

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



ANNUAL REVIEW OF

ENHANCED CAPITAL DISTRICT FUND,
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 Enhanced Capital District Fund, 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, 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 is located at 1225 Potomac Street, NW, Washington, DC.

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 Founder and Board Chairman Andrew Paul claims more than twenty years' venture capital experience. CAPCO President and CEO Michael Korengold claims nine years' venture capital experience. Managing Director Paul Kasper claims nine years' venture capital experience. Mark Slusar, the Managing Director, claims over 10 years' venture capital experience. No exceptions to this requirement 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.

The CAPCO is wholly owned by Enhanced Capital Partners, Inc. (“ECP, Inc”). ECP, Inc. is wholly owned by Enhanced Capital Partners Stock Ownership Trust, the trustee of which is Reliance Trust Company. The beneficial owners are the employees of ECP. No exceptions to this requirement 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.

For purposes of the review for the period ending December 31, 2009 the CAPCO provided copies of the debt instruments executed with each of the insurance CAPCO lenders. Those notes are in compliance with the statutory requirements. For purposes of this review the CAPCO provided a statement that the previously issued debt instruments had been amended on or after January 1, 2009, and no new debt instruments were executed on or after January 1, 2009.

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 provided financial records reflecting expenses and costs paid to operate the CAPCO, e.g., legal, accounting and other professional expenses. These payments do not appear to be unreasonable in relation to the types of services that were provided.

Based on the amount of the CAPCO’s Certified Capital the 2.5% limitation permitted annual payments were not to exceed \$648,000. Financial records supplied by the CAPCO reflect payment of total management fees during the

period under review in the amount of \$685,000. Of this amount, \$602,895 was 2007 accrued management fees and \$82,015 was 2008 accrued management fees. Zero management fees were therefore accrued in 2009. A review of payments of management fees attributable to 2007 and 2008 was made to determine whether the accrual of the 2009 payment in those years impacted the CAPCO's satisfaction of the 2.5% limitation. That review demonstrated that the accrual of the payments made in 2009 to those 2007 and 2008 left the total amount of management fees attributable to those years within the 2.5% cap for each of those years. 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 12, 2004. Its Certified Capital on the Allocation Date was \$25,919,405. The Qualified Business Applications as well as records of funding approvals from the DISB indicate that by May 31, 2007, the CAPCO had invested \$6,000,000, representing 23% of its Certified Capital. By November 12, 2008, the CAPCO had invested \$12,784,911, representing 49% of its Certified Capital. By December 31, 2008, the CAPCO had invested \$12,959,911, or 50% of its Certified Capital. By December 31, 2009, the CAPCO had invested \$13,734,910, or approximately 53% of its 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. According to the information that was provided the CAPCO'S investments were limited to Qualified Businesses and approximately \$417,000 in money market accounts in financial institutions. 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.

On January 28, 2010 the CAPCO provided the DISB with its 2009 DC Annual CAPCO Report. No exceptions to this requirement 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 on or about January 20, 2010. 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. During the period under review the CAPCO invested approximately \$450,000 in four new businesses purporting to satisfy the definition of a "Qualified Business." The CAPCO also made an additional \$175,000 investment in an existing Qualified Business. Though the end of 2009 the CAPCO had invested approximately 52% of its Certified Capital.

The CAPCO made the following new investments in 2009:

- Affinity Lab LLC \$50,000¹
- Content Now, Inc. \$100,000

¹ Since 8-% of Affinity lab's employees were D.C. residents at the time of funding the CAPCO as entitled to receive the 1.5% credit for purposes of calculating compliance with this requirement.

- Okie Dokie, Inc. \$150,000
- Park Place, Inc. \$150,000

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 each investment made during 2009 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 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.

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. 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:

- *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.

- *Okie Dokie, Inc.* Documentary evidence was provided demonstrating that 28% (24/86) of this Qualified Business' employees were DC residents at the time of initial funding.
- *Park Place, Inc.* Documentary evidence was provided demonstrating that 34% (40/118) 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.

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.

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 initial 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 initial funding.
- *Okie Dokie, Inc.* Documentary evidence was provided demonstrating that 100% (86/86) of this Qualified Business' employees were DC residents at the time of initial funding.
- *Park Place, Inc.* Documentary evidence was provided demonstrating that 100% (118/118) of this Qualified Business' employees were DC residents at the time of initial funding.

No exceptions to this requirement were noted.

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. Two of the Qualified Businesses funded by the CAPCO in 2009, Affinity Lab, LLC and Content Now, Inc. certified to the DISB that each met the

requirements for a small business concern. With respect to the two remaining Qualified Business applicants, Okie Dokie, Inc. and Park Place, Inc., documentation provided by the CAPCO indicates that these companies do not meet the SBA guidelines for a “small business” because their revenues exceeded the SBA’s guidelines. The applicants applied for and obtained a written waiver of this requirement from the DISB. No exceptions to this requirement were noted.

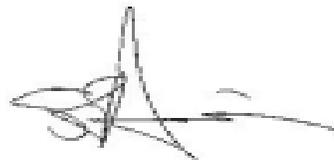
17. D.C. Official Code §31-5231(12)(A)(v) *requires certification in an affidavit that the Qualified Business was unable to obtain conventional funding, i.e., that the business tried and failed to obtain conventional financing, or that the business cannot be “reasonably expected” to qualify for conventional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

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

