

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, 2009 THROUGH DECEMBER 31, 2009

SALUTATION

Washington, DC
November 23, 2010

The Honorable Gennet Purcell
Commissioner, District of Columbia
Department of Insurance, Securities and Banking
810 1st Street, NE, Suite 701
Washington, DC 20002

Commissioner Purcell:

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 the CAPCO’s 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, 2009 through December 31, 2009, 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

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.*

According to the CAPCO's business plan, filings with DISB, and information on the CAPCO's website indicate that the CAPCO has at all times pertinent to this review been located within the District of Columbia at 3128 M Street, NW. 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 14 years of experience; Principal Douglas Beekman claims 9 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 98.9475% of the CAPCO is owned by Advantage Capital DC-MM-1; .0525% owned by FSA Portfolio Management, Inc.; and 1% is owned by Advantage Capital Investment Management, LLC. 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 are in compliance with the statutory requirements.

5. D.C. Official Code §31-5231(14) defines "Qualified Distributions," i.e., payments of the 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.

D.C. Official Code §31-5236(a) permits the payment of Qualified Distributions at any time.

The CAPCO's total Certified Capital as of the Allocation Date was \$10,974,178. The CAPCO provided financial records reflecting approximately \$50,000 in professional expenses. These payments do not appear to be unreasonable in relation to the types of services that were provided.

Other financial records supplied by the CAPCO reflect payment of management fees during the period under review in the amount of \$250,000. 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.

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. With the additional investments made in 2009, by year end the CAPCO has invested approximately 55% 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 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 approximately \$132,000 invested in marketable securities as of December 31, 2009. 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 2009 Annual Report to the DISB. That report contained the information required by the statute. 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 a copy of its 2009 audited financial statement and agreed upon procedures report. 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 payment was made to the DISB on or about January 27th. 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 its General Ledger 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: To continue to be certified, a CAPCO is required to make "Qualified Investments" in "Qualified Businesses" as defined in D.C. Official Code §31-5231(12). During the period under review, the CAPCO invested a total of \$325,000 in 6 businesses purporting to satisfy the definition of "Qualified Business." The total amount invested by the CAPCO represents approximately 55% of its Certified Capital.

Specific investments and the total amounts invested by the CAPCO are as follows:

- Content Now: \$75,000
- DC Biodiesel, LLC: \$50,000
- Finance Flows, Inc.: \$50,000
- Affinity Labs: \$50,000
- BizConnect: \$50,000
- Greenlight AC, Inc. \$50,000

13. 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 all but one of the investments made during 2009 (DC Biodiesel, LLC) the CAPCO provided documentation indicating that at the time of each

initial investment each of the Qualified Businesses was headquartered in and maintained its principal place of operations in the District.

The information provided by the CAPCO gave no indication that any of the Qualified Businesses were using invested funds to support business operations outside the District. In fact, none of the businesses examined appear to have any “operations” outside of the District. Consideration of compliance with this particular requirement, however, was limited to information in the possession of and provided by the CAPCO.

Concerning DC Biodiesel records provided by the CAPCO indicate that a waiver from this requirement was requested and obtained from the DISB on the grounds that DC Biodiesel’s business plan indicated it planned to refine a sell biodiesel fuel. At that time of the CAPCO’s investment, the company was still in the planning stages of its development, and thus was not engaged in the refining of biodiesel. The Company’s business plan indicates it will make the District its principal place of operations once the business was up and running. No exceptions to this requirement were noted.

14. 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 requires CAPCOs to submit independent evidence establishing that Qualified Business applicants comply with the 25% District residency requirement. That 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:

- *Affinity Lab LLC.* Documentary evidence was provided demonstrating that 100% (3/3) of this Qualified Business’ employees were DC residents at the time of initial funding.
- *Content Now, Inc.* Documentary evidence was provided demonstrating that 33% (1/3) of this Qualified Business’ employees were DC residents at the time of initial funding.
- *BizConnect LLC.* Documentary evidence was provided demonstrating that 100% (1/1) of this Qualified Business’ employees were DC residents at the time of initial funding.

- DC BioDiesel LLC. Documentary evidence was provided demonstrating that 33% (1/3) of this Qualified Business' employees were DC residents at the time of initial funding.
- Greenlight AC. Documentary evidence was provided demonstrating that 100% (2/2) of this Qualified Business' employees were DC residents at the time of initial funding.
- Finance Flows, Inc. Documentary evidence was provided demonstrating that 100% (1/1) of this Qualified Business' employees were DC residents at the time of initial funding.

No exceptions to this requirement were noted.

15. 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.*

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

- Affinity Lab, LLC. Documentary evidence was provided demonstrating that 100% (3/3) of this Qualified Business' employees work in the District at the time of funding.
- Content Now, Inc. Documentary evidence was provided demonstrating that 100% (3/3) of this Qualified Business' employees work in the District at the time of funding.
- BizConnect, LLC. Documentary evidence was provided demonstrating that 100% (1/1) of this Qualified Business' employees work in the District at the time of funding.
- DC. BioDiesel, LLC. Documentary evidence was provided demonstrating that 100% (3/3) of this Qualified Business' employees work in the District at the time of funding.
- Greenlight AC, LLC. Documentary evidence was provided demonstrating that 100% (2/2) of this Qualified Business' employees work in the District at the time of funding.
- Finance Flows, Inc. Documentary evidence was provided demonstrating that 100% (1/1) of this Qualified Business' employees work in the District at the time of funding.

No exceptions to this requirement were noted.

The DISB requires CAPCOs to certify that 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 all of the Qualified Businesses met this requirement.

16. 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.*

21 CFR § 121.201 establishes standards for businesses that qualify as “Small Business Concerns” based on either the entity’s gross revenue or number of employees. Based on the information reviewed in each Qualified Business’ funding application, no exceptions were noted.


17. D.C. Official Code §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.*

The application materials completed by each Qualified Business contained the required certification of compliance. The affidavits were completed and signed on behalf of each of the applicants and contained a statement that the applicant was unable to obtain conventional financing. The CAPCO also provided copies of declination letters from commercial lenders evidencing the applicant’s inability to obtain conventional financing. No exceptions to this requirement were noted.

18. D.C. Official Code §31-5231(12)(B) prohibits *Qualified Businesses from engaging in 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.

Respectfully Submitted,

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

Scott R. Harrison
Harrison Law Office, PC

Washington, DC