

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



ANNUAL REVIEW OF

ADVANTAGE CAPITAL D.C.  
PARTNERS I, LLC

FOR THE PERIOD

JANUARY 1, 2011 THROUGH DECEMBER 31, 2011

## **SALUTATION**

Washington, DC  
April 1, 2013

The Honorable William P. White  
Commissioner, District of Columbia  
Department of Insurance, Securities and Banking  
810 1<sup>st</sup> Street, NE, Suite 701  
Washington, DC 20002

Commissioner White:

Pursuant to your instructions and in accordance with D.C. Official Code § 31-5237(a) a review of Advantage Capital D.C. Partners I, LLC (“the CAPCO”) has been performed to assess CAPCO compliance with the requirements for Certified Capital Companies contained in D.C. Official Code § 31-5231 et seq.

## **FORWARD**

This report format sets forth reportable observations of both a positive and negative nature and notes material adverse findings. This is a report by exception. No negative observations or material adverse findings were identified.

## **SCOPE OF REVIEW**

This review covers the period from January 1, 2011 through December 31, 2011, including any material transactions or events occurring during the fieldwork and noted during the review. In reviewing material for this report, the Reviewer relied on records and materials maintained by the CAPCO and provided to the Reviewer in response to requests for information initiated by the Department of Insurance, Securities and Banking (“DISB”) and the Reviewer.

The review included consideration of the CAPCO’s compliance concerning operational and funding requirements contained in D.C. Official Code § 31-5231 et seq., including:

- Certification requirements
- Satisfaction of requirements for “Qualified Businesses”
- Aggregate limitations on premium tax credits
- Qualification for premium tax credits

- Requirements for continuance of certification

The review also includes new requirements provided by the “Certified Capital Companies Improvement Amendment Act of 2010.”

## **METHODOLOGY**

The review process involved a review of D.C. Official Code § 31-5231 et seq. to identify the various standards and requirements applicable to CAPCOs operating in the District of Columbia that would be considered during the review and information provided by the CAPCO to determine compliance with each of the standards and requirements. Following the completion of a work plan, an initial request for documentation and submission to the CAPCO was prepared. Supplemental requests for information were made as needed. Documents and other materials in response to the information request were provided by the CAPCO in hard copy and electronic format. The information was examined to determine whether the CAPCO satisfied the various tests and standards set forth in D.C. Official Code § 31-5231 et seq. Findings pertaining to the Reviewer’s findings were noted and were used in the preparation of the report.

Presentation of the Reviewer’s findings track D.C. Official Code § 31-5231 et seq., i.e., requirements and legal standards applicable to the operation of the CAPCOs, and separate requirements applicable to Qualified Businesses. Substantive findings in the report contain: (i) an initial statement of the specific requirement or legal standard contained in D.C. Official Code § 31-5231 et seq; (ii) a brief summary of the information reviewed; and (iii) the Reviewer’s findings relative to that requirement or legal standard.

## **FINDINGS**

### **REVIEW OF CAPCO**

1. *D.C. Official Code §31-5232(d) requires the CAPCO to maintain its principal office in the District of Columbia.*

Various documents and materials provided by the CAPCO, in addition to independent verification of address indicate that at all times pertinent to this review the CAPCO has been located within the District of Columbia. On November 1, 2009 the CAPCO relocated its office to 2445 M St., NW.

2. *D.C. Official Code §31-5232(e) requires that at least two of the CAPCO’s principals or two employees engaged to manage the funds for the CAPCO have three or more years of experience in the venture capital industry.*

In curricula vitae provided as part of the CAPCO’s response to the Reviewer’s request for information President & CEO Steve Stull claims more than 20 years’ experience. Managing Director Damon Rawie claims 15 years of experience;

Principal Christopher Harris claims more than 3 years' experience. No exceptions were noted.

3. *D.C. Official Code §31-5232(h) prohibits an insurance company, either directly or through an affiliate, from owning more than 15% of the voting equity interests or other voting ownership interests in the CAPCO.*

Ownership documents indicate that 98.5% of the CAPCO is owned by Advantage Capital DC-MM-1; .05% owned by FSA Portfolio Management, Inc.; and 1% is owned by Advantage Capital Investment Management, LLC. The insurance company investors own a 10% equity interest in the fund. According to the terms of the Operating Agreement their interests are non-voting and less than 15%. No exceptions were noted.

4. *D.C. Official Code §31-5231(13) requires that the CAPCO's debt instruments be issued at par or at a premium, with an original maturity date at least 5 years from the date of issuance and a repayment schedule which is no faster than a level principal amortization over 5 years, which does not permit the Certified Investor to receive prepayment of interest, and which contains no interest, distribution, or payment features which are related to the profitability of the CAPCO or the performance of its investment portfolio.*

The CAPCO provided copies of the debt instruments executed with each of the insurance CAPCO lenders. The notes appear to be in compliance with the statutory requirements.

5. *D.C. Official Code §31-5236(a) permits the payment of Qualified Distributions at any time. D.C. Official Code §31-5231(14) defines "Qualified Distributions," i.e., payments of a CAPCO in connection with the following:*

*(A) Reasonable costs and expenses that can be paid in connection with the CAPCO's formation or syndication, or related costs;*

*(B) Reasonable management costs, including payment of professional and management fees not to exceed 2.5% of Certified Capital.*

*(C) Projected increases in federal or state taxes of direct or indirect equity holders of the CAPCO resulting from the earnings or other tax liability of the CAPCO to the extent the increase is related to the investment in the ownership of a CAPCO.*

The CAPCO's total Certified Capital as of the Allocation Date was \$10,974,178. The CAPCO provided financial records reflecting payment of management fees during the period under review in the approximate amount of \$278,000. The combined payments for professional and management fees is within the 2.5% limitation. No exceptions to this requirement were noted.

6. *D.C. Official Code §31-5235(a) mandates minimum Qualified Investments of its Certified Capital by each CAPCO according to the following schedule: (1) 20% within 30 months after the CAPCO'S Allocation Date; (2) 40% within 4 years after the CAPCO's Allocation Date; and (3) 50% within 5 years after the CAPCO's Allocation Date. In 2010 the Act was amended to modify the calculation.*

No exceptions were noted in regard to the CAPCO's meeting each of the investment thresholds. The CAPCO's allocation date is November 19, 2004. The Qualified Business Applications as well as records of funding approvals from the DISB indicate that by May 19, 2007, the CAPCO had invested \$3,450,000, representing 31% of its Certified Capital. By November 30, 2008, the CAPCO had invested a total of \$5,727,949, representing 52% of its Certified Capital. The CAPCO made \$2,37500 in new initial investments in 2011. Through year end the CAPCO had invested \$8,477,949, representing approximately 77% of its initial Certified Capital.

7. *D.C. Official Code §31-5235(d) prohibits any single investment in a Qualified Business from exceeding 15% of its total Certified Capital.*

The Qualified Business Applications as well as records of funding approvals from the DISB indicate that the CAPCO has not exceeded the 15% cap on investments in any one Qualified Business.

8. *D.C. Official Code §31-5235(f) places restrictions on investments a CAPCO is permitted to make in investments other than Qualified Businesses, e.g., a prohibition against investing any more than 5% of Certified Capital in a security issued by a Certified Investor or its affiliate unless the investment is guaranteed or otherwise secured in favor of the Certified Investors.*

The CAPCO provided financial documentation of its investments. In addition to investments of its Certified Capital in Qualified Businesses, the CAPCO has invested funds in marketable securities. No exceptions were noted.

9. *D.C. Official Code §31-5235(g)(2) requires each CAPCO to report annually to the DISB on the following: (1) the amount of Certified Capital at the end of the prior year; (2) whether the CAPCO has invested more than 15% of its total certified capital in any one business; and (3) all Qualified Investments made in the prior year.*

The CAPCO provided a copy of its 2011 audited financial statement and agreed upon procedures report. No exceptions were noted.

10. *D.C. Official Code §31-5235(g)(3) requires each CAPCO to provide an annual, audited financial statement, as well as an agreed-upon procedures report conducted by the independent auditor to assess compliance with the requirements in Chapter 52-A.*

The CAPCO provided copies of audited financial statements and agreed upon procedures reports to the Reviewer. No exceptions were noted.

11. *D.C. Official Code §31-5235(g)(4) requires payment of an annual \$10,000 certification fee to the DISB.*

Documentation and other information provided by the CAPCO in response to the Reviewer's request indicated that the required payments were made to the DISB. No exceptions were noted.

12. *D.C. Official Code §31-5236 prohibits a CAPCO from making any distribution other than a Qualified Distribution before 100% of its Certified Capital has been distributed in Qualified Investments.*

The CAPCO provided financial records (Cash Logs) reflecting payments made during the review period. These records do not evidence any distributions other than a Qualified Distribution or a Qualified Investment.

## REVIEW OF QUALIFIED BUSINESSES

Overview: The law restricts investments by the CAPCO to "Qualified Businesses" as defined in §31-5231(12) of the law. The CAPCO made the following new investments on the following dates in 2011:

- Agency Q: \$1,600,000 (August 17, 2011)
- Rep Equity: \$775,000 (October 14, 2011)

The 2010 amendments to the CAPCO law added new designations of Qualified Businesses as either "Tier One," "Tier Two," or Tier Three," based upon the nature of the business, its location within the District, and other criteria. Among other things, the "Tier" designation determines the credit the CAPCO will receive for its investment in the business. The investments in Agency Q qualifies as a Tier One investment. The investment in Rep Equity qualifies as a Tier Two investment.

13. *D.C. Official Code §31-5235(b)(2)(F) provides that a Qualified Business that receives an Initial Investment or a Follow-on Investment and that fails to maintain satisfaction of the eligibility criteria to receive an Initial or a Follow-on Investment, as applicable, for 6 consecutive months after the date of the Initial or Follow-On Investment shall be deemed to have invested \$0 for every dollar invested.*

The CAPCO provided payroll records for each Qualified Business through year-end 2011, indicating that as of that date each remained a going concern and maintain its principal place of business in the District. The CAPCO provided payroll records for the Qualified Business evidencing payments made to employees in the fourth quarter. The CAPCO also provided payroll records for the business sufficient to establish that it satisfied the 25% District residency

requirement on a continuous basis from the date of funding through the end of the calendar year.

14. *D.C. Official Code §31-5231(12)(A)(i) establishes physical and operational contact requirements with the District of Columbia. Each Qualified Businesses must: (i) be headquartered in the District; (ii) have their principal place of operations located in the District; and (iii) use the Qualified Investments it receives to support business operations in the District.*

With respect to the investment made during 2010 the CAPCO provided documentation indicating that at the time of each initial investment each of the Qualified Businesses was headquartered in and maintained its principle place of operations in the District.

The information provided by the CAPCO gave no indication that the Qualified Business was using invested funds to support business operations outside the District. Consideration of compliance with this particular requirement, however, was limited to information in the possession of and provided by the CAPCO. A definitive determination of compliance with this requirement would require an examination of each Qualified Business' financial and other business records. Such an examination falls outside the scope of the review.

15. *D.C. Official Code §31-5231(12)(A)(ii) requires that at the time of initial funding a minimum of 25% of employees of a Qualified Business reside in the District.*

The application procedures established by DISB for initial and follow-on investments Qualified Businesses require a certification from the CAPCOs that the Qualified Business satisfied the District residency requirement. The information provided by the CAPCO to the Reviewer indicates that the required statement of compliance was included with each funding request. Further, the DISB now requires CAPCOs to submit independent evidence establishing that Qualified Business applicants comply with the 25% District residency requirement. This evidence can include drivers' licenses, utility bills, or other documentation that a particular employee is a District resident. In addition to this information, the Reviewer was also provided with payroll and other additional documentation of compliance with the residency requirement.

Specific findings in regard to each of these Qualified Businesses include:

- *Agency Q.* Documentary evidence was provided demonstrating that 16 of its 32 full-time employees, or 50%, were D.C. residents at the time of initial funding.
- *Rep Equity.* Documentary evidence was provided demonstrating that 15 of its 20 full-time employees, or 75%, were D.C. residents at the time of initial funding.

No exceptions to this requirement were noted.

16. *D.C. Official Code §31-5231(12)(A)(iii) requires that at the time of initial funding a minimum of 75% of employees of a Qualified Business be employed at a location within the District.*

The DISB requires CAPCOs to certify that the Qualified Businesses meet the 75% threshold at the time of initial funding. Information received from the CAPCO and reviewed supports a conclusion that at the time of initial funding both of the Qualified Businesses receiving funding in 2011 satisfying this requirement.

17. *D.C. Official Code §31-5231(12)(A)(iv) requires that Qualified Businesses meet the definition of a Small Business Concern as defined in 21 CFR § 121.201.*

- *Agency Q.* Documentary evidence included a signed certification stating that this Qualified Business met the definition of a Small Business Concern as defined.
- *Rep Equity.* Documentary evidence included a signed certification stating that this Qualified Business met the definition of a Small Business Concern as defined.

No exceptions to this requirement were noted.

18. *§31-5231(12)(A)(v) requires certification in an affidavit that the Qualified Business was unable to obtain conventional funding, i.e., that the business tried and failed to obtain conventional financing, or that the business cannot be “reasonably expected” to qualify for conventional financing.*

- *Agency Q.* The CAPCO provided a signed certification from the Qualified Business stating that it was unable to obtain conventional funding.
- *Rep Equity.* The CAPCO provided a signed certification from the Qualified Business stating that it was unable to obtain conventional funding.

No exceptions to this requirement were noted.

19. *D.C. Official Code §31-5231(12)(B)(i) through (iv) excludes from the definition of Qualified Business any business that is a regional or national franchise, is primarily engaged in real estate development or leasing projects, is primarily engaged in the business of insurance, or is engaged in providing professional services provided by lawyers, accountants, or physicians.*

The CAPCO submitted for review the business plans that were submitted by each applicant for a Qualified Investment. Those business plans contained information about the nature of the business, including the services that the business intended to provide. None of these business plans evidenced an intention to provide any of the proscribed professional services. Independent verification was also made where possible through checking the Qualified Business’ website and the



description of the business' services. No exceptions to this requirement were noted.

20. *For loans or investments in Qualified Businesses made on or after April 7, 2010, D.C. Official Code §31-5231(12)(A)(vi) requires certification that the business was not organized by a Certified Capital Company or an affiliate of a Certified Capital Company.*

- *Agency Q.* The CAPCO provided a signed certification from the Qualified Business stating it was not organized by the CAPCO or an affiliate.
- *Rep Equity.* The CAPCO provided a signed certification from the Qualified Business stating it was not organized by the CAPCO or an affiliate.

No exceptions to this requirement were noted.

21. *For loans or investments in Qualified Businesses made on or after April 7, 2010, D.C. Official Code §31-5231(12)(A)(vii) requires certification that the business does not have an ownership interest, investment interest, compensation arrangement, or similar financial arrangement with a Certified Capital Company or any affiliate thereof prior to the date of the initial investment.*

- *Agency Q.* The CAPCO provided a signed certification from the Qualified Business stating that it did not have a prior ownership, business or investment relationship with the CAPCO.
- *Rep Equity.* The CAPCO provided a signed certification from the Qualified Business stating that it did not have a prior ownership, business or investment relationship with the CAPCO.

No exceptions to this requirement were noted.

22. *For loans or investments in Qualified Businesses made on or after April 7, 2010, D.C. Official Code §31-5238.02(c)(1) requires each Qualified Business to annually report to the CAPCO the number of jobs that it created and retained in the District, salaries paid to each employee, taxes paid to the District, money spent with local businesses or persons, and whether such businesses are located in the District or elsewhere, and to provide documentation to the CAPCO in support of the information provided in the report.*

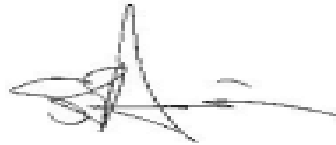
In addition to payroll records for each Qualified Business through year-end 2011, the CAPCO provided a certification stating that the CAPCO has collected and was in possession of the information from each Qualified Business as required by this section of the law.

23. *For loans or investments in Qualified Businesses made on or after April 7, 2010, D.C. Official Code §31-5238.02(c)(2)) requires each Qualified Business to*

*provide the CAPCO with documentation in support of its report, including copies of tax returns, invoices leases, payroll reports, employment records and contracts.*

In addition to payroll records for each Qualified Business through year-end 2011, the CAPCO provided a signed certification stating that the CAPCO has collected and was in possession of the information from each Qualified Business as required by this section of the law.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read 'Scott R. Harrison', with a long horizontal flourish extending to the right.

Scott R. Harrison  
Harrison Law Office, PC  
Washington, DC