
2. We would give each applicant 6 months from the date certified by Commerce to raise the minimum amount of capital.

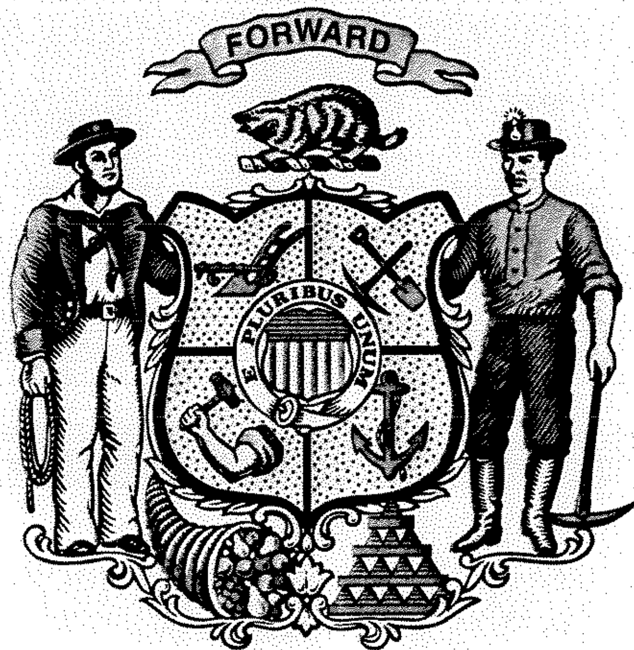
3. With regard to the Angel Investor credits, we would limit the investment in a certified business to no more than $1 million (4 angels @ $250,000 each).

4. From a budgetary perspective, the impact is as follows:

Program	FYE	6/04	6/05	6/06	6/07	6/08 - 6/13	
VC-Trad. Rnd 1		0	0	3.75	3.75	3.75	3.75
	Rnd 2	0	0	0.00	0.00	3.75	3.75
VC-Seed Rnd 1		0	0	1.25	1.25	1.25	1.25
	Rnd 2	0	0	0.00	0.00	1.25	1.25
Comm. Fund		0	0	0.50	0.50	0.50	0.50
Angel		0	0	2.50	2.50	2.50	2.50
Federal R&D		5	5	5.00	5.00	5.00	5.00
Tech. Trfr.		1	1	1.00	1.00	1.00	1.00
Total - Year		6	6	14.00	14.00	19.00	19.00
- Biennium		12		28		38	

Venture Capital Proposal




FORWARD
E PLURIBUS UNUM

Rosenak, Mary Jan

From: Ward, Dave
Sent: Wednesday, November 12, 2003 2:47 PM
To: *Legislative All Senate; *Legislative All Assembly
Subject: RE: URGENT: Wisconsin Capital Investment Corp (AB 524) vs. WISCAP (revised CAPCO)

Importance: High

CAPCO Program Impact 3-31-03.d...

Memo on AB 524.doc

Response to PCO News Summary

WISCAP Concerns and Answers.do...

Colleagues,

We have all received the below e-mail that criticizes the WISCAP program and promotes an alternate approach to raising venture capital in Wisconsin. These criticisms contain numerous factual inaccuracies and misleading statements. It attempts to use criticisms from experiences in other states where their bills bear little resemblance to the WISCAP program, and ignores Wisconsin's favorable experiences with the original CAPCO bill. The projections cited for AB 524 are highly speculative, and rest on the assumption that the proposal would, in fact, attract investors and qualified fund managers. Experienced venture capitalists that stand to benefit from any viable program adopted by the State have expressed numerous doubts about that key assumption. Unfortunately, the e-mail below was prepared by a group that has no documented experience as a general partner of a venture capital fund.

Additionally, AB 524 fails to consider the experience of the CAPCO program and incorporate the reforms that will help the WISCAP program do an even better job of focusing the funds on the desired investment activity. For those of you that have not seen the accomplishments of the existing CAPCO program, are not familiar how the WISCAP bill responds to concerns and criticisms, or have not seen how Wisconsin's venture capital community questions the viability of AB 524, we have attached that information for your review.

The current CAPCO program has been up and running for three years. Last session, we passed legislation in the Assembly which made changes to improve the program. Unfortunately, the Senate declined to move on the bill. Our WISCAP legislation reflects very dramatic changes to the CAPCO program - a culmination of attempted changes over the last two years. We have been working in good faith with the administration and colleagues for well over a two months and have sucessfuly reached a bipartisan consensus. It is unfortunate that the promoters of AB 524 choose to not recognize this fact.

Please do not hesitate to contact us if you have any questions or concerns.

Sincerely,

Representative David Ward, Senator Gwen Moore and Senator Ted Kanavas

-----Original Message-----
From: George Franco [mailto:gfranco@infc.net]
Sent: Wednesday, November 12, 2003 9:35 AM
To: Representative John Gard (E-mail)
Cc: Representative Alvin Ott (E-mail); Representative Amy Sue Vruwink (E-mail); Representative Ann Nischke (E-mail); Representative Annette Williams (E-mail); Representative Barbara Gronemus (E-mail); Representative Becky Weber (E-mail); Representative Bob Ziegelbauer (E-mail); Representative Bonnie Ladwig (E-mail); Representative Carol Owens (E-mail); Representative Christine Sinicki (E-mail); Representative Curt Gielow (E-mail); Representative Dan Meyer (E-mail); Representative Dan Schooff (E-mail); Representative Daniel LeMahieu (E-mail); Representative Daniel Vrakas (E-mail); Representative David Cullen (E-mail); Representative David Travis (E-mail); Representative David Ward (E-mail); Representative Dean Kaufert (E-mail); Representative

Debi Towns (E-mail); Representative Donald Friske (E-mail); Representative DuWayne Johnsrud (E-mail); Representative Eugene Hahn (E-mail); Representative Frank Boyle (E-mail); Representative Frank Lasee (E-mail); Representative Gabe Loeffelholz (E-mail); Representative Garey Bies (E-mail); Representative Gary Sherman (E-mail); Representative Glenn Grothman (E-mail); Representative Gregg Underheim (E-mail); Representative Gregory Huber (E-mail); Representative Jake Hines (E-mail); Representative James Kreuser (E-mail); Representative Jean Hundertmark (E-mail); Representative Jeff Fitzgerald (E-mail); Representative Jeffrey Stone (E-mail); Representative Jeffrey Wood (E-mail); Representative Jennifer Shilling (E-mail); Representative Jerry Petrowski (E-mail); Representative Joe Plouff (E-mail); Representative John Ainsworth (E-mail); Representative John Lehman (E-mail); Representative John Steinbrink (E-mail); Representative John Townsend (E-mail); Representative Johnnie Morris (E-mail); Representative Jon Richards (E-mail); Representative Josh Zepnick (E-mail); Representative Judy Krawczyk (E-mail); Representative Karl Van Roy (E-mail); Representative Kitty Rhoades (E-mail); Representative Larry Balow (E-mail); Representative Leah Vukmir (E-mail); Representative Lena Taylor (E-mail); Representative Leon Young (E-mail); Representative Lorraine Seratti (E-mail); Representative Louis J Molepske Jr. (E-mail); Representative Luther Olsen (E-mail); Representative Margaret Krusick (E-mail); Representative Mark Gottlieb (E-mail); Representative Mark Gundrum (E-mail); Representative Mark Honadel (E-mail); Representative Mark Miller (E-mail); Representative Mark Pettis (E-mail); Representative Mark Pocan (E-mail); Representative Marlin Schneider (E-mail); Representative Mary Hubler (E-mail); Representative Mary Williams (E-mail); Representative Michael Huebsch (E-mail); Representative Michael Lehman (E-mail); Representative Michael Powers (E-mail); Representative Pedro Colón (E-mail); Representative Phil Montgomery (E-mail); Representative Robert Turner (E-mail); Representative Robin Kreibich (E-mail); Representative Samantha Kerkman (E-mail); Representative Scott Gunderson (E-mail); Representative Scott Jensen (E-mail); Representative Scott Suder (E-mail); Representative Sheldon Wasserman (E-mail); Representative Sheryl Albers (E-mail); Representative Shirley Krug (E-mail); Representative Sondy Pope-Roberts (E-mail); Representative Spencer Black (E-mail); Representative Spencer Coggs (E-mail); Representative Stephen Freese (E-mail); Representative Stephen Nass (E-mail); Representative Steve Kestell (E-mail); Representative Steve Wieckert (E-mail); Representative Steven Foti (E-mail); Representative Suzanne Jeskewitz (E-mail); Representative Terese Berceau (E-mail); Representative Terri McCormick (E-mail); Representative Terry Musser (E-mail); Representative Terry Van Akkeren (E-mail); Representative Thomas Lothian (E-mail); Representative Tom Hebl (E-mail); Representative Tony Staskunas (E-mail); Representative Wayne Wood (E-mail)
Subject: URGENT: Wisconsin Capital Investment Corp (AB 524) vs. WISCAP (revised CAPCO)

Dear John:

Attached you will find information related to the Wisconsin Capital Investment Corporation (WCIC), a model (with fund managers' share of the carry that is in practice today) that optimizes the economic impact of Wisconsin tax credits. The return on investment for the State tax credits under the WCIC far exceeds that under WISCAP (revised CAPCO), an attempt to reform what is already a poor business model in terms of optimum economic growth for the State of Wisconsin. [I have grave concerns about the WISCAP approach at a time when taxpayers are appropriately hyper-sensitive to how the State utilizes our fiscal resources (tax credits).]

The WCIC represents a clear policy choice to drive critical Wisconsin deal flow of seed and emerging companies, venture capital, the economy and new jobs. While the CAPCO's are just now being forced to adopt reform proposals, they are still CAPCO's with a portion of the funds still wasting away in bond and idle investments, with abnormal profits going for fund managers' lobbying efforts, and with insufficient focus on obtaining, mentoring and growing ideas, seed entrepreneurs and angels.

For your information I have attached background materials showing the favorable aspects of the Wisconsin Capital Investment Corporation private initiative vs. the WISCAP (CAPCO) model.

- The first attachment has a one page WCIC Bullet Points Summary and a one page WCIC Economic Impact Summary

- The second attachment shows graphs and charts that compare the WCIC and WISCAP (revised CAPCO) proposals.

- The third attachment is a two page summary of news articles indicating the negative results that other state governments have unfortunately resulted from their being over-lobbied to pass a bad public policy CAPCO program, which delivered very limited investments and few or even loss of jobs, while still enormously profiting the fund managers.

Please reach me at (414) 406-9873 to discuss this further and so I can address any questions you may have.

Sincerely,

George

Geo. Franco
(414) 406-9873

<<WCIC Summary.pdf>> <<Charts & Graphs.pdf>> <<CAPCO News Summary.pdf>>

Certified Capital Company Program
Stimulating Wisconsin's High Tech Sector
March 31, 2003

The Importance of Venture Capital

Wisconsin possesses many of the characteristics that are viewed as essential ingredients to the establishment of a vibrant high tech economy. We are the home of a major research university that stimulates innovation. We have a highly educated and skilled workforce. However, we lack sufficient venture capital to start and grow many of the businesses with the greatest potential. Why is it strategically important for Wisconsin to have adequate pools of venture capital? Consider the characteristics of venture capital backed companies and the staggering impact of venture capital on the US economy. For every $1,000 in assets, companies that were originally venture backed outperformed other public companies on a relative basis across a number of economic measures between 1980 and 2000[1]:

- Venture backed companies had nearly double the revenue at $634 versus $391.
- Venture backed companies paid almost three times as much in Federal taxes at $14 compared to $5.
- Venture backed companies exported nearly double the product at $138 versus $72.
- Venture backed companies spent approximately three times as much on research and development with $44 versus $15.
- Approximately 11% of the US GDP and one out of every nine jobs in 2000 was generated by an originally venture backed enterprise. If supporting businesses that deliver goods and services to these venture backed companies were also included in the total, the jobs number increases by a factor of 2.2, translating to 27 million jobs.

The State of Wisconsin generates direct financial returns from the CAPCO program and the venture capital industry investment through the income tax of the employees and businesses, a capital gains tax from the gains of founders and investors, as well as sales and property taxes resulting from the activities of these new businesses and the individuals associated with them.

Wisconsin's need for venture capital

Despite being the home to the second largest research institution in the nation, and having above average per capita spending on Research and development at our universities, we lag in our capacity to commercialize our discoveries.

Wisconsin compared to the Nation	Wisconsin's Percent	Wisconsin's Rank
Population	1.95%	18th
R&D spending at Universities	2.24%	13th
Venture capital under management	0.04%	32th
Wealth	1.30%	41st
Sources: US Census Bureau, National Science Foundation, National Venture Capital Association, Wisconsin Tax Payers Alliance.		

According to the National Venture Capital Association, the venture capital industry has $253 billion under management[2], while Wisconsin has $96 million under management, or *only 0.04% of the national total*. The average venture capital firm in the U.S. in 2002 has $283.9 million under management, nearly three times the amount that all Wisconsin based 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,

[1] DRI-WEFA studies on Venture Capital, 2001 and 2002.
[2] National Venture Capital Association 2003 Yearbook

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 $6.99[3] million in 2002, and most companies need multiple rounds of funding over time. Wisconsin's three CAPCOs each have $16.7 million under management and have a statutory limitation of investments of $2.5 million per firm. However, most venture funds do not want to put more than 10% of their capital in any one deal. Furthermore, venture capital funds want to maintain reserve investment capacity for subsequent funding rounds, so 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 CAPCO Program causes venture capital fund formation in Wisconsin

The establishment of a venture capital industry in a state is a classic chicken and egg problem. Pools of capital are difficult to raise unless there are a demonstrated concentration of entrepreneurial success stories and an experienced group of venture capital fund managers. However, without the availability of capital, it is difficult to create the concentration of entrepreneurial success stories and fund managers cannot build their track record. We need to grow our own venture capital industry. Success in the venture capital business is tied to the ability to build a network of local and regional contacts and resources to advise and counsel a company. A successful venture capitalist is unlikely to abandon the resources they develop in one state and then start from scratch in a new location. Unfortunately, it is a difficult time to grow the state's venture capital industry. Traditional investors in venture capital are not currently getting liquidity from past investments in the weak climate for initial public offerings, slowing the ability to make new commitments to new funds in the US from a high of over $100 billion in 2000 to less than $1 billion in the first quarter of 2003.

The CAPCO Program uses tax credit incentives to tilt the playing field, reducing risk or enhancing returns to make an investment in a Wisconsin based fund relatively more attractive. Certified Capital Company legislation has been adopted by eight states: Louisiana, Missouri, Florida, New York, Colorado, Texas, Alabama, and Wisconsin. The evidence from these eight states is that the demand for this type of investment opportunity exceeds supply. As a result, the availability of additional tax credits for the CAPCO Program will almost certainly result in the availability of more venture capital in Wisconsin, even in the current difficult climate. Wisconsin's CAPCO Program is currently the smallest of the eight established programs.

STATE	Total Requested Since Inception of CAPCO Program (Industry-wide)	Total Allocated Since Inception of CAPCO Program (Maximum available)
Florida	$ 274,850,000	$ 150,000,000
Louisiana *	$ 1,121,000,000	$ 721,000,000
Missouri	$ 317,800,000	$ 140,000,000
New York	$ 758,200,000	$ 280,000,000
Wisconsin	$ 150,000,000	$ 50,000,000
Colorado	$ 454,000,000	$ 100,000,000
Alabama	Not yet allocated	Not yet allocated
Total	**$ 3,075,850,000**	**$ 1,441,000,000**

*Estimated: amount available was unlimited prior to 1998.
Source: Advantage Capital

[3] National Venture Capital Association 2003 Yearbook

The CAPCO Program has a multiplier effect

The CAPCO Program has a multiplier effect on the availability of venture capital in Wisconsin in two ways. First, the CAPCO fund managers serve as lead investors and actively solicit participating investment from other venture capitalists locally and nationally. Second, management of the CAPCO fund can enhance the ability of the manager to raise additional capital outside of the CAPCO Program.

The venture capital industry tends to be more cooperative than competitive. The typical transaction includes three or four venture capitalists that band together and provide financing on a single set of terms. This is usually necessary because the financing requirements of a single firm are commonly greater than the capacity of any single investor. This also provides greater capacity around the table for future rounds of financing, and greater diversity of expertise to assist the company. The investor that locates the deal, drafts the terms for investment, and coordinates or actively recruits the participation of the other investors is informally considered the lead investor. Advantage Capital Wisconsin Partners I L.P. has served as lead investor or co-lead investor in each of the six transactions in which it invested, while Stonehenge and Wilshire have led the majority of their deals. We have demonstrated that this is an effective means of attracting investment capital into Wisconsin.

Multiplier effect for CAPCO Program (dollars in millions)	**Advantage Capital**	**Stonehenge Capital**	**Wilshire Capital**	**Total[1]**
Amount invested by Wisconsin CAPCOs	$7.9	$5.5	$7.4	$20.7
Co-investment by other Wisconsin investors	$30.8	$14.2	$1.3	$35.5
Co-Investment by out-of-state investors	$86.3	$15.3	$0.1	$89.0
Total invested in Wisconsin companies	$125.0	$34.9	$8.7	$145.1
Multiplier of invested capital	**15.9 x**	**6.4 x**	**1.2 x**	**7.0 x**
Amount managed by CAPCO	$16.7	$16.7	$16.7	$50.0
Side-by-side venture capital fund raised	$37.1	0.0	$0.0	$37.1
Total raised	$53.8	$16.7	$16.7	$87.1
Multiplier of venture capital managed	**3.2 x**	**1.0 x**	**1.0 x**	**1.7 x**

Source: Venture Investors, Advantage Capital, Stonehenge Capital, Wilshire Capital
[1] Numbers do not total across because of common investments of CAPCOs

Venture Investors LLC, Advantage Capital's manager for their Wisconsin CAPCO, committed a portion of their investment returns from the CAPCO to the limited partners of Venture Investors Early Stage Fund III L.P. This proved to be an important component in obtaining investor commitments of $37.1 million for this new fund in 2000.

CAPCO backed companies create good jobs

The typical venture capital backed company operates in a rapidly growing sector of the economy and relies on highly skilled labor. The Wisconsin CAPCO experience has been consistent with the venture capital industry data that venture backed companies experience rapid employment growth. Thus far, Wisconsin's CAPCOs have invested $20.7 million in fifteen companies. These companies have had extraordinary growth in their number of employees, with continued growth expected. The growth is particularly strong when you consider that all the investments are three years old or less.

Employment growth at CAPCO backed companies	**Advantage Capital**	**Stonehenge Capital**	**Wilshire Capital**	**Total**
Wisconsin based employees at time of investmen	141	163	29	273
Wisconsin based employees as of 3-31-2003	247	208	44	430
Average annual salary	$71,521	$51,723	$149,941	$69,885
Total Payroll	$17,666k	$10,758k	$6,597k	$30,051k
Est. annualized Wisconsin income tax revenue	$1,218,934	$742,334	$455,221	$2,416,491

Sources: Venture Investors, Wisconsin Taxpayers Alliance
Estimated annualized tax revenue assumes a 6.9% tax rate.

The jobs created by the venture capital industry are good jobs. Managers, scientists and engineers account for 60.3% of the labor force in venture capital backed companies, versus 13.7% in the U.S. labor force. Wisconsin CAPCO backed companies have an average annual salary of $69,885, as compared to a personal income per capita of $29,270 in Wisconsin.

CAPCO backed companies generate wealth in Wisconsin

Wisconsin has $13,862 in wealth for every man, woman and child, which places it 41st nationally. The U.S. per capita average is $20,864, or 51% higher. It is far easier for wealth to be generated through the appreciation in value of a business than by personal savings from a paycheck.

In some communities in the country, the enormous success of a single company has generated the kind of wealth that transforms a local economy by spawning the next generation of companies from the seed capital of success. Dell Computer created thousands of millionaires and 20,000 jobs in Austin, Texas, setting the stage for a robust high tech economy. DePuy is an orthopedic business in little Warsaw, Indiana, and now together with spin-outs Zimmer and Biomet, Warsaw has three of the five largest orthopedic implant businesses in the world representing a combined 30% world market share. A study by DRI-WEFA[4] shows that venture capital has played a significant role in creating industry clusters. What if Whitefish Bay native and University of Wisconsin-Madison graduate John Mortgridge had decided to start Cisco Systems in Madison or Milwaukee? Even after the tech stock slide of the last few years, Cisco Systems is worth $118 billion today. Each CAPCO has focused on different market niches, often investing in more than one company in a particular industry cluster.

The DRI-WEFA study shows that venture backed companies outperform their peers, which translate into more rapid growth in the value of the company's ownership. When these investments reach maturity and investors receive liquidity from the initial public offering or sale of the business, unrealized gains will become realized and create wealth. Successful entrepreneurs become angels that back the next generation of companies.

The CAPCO Program is part of the solution to our State's budget shortfall

The CAPCO program provides stimulus to Wisconsin's economic future. The CAPCO funds have backed high growth companies in sectors that include biotechnology, medical devices, semiconductors, and communications. These companies are formed around patented innovations that provide a sustainable competitive position for continued future growth. They hire highly skilled professionals that graduate from Wisconsin's universities, plugging the brain drain while providing desirable high paying jobs that will help Wisconsin increase its personal income per capita closer to the national average. Many of these companies have invested or made long term lease commitments for highly specialized facilities that are necessary for their research, development and manufacturing needs. The combination of highly trained personnel and highly specialized facilities means that these companies are planting deep roots in Wisconsin that create substantial economic barriers to their possible relocation outside the state.

The existing $50 million CAPCO program may already be budget neutral, generating net tax revenue that exceeds the annual $5 million in tax credits. It adds to Wisconsin's tax base in a variety of ways:

- Income taxes: CAPCO backed companies retain or create jobs in Wisconsin, with a combined payroll of over $30 million and an estimated $2.4 million in income taxes. This does not include any multiplier effect of the jobs created by the other spending of the company or by the spending of those individual employees.
- Sales taxes: The CAPCOs have routinely been the lead investor in venture capital financings, and the $20.7 million invested by the CAPCOs has attracted total investment of $145.1 million. In addition to payroll and facilities costs, this money is largely spent on goods and services in Wisconsin. Furthermore, the individuals whose jobs are created by the CAPCO program are spending on goods and services, which results in sales tax revenue for the state.

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[4] Formed by the merger of Data Resources, Inc. and Wharton Econometric Forecasting Associates, DRI-WEFA is one of the leading economic and financial forecasting companies in the world.

- Property taxes: Many of the CAPCO backed companies have entered into long term leases that resulted in the construction of specialized facilities with a net cost of at least $21 million to meet their unique needs. This adds to the property tax base in the state. This is in addition to any new home construction by the 430 individuals employed by a CAPCO backed company or whose job has been indirectly created or supported by the activities of a CAPCO backed company.
- Capital gains tax: The CAPCO program is still too young to have created significant realized capital gains thus far. However, most CAPCO backed companies have aspirations to become a public company, which typically requires a growth in total market value to an amount of at least $150 million. Such an event results in significant capital gains and generates tax revenue.

Recognizing the initial budget impact of the CAPCO program, Wisconsin's existing CAPCOs have recommended that the new CAPCO legislation delay the availability of the first tax credit until the next biennium. This would enable the CAPCOs to raise capital from insurance company investors today, with all tax revenue in the current biennium reducing the budget shortfall. By the time of the initial tax credits, the investment activity will have stimulated economic activity to reduce any temporary negative impact, and will shorten the path to the long term positive budget impact.

Why is additional funding needed now?

There are two factors that are driving the need for additional funding for the CAPCO Program. First, the CAPCO Program is working in Wisconsin, but its small size limits its effectiveness. Second, if the Program is not funded now, the continuity of the program will be lost.

The average venture capital fund formed in 2002 raised $141 million[5]. Each of Wisconsin's three CAPCOs have $16.7 million under management. As noted previously, the average first round of company financing by venture capitalists is $6.99 million nationally. The appetite for capital of Wisconsin based companies that are trying to compete internationally is no different. Wisconsin's three CAPCOs are limited to $2.5 million per company. Since these companies commonly require multiple rounds of financing, most venture capitalists limit their first round of funding to a company to half their capacity. As a result, the Wisconsin CAPCOs are practically limited to initial investments of $500,000 to $1,000,000 in most cases. Venture capitalists from the east coast and California will consider investments in the Midwest, but rarely in the first round of funding. They will consider investment once operations are well established and a complete management team is in place. As a result, the first round of venture capital funding has to originate from the region. The current CAPCO Program is not large enough to address the needs of the market.

Like any venture capital firm, CAPCOs must charge fees to a fund to cover operating costs and salaries for a professional team. Thus, a portion of the requirement to invest 100% of the committed amount can not be fulfilled until first investments have been successfully exited. Furthermore, venture capitalists must reserve money for follow-on investment. Two of Wisconsin's CAPCOs are nearing the investment of 50% of the current allocation, which will limit the ability to back additional companies until an exit event occurs. Without additional funding, these firms will effectively be out of the market. This type of disruption in the CAPCOs ability to serve the market would undermine the groundwork that has been laid thus far. In addition, it impacts the ability of the CAPCOs to recruit and retain a team of skilled professionals.

This document was prepared by Venture Investors LLC (VI LLC). VI LLC is a venture capital management company founded in 1982 that serves as the manager of $76 million in four early stage venture capital funds, including Advantage Capital Wisconsin Partners I Limited Partnership, a Wisconsin Certified Capital Company (CAPCO) with $16.7 million under management. Venture Investors is focused on early stage investment opportunities, with a particular interest in technologies spinning out of the University of Wisconsin-Madison, the nation's second largest research institution. Venture Investors manages the MGE Innovation Center in the University Research Park, a business incubator for early stage companies that have a relationship with the UW - Madison.

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[5] National Venture Capital Association 2003 Yearbook

November 6, 2003

Memorandum

To: Senator Kanavas, Secretary Nettles, Senator Moore, Representative Ward, Representative McCormick, Secretary Marotta, Secretary Morgan, Representative Kreuser, Representative Gard, Representative Richards, Representative Taylor, Senator Panzer

From: John Neis, Senior Partner, Venture Investors LLC

Regarding: AB 524

Thank you again for the opportunity to comment on AB 524. There was progress since the earlier draft description, and there are elements that offer greater potential for this to evolve into a bill that could have a meaningful impact. However, I believe the model inserts an unnecessary intermediary that would provide questionable value, results in an unnecessary level of administrative costs and reduces fund manager incentive by siphoning off fees and a share of the gains. It presents a significant obstacle for the attraction of investment by those that do not benefit from the tax credits, namely tax-exempt investors and out-of-state investors. Pension funds, foundations and endowment funds are the largest investors in the asset class, and if you diminish the ability to attract them, you greatly reduce access to capital. Since we are a state with little wealth, reducing the attractiveness to out-of-state investors will not benefit the program and will further reduce the chance for a successful program.

Corey Nettles and Tod Kearney at Commerce, and Senator Kanavas can attest to the fact that I have been open to programs other than CAPCO and have discussed characteristics that are important. I believe that the Governor has accurately identified five guiding principals for this topic which should be beyond dispute and which are non-partisan (1. The plan must be affordable, 2. The plan should focus on early stage needs, 3. It should be focused on sectors that create high paying jobs, 4. Administrative costs should be reasonable, 5. The program should leverage additional resources from the private sector). Yet, in its current form, this proposal falls short on many of these criteria. What is particularly disconcerting is that the CAPCO program was criticized for a variety of shortcomings, each of which has been addressed with comprehensive reforms. Yet, this proposal in its current form contains all the shortcomings of the CAPCO program in its original form and more, with none of the proposed CAPCO reforms reflected. CAPCO was criticized for an inadequate early stage focus, yet AB 524 has less of an early stage focus than the original CAPCO bill and far less than the reform CAPCO bill (violating guiding principal #2). One CAPCO operator was criticized for transactions outside the legislative intent and the proposed reforms addressed those shortcomings, yet AB 524 lacks the reforms and is even more open to abuse than the original CAPCO bill (violating guiding principal #3). The CAPCO program was criticized for yielding an inadequate amount of capital because of its fundraising methodology and addressed this in a reform proposal last week, yet AB 524 adds a redundant administrative layer (violating guiding principal #4) that will reduce the available dollars and complicate the effort to raise capital (violating guiding principal #5). The reformed CAPCO bill meets all of the guiding principles, and if the proponents of AB 524 believe it that this proposal meets any but the first, it is at best open to debate.

The positive attributes

There are several positive attributes I want to commend. I believe that the size and timing of the of the credits has the potential to attract investors. I believe the scaling of the credits based on size of company is reasonable (although even the description of the seed and early stage eligibility results in a later stage focus than the CAPCO program, and the availability of credits for investments in companies with 500 or more employees is questionable since these don't even

meet SBA small business standards. Again, this is inconsistent with guiding principal #2). The issuance of the credits at the time of investment into an eligible company is very appropriate in this structure for a few reasons. One, rather than placing restrictions on where the money is invested and producing the criticism of "social investing" in a co-mingled fund as a fiduciary, it is rewarding tax credits for actual investments. Second, since many parties are concerned about the budget impact, this will spread the credits over a decade. That is because any traditional fund selects its investments over the course of the first five years of the fund life, and often makes follow-on investments beyond that time frame. As a result, the four year spread of the credits would initiate at several points in time over the funds life. It would be very modest in early years, probably peak in years 4-6 (not exceeding 25% of the total) and decline potentially out through year 12-13 if a follow-on investment was made very late in the fund life. Thus, it meets the first guiding principle.

The Problems

Several aspects of the role of the Capital Investment Corporation (CIC) appear to add unnecessary administrative expense and will actually hamper the ability for qualified venture capitalists to raise capital. While I have not heard the concept pitched directly, multiple parties that attended today's meeting at the Department of Commerce have described the envisioned role of this intermediary to me. In essence, this entity would anoint certain funds with tax credit eligibility, and those funds would then raise capital directly from investors. On the other side, companies would be qualified based on size, and when the anointed funds invested in the qualified entities, a tax credit would flow to the eligible investors. The funds would be charged an annual fee of 1% on the amounts raised from tax credit eligible investors by the CIC, and would surrender 7% of the gains to the CIC. Managers of the fund would get somewhere between 10-13% of the gains from those dollars instead of the customary 20%, which is commonly referred to as "carried interest". The CIC would fill a role in assisting entrepreneurs by helping write business plans and other assorted consulting services, it claims that it would coordinate and facilitate investments in the funds by institutional investors and in companies by the funds, and it would provide a variety of other administrative services and data collection.

The described role of the CIC is normally the responsibilities of the entrepreneur and the venture capitalist. It seems unrealistic that the CIC will have the breadth of expertise to serve all industries, they can not be expected to do the depth of due diligence (because of time, resources and relevant experience) that gives them the deal specific knowledge to make appropriate recommendations or contributions (and even if they did, the venture capitalist will have the fiduciary responsibility that forces them to duplicate the effort), and their involvement may intrude on the development and fostering of the important long term relationship between the entrepreneur and their venture capitalist. Furthermore, I know from experience that the proposed services to businesses are likely to be underutilized. As manager of the MGE Innovation Center in the University Research Park since its inception in 1992, we originally offered some of the proposed services to the tenants in the Center, yet only portfolio companies elected to utilize them. Questions about confidentiality and commitment to the company result in a reluctance to utilize a resource that does not owe them a fiduciary duty. The role of facilitating and coordinating an investment in the funds by institutional investors could be disruptive to the process and taint the fund as an economic development fund. The proposed facilitation between the funds and companies is proposal to fill a non-existent need. The administrative role and data collection would be redundant with capabilities within the Department of Commerce. The 1% annual fee paid to the proposed CIC by the funds either means that it is adding to the program administrative cost, thereby reducing the net available for investment from 75% to 65% over a ten year fund life, or it is reducing the management fee paid to the venture capitalist from 2.5% to 1.5% per annum and diminishing their ability to afford the resources they need to properly carry out their responsibility. The reduction in the carried interest to half or two thirds of the industry norms would impact a qualified venture capital firm because it would reduce their ability to attract and provide customary incentives to general partners (the fund managers) and staff, and/or it will

result in the attraction of lesser qualified "want to be venture capitalists" as managers of these funds. The skimming from this entity has broad ramifications on the ability to attract the traditional investors in the asset class that are not eligible for the tax credits.

The presence and compensation to the CIC will diminish the ability of the anointed funds to raise capital from those investors that are not eligible for the tax credits. A below market incentive will taint the fund with a perception of not being good enough to earn a full standard carried interest, or as having inadequate incentive because the will not have the same financial motivation as in a typical fund. If you only end up attracting the "want to be venture capitalists", they will face all the normal challenges of first time funds that will reduce the capital that they can raise.

The structure would not allow management of side-by-side funds in a way that would be acceptable to the market. The conflict of interest between the funds would interfere with the perceived ability to fulfill the fiduciary duty of loyalty, because there would be no gains to share to align the interest of funds. Investors in the fund enabled by AB 524 would be particularly concerned that the side-by-side fund may "cherry pick" the most attractive deals for the side-by-side fund, in which case the investor doesn't participate in the gain and the fund manager has a greater carried interest.

Conclusion

In its present form AB 524 is a step backwards. I have shared thoughts with Nettles, Kearney, and Kanavas on how this could be modified in a way that would make it a viable experiment if the CAPCO label makes impossible for legislators to read and consider the CAPCO reforms with an open mind. If there is an ability to consider the CAPCO reforms that have been actually proposed (which go far beyond the criticisms and proposed reforms in the Colorado CAPCO audit that many critics have cited) it is worth a fair and open discussion, and it should at least have a side by side comparison to other proposals. If credits structured along the lines of AB 524 represent the only approach that legislators and the administration are willing to consider, I would appreciate the opportunity to participate in the discussion between policymakers, the administration, and the proponents of these alternate proposals so that you have the opportunity to consider the perspective of a real world practitioner whose industry and market will be impacted by your actions.

Response to "CAPCO News Summary"

1. "On Point: CAPCO Revealer" Commentary, Rocky Mountain News, Denver, CO October 30, 2003

   - Colorado CAPCOs invested about $14.1 million in Colorado businesses since the start of the program in 2001, but collected $15.2 million in start-up and management fees

     Response: Most of this refers to the defeasance mechanism which is a one time upfront tool used to reduce the cost of capital. Only $3.9 million was paid to the six firms to cover operating costs. While the Colorado Program permits a number of fees over and above the management fee, those other expenses have to be covered by the 2.5% management fees in the Reformed CAPCO bill. A 2.5% management fee is normal for the venture capital industry.

   - Colorado CAPCOs have spent $471,503 on lobbyists and could use their CAPCO funds to sue the state if it changes the current law.

     Response: In Colorado, some are proposing to abolish the tax credits that have already been granted. CAPCO operators were told that once granted the credits could not be taken away and they relied upon this to raise capital from insurance company investors. If Colorado reneged on this promise, it could force the CAPCOs into bankruptcy. No CAPCO has ever sued a state. As in Wisconsin, if a fund manager has enough contacts with a legislator or administrator, they must register as a lobbyist, and they must prorate a percentage of their income to lobbying activity even if there is no additional out of pocket cost. Using this methodology, you arrive at the figure above in Colorado with six firms over four years. Some Wisconsin CAPCOs have retained lobbyists to propose reforms and educate legislators, while others have relied on Wisconsin fund managers to communicate with the State.

   - The Colorado CAPCO law allows a Colorado business to use CAPCO money to build a facility in another state or country. Auditors were unable to verify CAPCO claims that the program creates jobs.

     Response: The Wisconsin CAPCO Program requires that 75% or more of the employees are in Wisconsin at the time of investment. The companies must agree to keep 75% or more of their employee base in Wisconsin, and prohibits them from using the money to move from the state. Employment growth claims in Wisconsin are not in dispute.

2. "Colorado CAPCOs Draw More Heat", by John Sanko and David Millstead, Rocky Mountain News, Denver Colorado, October 29, 2003

   - The Colorado Legislative Audit Committee learned that the state has given CAPCOs $100 million in tax credits for use in the next ten years, but just over $40 million was available for investment from that money, thanks to that program's dependence on insurance company investors. The CAPCOs have already taken $3.9 million in expenses.

     Response: The Reformed CAPCO legislation requires that the CAPCOs have 75% of their capital available for investment. It has opened up participation to any type of Wisconsin tax paying corporate investor, not just insurance companies. The $3.9 million in expenses should not be alarming after a year and a half into the program for six funds. Any venture capital fund needs to cover salaries, office space, consultants, legal expenses, etc., and the CAPCOs are charging the customary 2.5% management fee for the industry. For a $22 million fund (the largest CAPCO in Colorado), that is only a $550,000 annual operating budget.

   - "I think this state would be hard pressed to design a program that cost the tax payers more and delivered less", Bob Lee, the head of Colorado's Office of Economic Development, told the committee. Lee's office administers the program.

Response: There were people at this hearing that testified that the program would result in no more than 12.5% of the $100 million invested in Colorado, a figure that has already been surpassed. In Wisconsin, where the program is two years older, two of the three CAPCOs have invested more than 50%, and the third is at 40% invested. The quote above was read by Lee from a letter that was written by the Governor in advance of testimony and a review of the facts, and read immediately upon the conclusion of the testimony prior to discussion. The process was highly politicized in Colorado, and the program lacks most of the restrictions in the original Wisconsin CAPCO bill and the recommendations in the audit in Colorado are already contained in the Reformed CAPCO bill.

- CAPCOs could invest as little as $37.5 million of the money they have received and pocket the rest.

  Response: In Wisconsin, CAPCOs must invest 100%. To the extent fees are charged, Wisconsin CAPCOs are required to take exit proceeds from the sale of an investment and reinvest them until 100% is invested (75% is required to be available initially). No gains can be distributed prior to reaching the 100% threshold. Colorado offered to count investments in rural counties as double credit towards the 100% goal and no such provision exists in Wisconsin law.

3. "Other States" (sidebar story) by Brian Lawson, Huntsville Times, Huntsville, AL, October 6, 2003

- Louisiana was the first state to develop a CAPCO program, but it did not limit the amount of tax credits companies could sign up for through the CAPCO program. Louisiana concluded its CAPCOs had raised $517 million in capital from insurance companies from 1988 to 1998, but invested only $149 million in qualified businesses in Louisiana.

  Response: These figures are inaccurate, and I will get the correct figures. Both existing CAPCO bill and the Reformed CAPCO bill require that 30% of the money must be invested within three years and 50% within five years (a pace consistent with a traditional venture capital fund). If these timetables are not met, tax credits are recaptured from the investors and no further tax credits are available to that firm. No distributions of gains or principal are permitted until 100% is invested, so CAPCOs are motivated to reach these thresholds.

- New York and Florida have both expanded their CAPCO Programs:

  - Florida reported that for 2002, its CAPCO program created two net jobs in 2002; the State found its program had a net job loss of 153 jobs from 2001 to 2002 for companies receiving loans from CAPCOs

    Response: As everyone knows, the last few years have been particularly difficult for the high tech sector, and CAPCO backed companies are not exempt from this economic cycle. There has been a net gain of employment of 157 jobs in companies backed through Wisconsin's CAPCO program to a total of 430, but that is only part of the story. AlfaLight, a seed capital investment in a producer of high power lasers, employs far less than it did at its peak (although far more than the six original employees at the time of the CAPCO investment), so its employment has declined in the last year. However, most of its competitors have gone out of business in this period, and AlfaLight is now poised to be leader when the economy turns around. Gala Design was two weeks from running out of cash and faced a lay-off of its 20 employees at the time of the original CAPCO investment. They employed 34 when acquired by Cardinal Health on October 1, 2003, and this morning they told Governor Doyle that they now expect to grow to 50 employees by the end of the year. Florida may have had a job decline in this tough economic period, but it would have been a more severe decline without CAPCO.

  - New York, which has supported three CAPCO Programs and a total of $280 in tax credits, has seen an increase of 38 jobs created since the program went into effect in 1998.

Response: The story is similar to Florida, but the New York CAPCOs faced an even tougher climate. They were promoting themselves as "Silicon Alley" and had a concentration of .com companies, and the CAPCOs were strongly encouraged to consider these investments. The combined collapse of the e-commerce sector, along with the post 9/11 exodus from New York City, had a devastating impact on their high tech sector.

4. Fourth Annual Report on the New York State Certified Capital Company Program, Annual Report, Executive Summary, New York State Department of Insurance, Albany, NY, September 20, 2003

- Each New York CAPCO is required to invest 50% of its certified capital in qualified businesses. As a result of the $100 million, $30 million, and $150 million allocations from New York's CAPCO Programs One, Two, and Three, respectively, 56.3% (began 1998), 45% (began April 2000), and 33.9% (began December 2000) of the certified capital has been invested in qualified businesses as of December 2002

  Response: If 56.7% is invested after five years, 45% after 2 years and eight months, and 33.9% after 2 years, it demonstrates that CAPCOs are motivated to deploy the capital faster than the requirement to invest 30% in three years and 50% in five years. In Wisconsin, Venture Investors / Advantage Capital hit the 50% mark in four years, and the other two are around 40%.

- Payment of CAPCO fees (e.g. commitment, financing, origination, monitoring) and charges for services (e.g. legal, due diligence) resulted in reduced funds for the entities being invested in by the CAPCOs

  This is as true for the CAPCOs as it is for any traditional fund. We are unable to find staff, consultants, accountants, attorneys, and landlords that are willing to work or provide space for free. However, unlike a traditional fund, CAPCOs are not permitted to distribute gains or principal and are required to reinvest the proceeds from a sold investment until an amount equal to 100% is invested.

5. Nothing Ventured, Millions Gained, by S.V. Date, Palm Beach Post, Palm Beach Florida, May 22, 2003

- Imagine the state gives you $75 million in tax money to invest in new business to create jobs, imagine that, rather than creating jobs, the companies you invested in lost 174 jobs in the first four years. Imagine that you got to keep all the money anyway, without having to risk a penny of your own.

  Response: The job loss is discussed above and is not consistent with the experience in Wisconsin. The CAPCOs must put a minimum of $500,000 of their own money at risk, and with the WISCAP requirement that a net of 75% be available for investment, they will probably have to put significantly larger amount of their own capital at risk.

- For the three venture capital firms, its all true, but not good enough. They are pressing for a second round of tax credits to get as much as $75 million more between them.. One, New Orleans-based Advantage Capital Partners, which wrote the law creating the program in 1998, actually threatened Gov. Jeb Bush with a lawsuit if the money isn't forthcoming.

  Response: No CAPCO has ever sued a state and Advantage Capital is not threatening to sue Florida.

- When the Florida Law passed in 1998, Advantage sought the entire $150 million by signing up 35 insurance companies for the tax credits. Bush's office however granted two other venture capital companies a portion of the total.

Response: Firms are permitted to submit commitments for up to the amount of the maximum available credits, and they are they allocated prorate. Advantage Capital never expected to get all of the available capital.

- After setting aside as much as $75 million to pay back the insurance companies, the venture firms are free to keep the other $75 million...

  Response: This is an inaccurate claim that is continually repeated by supporters of a competing program. In Wisconsin, like Florida, the CAPCOs must invest 100% of the amount in qualified businesses before they can ever distribute portion of the gains to themselves, and must have successful investments before they financially benefit.

Who Gets What under a CAPCO deal

Response: This does not accurately reflect the economics in the WISCAP program where the state gets 30% of the gains, and the comparison to a traditional arrangement fails to consider that the constraints of the CAPCO program produces lower returns than a traditional fund, and the managers must wait much longer to receive them because of the requirement that 100% of the amount must be invested before they can make distributions.

Of course, the party circulating these negative points is highlighting the negative press. Here is sample from the other side:

1. "Certified Capital Company program a resounding success" - Kansas City Star headline

2. "To date, the experience of the Missouri CAPCO program has been quite promising. The results to date in terms jobs and additional leveraged investments are stellar. The investments are benefiting Missouri's new economy now and show every indication of proving even more beneficial in the future." Dr. James Jarrett, IC2 Institute, University of Texas.

3. CAPCO Study prepared for Louisiana Department of Economic Development, Postlethwaite and Netterville:

   - The CAPCO program has facilitated the development of private VC management firms in States which prior to CAPCO had no discernable VC industry
   - A reasonably discernable and robust venture capital industry exists today only by virtue of the CAPCO program
   - "The present value of all tax credits is only one third of increased tax revenue from business activity and job creation. An economic analysis of the CAPCO program from 1988 to 1998 suggests that the 1999 value of all tax credits generated {cost to state}...amounts to $405.4 million, while the 1999 value of estimated tax revenues {benefits to state}...associated with the business activity and jobs related to the qualified Louisiana investments is $1206 million."

Reformed CAPCO, now called WISCAP, Addresses Concerns and Criticisms

Concern with original CAPCO bill	New WISCAP Program
• The CAPCO Program only targets insurance companies for investment.	• WISCAP is open to investments from any business entity that pays corporate income tax, corporate franchise tax or premium tax.
• The CAPCO Program prevents established Wisconsin players like Robert W. Baird from participating because of their insurance company affiliation (intended to prevent self-dealing by eligible investors).	• The new program permits affiliates of eligible investors to form a WISCAP, provided that they raise capital from sources other than their affiliate (retaining the self-dealing prohibition).
• The CAPCO Program has high administrative costs.	• WISCAP puts further limitations on qualified distributions, limiting the costs to original cost of raising capital and a 2.5% management fee.
• The defeasance mechanism to secure bonds sold by CAPCOs reduces the net capital available for investment to 50% of the amount raised.	• The new program requires that WISCAPs have no less available than 75% of the capital raised available for investment (which they will have to achieve by reducing returns promised to investors and/or by putting more of their own capital at risk).
• The standards for becoming certified as a CAPCO are low.	• WISCAP requires identification of all parties that benefit from certification, a 5-year business plan, the investment strategy and investment criteria. Commerce can determine whether the strategy is compatible with the law before the WISCAP would be certified.
• The CAPCOs may be motivated to make lower risk, later stage, short term investments (although most of the dollars went into early stage deals).	• WISCAP requires that 50% of the first 50% will be invested in earlier stage businesses (All the businesses will meet the early stage criteria that had been proposed in AB 524). • WISCAP prohibits short-term investment commitments, requires that the majority of investments must be made in the form of equity and retains the requirement that any debt instruments must be long term with a maturity of at least 5 years.
• The CAPCOs are not always focusing on the sectors where there is a need and where high paying jobs are created.	• WISCAP tightens the definition of what is a qualified business, and restricting what kind of business is eligible. • WISCAP requires approval of an investment strategy and investment criteria before being certified, and Commerce has the ability to determine whether the business was qualified and whether it was consistent with the strategy and criteria prior to the investment.
• If the CAPCOs only have to invest 50%, and then they can pull the rest out in fees and decertify in 10 years.	• WISCAP does not permit distributions or decertification until the WISCAP has invested 100%. If the WISCAP does not meet their investment threshold test, then they can not charge administrative fees.

• CAPCOs can invest in entities they start and control, thus controlling the ability to pay themselves back early.	• The new program prohibits prior financial interest in the business, investing in businesses formed, created, or organized by the WISCAP, and is prohibited from owning more than 50% of the business unless approved by Commerce.
• The State of Wisconsin receives no return except for tax revenue from the jobs and economic activity created.	• WISCAP provides 30% of the gains from the investments back to the State of Wisconsin, unless gains are promised to a side-by-side fund, in which case the State of Wisconsin receives 20% of the gains.
• CAPCO does not leverage the amount of capital available, except for the co-investment in companies by other investors.	• The new program provides the ability to offer 10% of the WISCAP gains to investors in a side-by-side fund, providing an incentive for the WISCAP to form a side-by-side fund, and for investors (including tax exempt institutional investors) to invest in a side-by-side fund.
• The current CAPCO law does not define any penalty or procedure if a business violates the required covenants.	• WISCAP has a timetable to reduce or eliminate the ability to count an investment towards the requirement to invest 100% if the company violates its covenants.
• There is a risk that funds waiting for investment could be invested inappropriately by the CAPCOs.	• A more detailed description of a permissible non-qualified investment provides assurance that the funds will be available for investment in qualified businesses.
• The current CAPCO law requires the CAPCO's to report their investment on an annual basis.	• WISCAP managers will be required to report their investments to Commerce within 3 business days, in which Commerce then has 3 days to make available to the public (website).
• Under the current law, the CAPCOs can be operated from outside Wisconsin.	• WISCAP makes this requirement, now a part of the rules, a part of the law.

WISCAP meets the guiding principles of Governor Doyle for his signing

1. **The plan must be affordable:** The cost of the program will be $75 million over ten years of which the tax credits will take an incremental effect (ie fewer credits in the upcoming years and more in the outer years), also less the revenue from tax collections from economic activity generated and the State's share of the program gains.
2. **The plan must target early stage needs:** WISCAP is exclusively targeted on companies with fewer than 100 employees with an emphasis on early stage development.
3. **The plan must be focused on creating jobs at the high end:** WISCAP tightens the definition of a qualified business and requires approval of investment strategies for certification, to provide assurance of delivery on legislative intent.
4. **The money must go towards investment, not administrative fees:** The new program requires that the WISCAPs have 75% of the dollars raised available for investment and tightens the permissible fees and distributions.
5. **The plan should leverage additional resources from the private sector:** WISCAP encourages formation of side-by-side venture capital funds and creates incentives that will attract tax exempt and out of state investors to those funds.