Committee Name:
Senate Select Committee – Job Creation (SSC–JC)

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WISCONSIN LEGISLATIVE COUNCIL

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

TO: SENATORS CATHY STEPP AND TED KANAVAS, CO-CHAIRS, SENATE SELECT COMMITTEE ON JOB CREATION

FROM: Laura D. Rose, Deputy Director

RE: Suggestions for Regulatory Reform

DATE: September 5, 2003

This memorandum summarizes suggestions for regulatory reform made by invited speakers at the August 5, 2003 hearing of the Select Committee on Job Creation as well as the May 15, 2003 joint hearing of the Senate Committee on Economic Development, Job Creation, and Housing and the Assembly Committee on Economic Development. The memorandum organizes suggestions by five broad topic areas. The source for each suggestion is noted in parentheses.

A. ISSUES RELATING TO LEGISLATIVE AND ADMINISTRATIVE REVIEW OF REGULATIONS

1. Endorse the passage of 2003 Senate Bill 100 (and its companion bill, 2003 Assembly Bill 267), the small business regulatory reform legislation. (National Federation of Independent Business, 5/2003.)

2. Clarify current law (s. 227.10 (1), Stats.) relating to the requirement that agency policies (i.e., "Guidances") be promulgated as administrative rules; create penalties for agencies that circumvent this requirement. (Wisconsin Manufacturers and Commerce (WMC), 8/2003; Wisconsin Realtors Association, 5/2003.)

3. Expand the types of analyses required for administrative rules and enforce those that currently exist, such as the regulatory flexibility analysis in s. 227.114, Stats., that apply to regulations affecting small businesses. Examples of additional analyses that could be required include:

   a. A cost/benefit analysis of a proposed rule, which would apply regardless of the size of the business affected; and

   b. Require regulating agencies to document the hazards that the rules are trying to alleviate.

B. Department of Natural Resources' Issues

1. Air quality regulation.

   a. Require Department of Natural Resources' (DNR's) air permit streamlining advisory to issue recommendations by the end of the year to the DNR board, rather than in April 2004. (Select Committee on Job Creation.)

   b. Prohibit DNR from designating counties as nonattainment counties for the eight-hour ozone standard established by Environmental Protection Agency (EPA), when they meet the ozone standards set by EPA. (Wisconsin Transportation Builders Association, 5/2003.)

2. Water quality regulation.

   a. The Legislature should act on the Legislative Council bill to recodify ch. 30, Stats., relating to navigable waters. The Legislature should also establish a three-tier system for ch. 30 permits, as follows:

      i. Create exemptions from permits, for those activities with "*de minimus*" impacts, or when the activity is regulated through other DNR programs;

      ii. Establish and grant general permits, for activities which are routine in nature, have modest potential impacts, and do not call for individual conditions; and

      iii. Utilize individual permits, for projects with potentially significant impacts that require individual review and conditions. (Wisconsin Builders Association, 5/2003 and 8/2003.)

   b. Work with DNR's water division and local governments to sort out and remove multiple overlaps that exist in water regulations. (Wisconsin Builders Association, 5/2003, see the attachment; see also similar comment relating to storm water management made by Metropolitan Builders Association, 5/2003 and 8/2003.)

   c. Eliminate either DNR or Department of Commerce regulatory authority over erosion control, or allow municipalities with approved erosion control ordinances and inspectors to issue the permits and inspect the sites. Currently, both state agencies and municipalities inspect sites and sometimes offer differing opinions and site directives. (Metropolitan Builder's Association and MLG Commercial, 5/2003 and 8/2003.

   d. Revamp the floodplain management program at both the state and federal levels to provide program users with only one review when seeking changes to the floodplain map or seeking approval and calculations necessary to build in the floodplain. (Metropolitan Builder's Association and MLG Commercial, 5/2003 and 8/2003.)

   e. Repeal s. 59.692 (7), Stats., relating to requiring an annexing city or village to adopt the county regulations in shoreland areas. (Metropolitan Builder's Association and MLG Commercial, 5/2003 and 8/2003.)

f. Streamline the process for approval of the installation of sanitary pipes in the area within the jurisdiction of the Milwaukee Metropolitan Sewerage District. (Metropolitan Builder's Association and MLG Commercial, 5/2003 and 8/2003.)

g. Establish a general permit approval process within the DNR for water quality certification. (Metropolitan Builder's Association and MLG Commercial, 5/2003 and 8/2003.)

h. Create a uniform definition of "bank" within the statutes, as follows: "bank" means an area of land between the ordinary high water mark of the waterbody and the point where the slope toward the water becomes less than 12%, but in any event not less than 25 feet from the ordinary high water mark. (Metropolitan Builder's Association and MLG Commercial, 5/2003 and 8/2003.).

3. Allow agencies to subcontract permit reviews to approved outside reviewers, upon payment of the requisite fee by applicants. Express support for "Green Tier" idea, as presented in 2003 Senate Bill 61 (currently in the Senate Organization Committee, awaiting the Criminal Penalties Committee report). (WMC report.)

4. Require cooperation between Public Service Commission (PSC) and DNR on the siting of energy facilities. Establish a lead agency or a formal chain of command to be followed when both agencies must give approvals for projects. (Bert Garvin, 5/2003.)

5. Accelerate the permit approval process for biotechnology-related activities. (Wisconsin Biotechnology Association, 5/2003.)

6. Establish clear timeframes for permit approvals under the Wisconsin Environmental Protection Act and create clear consequences for permit reviewers who fail to meet these deadlines. (Foth and Van Dyke, 5/2003.)

7. Require reviewers in the Environmental Impact Statement process to rely on the work of the licensed professionals who prepared the documents that are submitted on behalf of an application, rather than re-engineering the project as part of the review process. (Foth and Van Dyke, 5/2003.)

C. Transportation Issues

Chapter Trans 233, Wis. Adm. Code, was substantially revised in 2000. However, testimony cited the following continuing concerns with the administration of ch. Trans 233 by the Department of Transportation (DOT):

1. The restrictions on placement of structures in setback areas.

2. The length of time taken by DOT in projects under ch. Trans 233.

3. Requiring review of final plats in all cases, even when the review of the preliminary plat results in no changes.

Specifically list, in the rule, all of the requirements that developers must meet under ch. Trans 233. (MLG Commercial, 5/2003.)

D. General Permit Approval Issues

1. Allow for presumptive permit approval if deadlines are missed. (WMC; Wisconsin Realtors Association, 5/2003.)

2. Amend 1997 Act 307 to establish permit deadlines in statute for which a fee refund will be given if deadlines are missed. (WMC Report, p. 13.)

3. Allow construction and other projects requiring approvals to proceed pending permit approval, with the understanding that projects will proceed "at risk" of having to make changes that are ultimately incorporated into the approval that is granted.

4. Establish unified development permit processes at state and local government levels, which includes a comprehensive list of all permits required; a sequence of the permit approval processes with specific names of responsible governments, departments, and individuals involved in the process; disclosure of required recorded hearings, and estimate the time necessary for review. (Wisconsin Realtors Association, 5/2003.)

5. Accelerate the permit approval process for biotechnology-related activities. (Wisconsin Biotechnology Association, 5/2003.)

6. Freeze development regulations for completed permit applications, and provide that any subsequent changes in land use regulations will not affect the consideration of the pending applications. (Wisconsin Realtors Association, 5/2003.)

7. Do not permit impact fees to be collected prior to the issuance of a building permit. Provide a procedure for individualized assessment of impact fees, an appeals process, and the provision of credits for onsite improvements and for impact fees paid in excess of a development's proportionate share. Require a refund of assessed impact fees if the capital improvement is not commenced within five years. (Wisconsin Realtors Association, 5/2003.)

E. Labor and Employment Law Issues

1. Coordinate requirements of federal and state employment laws, such as the American with Disabilities Act, fair employment law and the Family and Medical Leave Act. (Mark Bentley, 8/2003.)

2. Eliminate sales and use tax on temporary employment services. (Jon Skavlem, CPA; Virchow Krause and Company; 5/2003.)

3. Reverse the change to the apprenticeship ratio standards for contractors training electrical apprentices that went into effect on June 2, 2003. (Associated Builders and Contractors, 5/2003.)

If you have any questions, please feel free to contact me directly at the Legislative Council staff offices.

LR:rv:wu;tlu

Attachment

Risch, Jay

From: Sen.Stepp

Sent: Wednesday, September 10, 2003 10:39 AM

To: *Legislative Assembly Democrats; *Legislative Assembly Republicans; *Legislative Senate Democrats; *Legislative Senate Republicans

Cc: Lhatsang, Sherab; Rose, Laura

Subject: RE: SHORT DEADLINE COSPONSOR 9-12-03 4:00 pm - Permit Deadlines

The deadline is indeed Friday, September 12, 2003, 4:00 pm (the last email incorrectly read "Friday, September 10")

-----Original Message-----
From: Sen.Stepp
Sent: Wednesday, September 10, 2003 10:28 AM
To: *Legislative Assembly Democrats; *Legislative Assembly Republicans; *Legislative Senate Democrats; *Legislative Senate Republicans
Cc: Lhatsang, Sherab; Rose, Laura
Subject: SHORT DEADLINE COSPONSOR 9-12-03 4:00 pm - Permit Deadlines

SHORT DEADLINE: Friday, September 12, 2003, 4:00 pm

This bill is one of the products of a joint hearing of the Senate and Assembly Committees on Economic Development and a hearing of the Senate Select Committee on Job Creation. At both hearings, many people and organizations proposed several ideas on how to reform Wisconsin's regulatory climate. However, the strongest theme that emerged from the hearings was that Wisconsin's permitting process is too cumbersome and time consuming. In fact, permit deadlines was the number one regulatory reform priority.

This bill will give job providers in the regulated community the streamlined process and date-certainty they need to stay in Wisconsin. By passing this bill, we can capture the new jobs we forego every year when companies take their million dollar deals to other states with friendlier regulatory environments. Governor Doyle and members of his administration have indicated that Wisconsin's permitting process takes too long and is ripe for reform.

Please contact Senator Cathy Stepp's office at 266-1832 if you would like to sign on to this bill.

Analysis by the Legislative Reference Bureau:

Deadline for agency action

This bill requires state agencies to promulgate rules establishing periods within which the agencies intend to approve or disapprove applications for specified licenses, permits, and other approvals that the agencies issue. The following state agencies are required to promulgate rules: the Department of Natural Resources (DNR); the Department of Agriculture, Trade and Consumer Protection (DATCP); the Department of Commerce; the Department of Financial Institutions (DFI); the Department of Transportation (DOT); and the Department of Revenue (DOR).

Automatic approval upon failure to meet deadlines

Under this bill, there are two possible consequences of failure to act on an application within the period established by rule. For some kinds of approvals, if an agency fails to act within the period established by rule or before the end of an authorized extension of that period, the application is automatically approved. An agency may extend the period for these approvals on the grounds that an application was incomplete if the agency provides written notice to the applicant, within 14 days of receiving the application, describing the information that must be provided to complete the application.

An agency may extend the period by not more than 30 days if it finds that there is a substantial likelihood that the activity proposed to be conducted under the application would result in substantial harm to human health or safety and that the agency cannot adequately review the application within the period. The bill also authorizes agencies to promulgate rules providing for extensions of the period for acting on an application because the applicant makes a material modification to the application.

A license or permit that is automatically approved is subject to any terms or conditions specified by statute or rule for that kind of license or permit and the agency may suspend or revoke it for failure to comply with those terms or conditions.

Approvals for which to act by a deadline results in automatic approval include: high-capacity well approvals, water pollution permits, solid or hazardous waste facility operating licenses, and permits and other determinations related to structures and deposits in navigable waters issued by DNR; nursery dealer, pesticide manufacturer, commercial feed manufacturer, food processing plant, and grain dealer licenses, and farm-raised deer registrations issued by DATCP; approvals of constructions site erosion control plans, approvals of exemptions from requirements related to the retention and disclosure of information about toxic substances, and approvals of agencies that inspect manufactured homes issued by the Department of Commerce; approvals of plans for mergers by certain business entities and approvals relating to the operations of state banks, savings banks and savings and loans, and credit unions issued by DFI; and approvals by DOT relating to maintenance of highway vegetation and certain types of business and vehicle registration.

Fee refunds upon failure to meet deadlines

For the kinds of approvals that are not subject to automatic approval under the bill, an agency must refund fees paid by an applicant for an approval if the agency fails to act within the period established by rule. Also, an applicant may choose to treat the application as though it had been denied and obtain administrative and, if necessary, judicial review of the denial. An agency may extend the period for these approvals on the grounds that an application was incomplete if the agency provides written notice to the applicant within 14 days of receiving the application describing the information that must be provided to complete the application.

Approvals for which the consequence of failure to act on an application within the period established by rule is refund of fees include: air pollution permits, well driller registrations, bait dealer licenses, and commercial fishing licenses issues by DNR; milk producer, buttermaker, and cheesemaker licenses issued by DATCP; electrician certifications, plumber licenses, and building plan approvals issued by the Department of Commerce; mortgage banker and investment advisor licenses issued by DFI; outdoor advertising permits issued by DOT; and permits related to the sale of cigarettes, tobacco products, and alcohol beverages issued by DOR.

For further information, see the state fiscal estimate, which will be printed as an appendix to this bill.

Olver –
Commerce
Hand Out
9/25/03

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, Wisconsin based venture capital is an essential ingredient to building companies and attracting investment capital from outside of Wisconsin.

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

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

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

[3] National Venture Capital Association 2003 Yearbook

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.

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

Multiplier effect for CAPCO Program (dollars in millions)	Advantage Capital	Stonehenge Capital	Wilshire Capital	Total[1]
Amount invested by Advantage Capital	$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**

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 investment t	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.

[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 our 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

State of Wisconsin Investment Board

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25 September 2003

un-introduced

Senator Cathy Stepp, Chair
Senator Ted Kanavas, Chair
Select Committee on Job Creation
State Capital
Madison, WI 53702

Dear Senators:

Thank you for giving us the opportunity to comment on LRB 2388. This bill would create a venture capital investment trust fund within the Wisconsin Retirement System and would permit active employees to direct 10% of their future contributions to the venture capital investment fund. The State of Wisconsin Investment Board would manage the fund and be required to invest the assets primarily in equity securities of Wisconsin corporations in the venture capital stage.

I can appreciate the interest that the bill's sponsors have in creating new ways to stimulate business growth in Wisconsin. Last year, the Investment Board made nearly $1.0 billion of new investments in Wisconsin through the purchase of stock, bonds, real estate, business loans and private equity. However, we have a number of concerns about the approach that is taken by the bill. But before addressing those concerns, we would first like to provide some information about how venture capital funds operate and SWIB's involvement in investing in venture capital.

As part of a diversified investment strategy, SWIB has made venture capital investments in the Fixed Retirement Trust Fund since the 1980s. In 1999, the Board of Trustees approved an initial $50 million for venture capital investments in healthcare, biotechnology and other technological opportunities with a focus on Wisconsin and the Midwest. We contracted with two Wisconsin firms and committed $20 million with Venture Investors in Madison and $25 million with Mason Wells in Milwaukee, with the possibility of investing additional funds.

Last September, the Board approved an additional $100 million for venture capital investing, again with a primary focus on Wisconsin and surrounding states. Following another extensive national search, we committed to invest in two additional venture capital funds, R. W Baird of Milwaukee and Frazier Capital Partners, which is opening a Madison office. Although we encourage the funds to invest in Wisconsin firms, we do not require that they do so as that would be a violation of our fiduciary duty to invest only in the best financial interests of the retirement fund participants. However, we anticipate that a substantial portion of the investments will be in Wisconsin companies because the venture firms are located here and will be focusing on opportunities in this region.

Venture capital investments are illiquid and carry greater risk than investments in public markets (stocks and bonds). Investment returns from venture investments are also more volatile. Any venture investments we make must meet the Board's investment guidelines and fiduciary requirements. The Board approved the $150 million allocation because it does offer the potential of a greater rate of return and adds diversification to the fund. However, the $150 million is less than 3/10 of one percent of the entire WRS. Gains and losses that we may incur with these investments would be spread over the entire $51 billion Fixed Fund and all 500,000 participants.

Because of the nature of companies seeking venture capital, allocated monies are not all invested at one time. The companies seeking the capital are often small, have an idea or product that may or may not be marketable, and have little if any experience running a business or management experience. Consequently, it takes longer for a venture capital firm to evaluate the viability of a company seeking funds, including extensive legal and accounting reviews, and often requires hands-on management guidance once the investment is made. The firm initially may expend hundreds of thousands of up-front fees without closing a deal. Once a venture capital investment is made, it typically takes five or more years before there is a positive return on venture capital investments

Because SWIB does not have in-house staff to run a venture capital fund, we contract with external firms. However, because the venture capital investment process is extremely labor intensive, their fees are substantial. For example, on a $100 million fund an annual fee of 2-2 ½% of the amount committed is not uncommon. In addition to the annual fees, the fund manager normally receives 20% of any returns earned.

Now referring to LRB 2388, we have the following concerns:

- Of the $150 million that SWIB has already allocated for venture capital investments in Wisconsin and the surrounding region, approximately $22 million has been called for to date. It will take a number of years before the recent initiatives to invest these funds are fully implemented. While we are always open to considering new investment opportunities, it is unlikely that we would be able to put the additional venture capital funding to work in the near future.

- The nature of venture capital is such that negative returns occur on investments for five or more years before gains are realized. As a result, WRS participants who might elect to place 10% of their contributions in the separate venture capital account are likely to see losses in their account during this period.

- Venture capital investments require a commitment of funds for an extended number of years. However, the best interests of WRS participants would suggest that they have the opportunity to switch.

- If this were an investment option being offered to more than 35 investors by a private firm, rather than the State, it would likely be limited to "accredited investors" under Regulation D of the Federal Securities Laws in order to avoid onerous registration and securities filing requirements. According to SEC regulations, accredited investors must have a net worth of at least $1 million or annual income for an individual of over $200,000 ($300,000 for couples). It is unlikely that more than a handful of WRS beneficiaries would qualify as "accredited investors." Does this raise an inference that the option is being offered to unsophisticated investors who are not in a financial position to take such risks?

- There are extensive disclosure requirements that would apply under federal securities laws for offerings of a similar investment program by private entities. Although SWIB and the WRS are exempt from the federal disclosure requirements, WRS participants should be provided with educational and disclosure information about the level of risk and how it could impact their future pensions. The cost and personnel requirements to provide a similar level of disclosure should be evaluated.

- Given the risk involved and the federal requirements, no private investment advisors would recommend putting 10% of a person's retirement fund into venture capital. The offering of this option might expose the State to potential future liability for offering an investment option that would be considered imprudent in the private sector.

- SWIB is subject to the prudent expert standard of care required by the federal ERISA for private and public pension fund administrators. It is unclear how SWIB could continue to meet that standard if required to invest 10% of future contributions in venture capital, particularly with the further restriction that the investments be made in Wisconsin based companies.

- Not knowing how much might be directed to the venture capital fund would make investment planning difficult. Because of the restrictions on how the fund may be invested, SWIB would be unable to commingle these funds with other venture capital funds. This in turn would restrict the fund managers who might be interested and qualified to manage the monies. Also, the smaller the fund, the higher the fees the manager would require.

- LRB 2388 allows individuals to opt out of the venture capital trust fund at any time and transfer the monies from that fund to the fixed trust fund. While the ability to opt out would give investors a level of choice and protection they ought to have, it would force SWIB to sell these non-liquid assets at a loss.

SWIB has an active investment program that benefits both the WRS and business in Wisconsin. We would be happy to discuss the various ways that our investment activities help the state's economy and the initiatives we are taking. However, we do not believe the bill would be prudent or consistent with the fiduciary standards that we must meet. We, therefore, urge the committee not to support LRB 2388.

Sincerely,

Patricia Lipton

Patricia Lipton
Executive Director

State Senator
Cathy Stepp
WISCONSIN'S 21ST DISTRICT

November 19, 2003

Senate Majority Leader Mary Panzer
Senate Committee on Organization
211 South State Capitol
Madison, WI 53707

Dear Senator Panzer:

In an effort to continue and expand the Legislature's dialogue on economic development, The Senate Select Committee on Job Creation is requesting that it be allowed to hold an informational hearing on the Job Creation Act on Tuesday, November 25th in Milwaukee. Members of the Senate Select Committee on Job Creation will be joined by the newly-created Assembly Select Committee on Job Creation.

The joint hearing would be held at the Milwaukee Area Technical College, Room S 120, 700 W. State St at 11:00 am. We would appreciate the services of a page from the Sergeant-at-Arms' office.

There is no charge for the use of the room. On behalf of the committee, we would request reimbursement for mileage and actual and necessary expenses incurred by its members for the purposes of attending this hearing.

Sincerely,

Cathy Stepp	Ted Kanavas
State Senator	State Senator
21st Senate District	33rd Senate District

Madison: Room 7 South, State Capitol, PO Box 7882, Madison, Wisconsin 53707-7882 • Phone: (608) 266-1832 • Fax: (608) 267-6793
Toll-free: 1 (866) 615-7510 • Email: Sen.Stepp@legis.state.wi.us
District: 730 Wisconsin Avenue – Room 275 • Racine, Wisconsin 53403 • Phone: (262) 636-3617

State Senator
Cathy Stepp
WISCONSIN'S 21ST DISTRICT

November 26, 2003

Senate Majority Leader Mary Panzer
Senate Committee on Organization
211 South State Capitol
Madison, WI 53707

Dear Senator Panzer:

In an effort to continue and expand the Legislature's dialogue on economic development, The Senate Select Committee on Job Creation is requesting that it be allowed to hold an informational hearing on the Job Creation Act on Wednesday, December 3rd in Wausau. Members of the Senate Select Committee on Job Creation will be joined by the newly-created Assembly Select Committee on Job Creation.

The joint hearing would be held at Northcentral Technical College, 1000 W. Campus Dr, Room D101 at 11:00 am. We would appreciate the services of a page from the Sergeant-at-Arms' office.

There is no charge for the use of the room. On behalf of the committee, we would request reimbursement for mileage and actual and necessary expenses incurred by its members for the purposes of attending this hearing.

Sincerely,

Cathy Stepp
State Senator
21st Senate District

Ted Kanavas
State Senator
33rd Senate District

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