

Introduced by Senators Dutton and PriceFebruary 18, 2010

An act to amend Sections 28047, 28100, 28152, 28154, 28200, 28400, and 28551 of, to add Sections 28047.1 and 28111 to, to repeal Sections 28002, 28151, 28401, 28402, 28403, and 28404 of, and to repeal and add Article 2 (commencing with Section 28820) of Chapter 12 of Division 3 of Title 4 of, the Corporations Code, relating to capital access companies.

LEGISLATIVE COUNSEL'S DIGEST

SB 1155, as introduced, Dutton. Capital access companies.

Existing law, the Capital Access Company Law, provides for the licensure and regulation by the Commissioner of Corporations of capital access companies to enable those entities to provide risk capital and management assistance to small businesses in the state, exempt from the requirements of the federal Investment Company Act of 1940.

Under existing law, a capital access company is only authorized to engage in the business of providing financing assistance through the purchase of securities of small business firms doing business or proposing to do business wholly or substantially in this state, and providing managerial and technical assistance to these firms, subject to certain exceptions. Existing law defines a "small business firm" as a person meeting specified criteria, including, without limitation, having fewer than 500 employees.

This bill would redefine a small business firm as a person that, together with its affiliates, has a net worth of not more than \$18,000,000 and average net income after federal income taxes, as specified, no greater than \$6,000,000. The bill would also define a "smaller business firm" as a person that, together with its affiliates, has a net worth of not

more than \$6,000,000 and average net income after federal income taxes, as specified, no greater than \$2,000,000, and would require that at least 20% of all financing assistance provided by a licensee shall be through the purchase of securities of smaller business firms proposing to do business wholly in this state.

Existing federal law provides for licensure and regulation of small business investment companies by the Small Business Administration.

This bill would provide that, if a capital access company becomes a small business investment company, specified federal regulations shall supersede regulatory requirements under the Corporations Code, except as specified.

Existing law requires, as a condition of licensure of a capital access company, that a person who makes recommendations with respect to the investment of funds of the company be an investment adviser, as specified, and not be subject to specified acts and omissions, convictions, and other legal actions.

This bill would instead require that no controlling person of an applicant be subject to those acts, omissions, convictions, or other legal actions.

This bill would also revise and recast provisions of the Capital Access Company Law relating to conflicts of interest.

Existing law specifies the activities a capital access company is authorized to conduct, prohibits it from issuing redeemable securities, and specifies limitations on the sale of its securities and on securities it may purchase. Existing law also provides that the Corporate Securities Law of 1968, that regulates securities offerings in this state, applies to capital access companies.

This bill would eliminate the latter provision.

Existing law prohibits the transfer or assignment of a capital access company.

This bill would permit those transactions, if approved by the commissioner.

Existing state law requires a capital access company to use its best efforts to provide financing assistance to small business firms doing business or proposing to do business wholly or substantially in this state, and makes related prohibitions and exceptions to providing services to persons out of state. Existing state law also prohibits a capital access company from providing financing assistance to a small business firm whose primary business is providing financing assistance. Existing federal law requires a California capital access company to state in its

organizational documents that its activities are limited to providing financial or managerial services to enterprises doing business, or proposing to do business, in this state.

This bill would eliminate those state law prohibitions.

Vote: majority. Appropriation: no. Fiscal committee: yes.

State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 28002 of the Corporations Code is
2 repealed.

3 ~~28002. The provisions of the Corporate Securities Law of 1968~~
4 ~~(Division 1 (commencing with Section 25000) of Title 4) shall~~
5 ~~apply to licensees.~~

6 SEC. 2. Section 28047 of the Corporations Code is amended
7 to read:

8 28047. “Small business firm” means a person that: ~~(a) proposes~~
9 ~~to transact, or transacts, business on a regular and continuous basis~~
10 ~~in California; (b) has fewer than 500 employees; (c) is (1) a~~
11 ~~California corporation, (2) a foreign corporation, which is either~~
12 ~~(A) subject to Section 2115 without regard to the filing requirement~~
13 ~~under Section 2108 or (B) not subject to Section 2115, but by~~
14 ~~applying the three-factor test set forth in subdivision (a) of Section~~
15 ~~2115, has an average property factor, payroll factor, and sales~~
16 ~~factor of not less than 25 percent during the latest full income year,~~
17 ~~provided that the payroll factor for the same period is at least 50~~
18 ~~percent, and has a percentage of outstanding voting securities held~~
19 ~~of record, as of the last record date for a shareholder’s meeting,~~
20 ~~by persons having addresses in this state of at least 25 percent, or~~
21 ~~(3) a limited partnership, limited liability company, or other form~~
22 ~~of business entity organized under the laws of the State of~~
23 ~~California; (d) is not an investment company subject to the~~
24 ~~Investment Company Act of 1940; and (e) is not a person that~~
25 ~~either (1) has no specific business plan or purpose or (2) has~~
26 ~~indicated that its business plan is to engage in mergers or~~
27 ~~acquisitions with unidentified companies or other entities. and,~~
28 ~~together with its affiliates, has a net worth of not more than~~
29 ~~eighteen million dollars (\$18,000,000) and average net income~~
30 ~~after federal income taxes, excluding any carryover losses, for the~~

1 *preceding two years no greater than six million dollars*
2 *(\$6,000,000).*

3 SEC. 3. Section 28047.1 is added to the Corporations Code,
4 to read:

5 28047.1. “Smaller business firm” means a person that proposes
6 to transact, or transacts, business on a regular and continuous basis
7 in California and, together with its affiliates, has a net worth of
8 not more than six million dollars (\$6,000,000), and average net
9 income after federal income taxes, excluding any carryover losses,
10 for the preceding two years no greater than two million dollars
11 (\$2,000,000).

12 SEC. 4. Section 28100 of the Corporations Code is amended
13 to read:

14 28100. The commissioner shall administer and enforce the
15 provisions of this division *in a manner that facilitates the*
16 *legislative purposes set forth in Section 28004, consistent with*
17 *protection of investors.*

18 SEC. 5. Section 28111 is added to the Corporations Code, to
19 read:

20 28111. If a licensee becomes licensed as a small business
21 investment company and is subject to regulation by the Small
22 Business Administration under the federal Small Business
23 Investment Act of 1958, the regulations under that act shall
24 supersede all of the regulatory requirements under this division
25 except those provisions required to exempt licensees from
26 regulation under the federal Investment Company Act of 1940,
27 and the provisions of Chapter 8 (commencing with Section 28550),
28 Chapter 9 (commencing with Section 28600), Chapter 10
29 (commencing with Section 28650), Chapter 11 (commencing with
30 Section 28700), Chapter 12 (commencing with Section 28800),
31 Chapter 13 (commencing with Section 28900), and Chapter 14
32 (commencing with Section 28950).

33 SEC. 6. Section 28151 of the Corporations Code is repealed.

34 ~~28151. No person other than a person who meets the definition~~
35 ~~of a licensee may be issued a license under this division.~~

36 SEC. 7. Section 28152 of the Corporations Code is amended
37 to read:

38 28152. If the commissioner finds all of the following with
39 respect to an application for a license, the commissioner shall
40 approve the application:

1 (a) That the applicant has a tangible net worth, exclusive of the
2 funds to invest under subdivision (b), in an amount that is not less
3 than two hundred fifty thousand dollars (\$250,000) and that the
4 tangible net worth is adequate for the applicant to transact business
5 as a capital access company.

6 (b) That the applicant has funds to invest in an amount that is
7 not less than five million dollars (\$5,000,000).

8 (c) That the applicant has, in addition to the requirements of
9 subdivisions (a) and (b), financial resources in an amount that is
10 adequate for the applicant to pay its expenses in transacting
11 business as a capital access company for a period of not less than
12 three years from the date of licensure.

13 (d) That the directors, officers, and controlling persons of the
14 applicant are each of good character and sound financial standing,
15 that the directors and officers of the applicant are each competent
16 to perform their functions with respect to the applicant, and that
17 the directors and officers of the applicant are collectively adequate
18 to manage the business of the applicant as a capital access
19 company. For purposes of this subdivision, the commissioner shall
20 accord weight to the prior or current successful operation of a
21 commercial or investment enterprise.

22 (e) ~~That any no controlling person who makes recommendations~~
23 ~~with respect to the investment of funds of the company is an~~
24 ~~investment adviser, either registered under the Investment Adviser~~
25 ~~Act of 1940 or licensed as an investment adviser under the~~
26 ~~Corporate Securities Law of 1968, or exempt from registration or~~
27 ~~licensure, and that the person is not of the applicant is subject to~~
28 any act or omission enumerated in subdivision (a), (e), (f), or (g)
29 of Section 25212, or has been convicted of, or pled nolo contendere
30 to, any offense or been held liable in any civil action specified in
31 subdivision (b) of Section 25212, or is enjoined from any act,
32 conduct, or practice specified in subdivision (c) of Section 25212,
33 or is subject to any order specified in subdivision (d) of Section
34 25212.

35 (f) That it is reasonable to believe that the applicant, if licensed,
36 will comply with the provisions of Section 6(a)(5) of the
37 Investment Company Act of 1940, the applicable provisions of
38 the Corporate Securities Law of 1968, this division, and of any
39 regulation adopted or order issued under this division.

1 If, after notice and a hearing, the commissioner finds otherwise,
2 the commissioner shall deny the application.

3 SEC. 8. Section 28154 of the Corporations Code is amended
4 to read:

5 28154. No license shall be transferable or assignable *without*
6 *the approval of the commissioner.*

7 SEC. 9. Section 28200 of the Corporations Code is amended
8 to read:

9 28200. The organizational documents of the licensee shall
10 include the following statement:

11 (a) The activities of the licensee are limited to the promotion
12 of economic, business, or industrial development in the State of
13 California through the provision of financial or managerial
14 assistance primarily to small business firms and to other activities
15 that are incidental or necessary to carry out that purpose.

16 (b) The licensee will not engage in the business of issuing
17 redeemable securities.

18 (c) The security holders of the licensee are limited, on a
19 class-by-class basis, to persons who reside in the State of
20 California, or who have a substantial business presence in the State
21 of California, and who hold not less than 80 percent of the
22 licensee's securities.

23 (d) The securities of the licensee will be sold solely to accredited
24 investors (Section 28031) and the licensee will not purchase any
25 securities issued by an investment company as defined in Section
26 3 of the Investment Company Act of 1940 or issued by any
27 company that would be an investment company except for the
28 exclusions from that definition under paragraph (1) or (7) of
29 Section 3(a) of that act, other than (1) any debt security that is
30 rated investment grade by not less than one nationally recognized
31 statistical rating organization or (2) any security issued by a
32 registered open-end investment company that is required by its
33 investment policies to invest not less than 65 percent of its total
34 assets in securities described in paragraph (1) or securities that are
35 determined by that registered open-end investment company to be
36 comparable in quality to securities described in paragraph (1).

37 (e) The licensee will engage in the transaction of business
38 pursuant to the exemption from registration under the Investment
39 Company Act of 1940 afforded to economic, business, and
40 industrial development companies as provided for by Section

1 6(a)(5) of the Investment Company Act of 1940, as amended (15
2 U.S.C. Sec. 80a-6(a)), and a license pursuant to the Capital Access
3 Company Law (Division 3 (commencing with Section 28000)).

4 (f) The investment of funds by the licensee will be limited by
5 and subject to the provisions of Section 6(a)(5) of the Investment
6 Company Act of 1940, ~~the Corporate Securities Law of 1968,~~ and
7 the Capital Access Company Law.

8 SEC. 10. Section 28400 of the Corporations Code is amended
9 to read:

10 28400. No licensee shall engage in any business other than the
11 following:

12 (a) The business of providing financing assistance through the
13 purchase of securities of small business firms *or smaller business*
14 *firms* doing business or proposing to do business wholly or
15 substantially in this state.

16 (b) The business of providing managerial assistance (including
17 managerial and technical assistance) to small business firms *or*
18 *smaller business firms* doing business or proposing to do business
19 wholly or substantially in this state.

20 (c) *At least 20 percent of all financing assistance provided by*
21 *the licensee shall be through purchase of securities of smaller*
22 *business firms doing business or proposing to do business wholly*
23 *in this state.*

24 SEC. 11. Section 28401 of the Corporations Code is repealed.

25 ~~28401. Each licensee shall use its best efforts to provide~~
26 ~~financing assistance to small business firms doing business or~~
27 ~~proposing to do business wholly or substantially in this state.~~

28 SEC. 12. Section 28402 of the Corporations Code is repealed.

29 ~~28402. (a) Except as provided in subdivision (b), no licensee~~
30 ~~shall provide financing assistance to any person other than a small~~
31 ~~business firm in this state.~~

32 ~~(b) (1) If a licensee provides financing assistance to a small~~
33 ~~business firm in this state that is a franchisor, the licensee may~~
34 ~~also provide financing assistance to any small business firm in~~
35 ~~another state that is a franchisee of the franchisor.~~

36 ~~(2) If a licensee provides financing assistance to a small business~~
37 ~~firm in this state that is a franchisee of a franchisor, the licensee~~
38 ~~may also provide financing assistance to any small business firm~~
39 ~~in another state that is a franchisee of the franchisor.~~

40 SEC. 13. Section 28403 of the Corporations Code is repealed.

1 ~~28403. Except as otherwise provided in subdivision (b) of~~
 2 ~~Section 28402, no licensee shall provide financing assistance or~~
 3 ~~management assistance for use primarily outside this state.~~

4 SEC. 14. Section 28404 of the Corporations Code is repealed.

5 ~~28404. (a) No licensee shall provide financing assistance to~~
 6 ~~any small business firm the primary business of which is to provide~~
 7 ~~financing assistance.~~

8 ~~(b) No licensee shall provide financing assistance to any small~~
 9 ~~business firm for the purpose of evading the requirements of this~~
 10 ~~division.~~

11 SEC. 15. Section 28551 of the Corporations Code is amended
 12 to read:

13 28551. The commissioner shall approve an application for
 14 approval to acquire control of a licensee only if, after notice and
 15 a hearing, the commissioner finds ~~all of the following~~:

16 ~~(a) That that the applicant and the directors and officers of the~~
 17 ~~applicant are of good character and sound financial standing. shall~~
 18 ~~all be subject to the same conditions required of an original~~
 19 ~~applicant.~~

20 ~~(b) That it is reasonable to believe that, if the applicant acquires~~
 21 ~~control of the licensee, the applicant will comply with all applicable~~
 22 ~~provisions of this division and of any regulation or order issued~~
 23 ~~under this division.~~

24 ~~(c) That the applicant's plans, if any, to make any major change~~
 25 ~~in the business, corporate structure, or management of the licensee~~
 26 ~~are not detrimental to the safety and soundness of the licensee or~~
 27 ~~the accredited investors of the licensee, or to the public convenience~~
 28 ~~and advantage.~~

29 SEC. 16. Article 2 (commencing with Section 28820) of
 30 Chapter 12 of Division 3 of Title 4 of the Corporations Code is
 31 repealed.

32 SEC. 17. Article 2 (commencing with Section 28820) is added
 33 to Chapter 12 of Division 3 of Title 4 of the Corporations Code,
 34 to read:

35
 36 Article 2. Conflicts of Interest

37
 38 28820. In this article, unless the context otherwise requires:

39 (a) (1) "Associate," when used with respect to a licensee, means
 40 all of the following:

1 (A) Any principal shareholder, director, officer, manager, agent,
2 or adviser of the licensee.

3 (B) Any director, officer, partner, general manager, agent,
4 employer, or employee of any person referred to in subparagraph
5 (A).

6 (C) Any person who controls, is controlled by, or is under
7 common control with, any person referred to in subparagraph (A),
8 directly or indirectly, through one or more intermediaries.

9 (D) Any close relative of any person referred to in subparagraph
10 (A).

11 (E) Any person of whom any person referred to in subparagraphs
12 (A) to (D), inclusive, is a director or officer.

13 (F) Any person in whom any person referred to in subparagraphs
14 (A) to (D), inclusive, or any combination of persons acting in
15 concert owns or controls, directly or indirectly, a 10-percent or
16 greater equity interest.

17 (2) For purposes of this subdivision, any person who is in any
18 of the relationships referred to in subparagraphs (A) to (F),
19 inclusive, of paragraph (1) within six months before or after a
20 licensee provides financing assistance shall be deemed to be in the
21 relationship as of the date when the licensee provides the financing
22 assistance.

23 (3) For purposes of this subdivision, if a licensee, in order to
24 protect its interests, designates any person to serve as a director
25 of, officer of, or in any capacity in the management of, a small
26 business firm to which the licensee provides financing assistance,
27 the person shall not, on that account, be deemed to have any
28 relationship with the small business firm. However, this paragraph
29 shall not apply in any case where the person has, directly or
30 indirectly, any other financial interest in the small business firm
31 or where the person, at any time before the licensee provides the
32 financing assistance, served as a director of, officer of, or in any
33 other capacity in the management of, the small business firm for
34 a period of 30 days or more.

35 (b) “Close relative” means ancestor, lineal descendant, brother
36 or sister and lineal descendants of either, spouse, father-in-law,
37 mother-in-law, son-in-law, brother-in-law, daughter-in-law, or
38 sister-in-law.

39 28821. (a) A licensee shall not self-deal to the prejudice of a
40 small business firm or smaller business firm, the licensee, its

1 shareholders, or partners. Unless a licensee obtains a prior written
2 exemption from the commissioner for special instances in which
3 providing financial assistance may further the purposes of this
4 division despite presenting a conflict of interest, a licensee shall
5 not directly or indirectly do any of the following:

6 (1) Provide financial assistance to any of the licensee's
7 associates.

8 (2) Provide financial assistance to an associate of another
9 licensee, if one of the licensee's associates has received or will
10 receive any direct or indirect financial assistance or a commitment
11 from that licensee or a third licensee, including financial assistance
12 or commitments received under any understanding, agreement, or
13 cross dealing, reciprocal or circular arrangement.

14 (3) Borrow money from any of the following:

15 (A) A small business firm or smaller business firm to which the
16 licensee has provided financial assistance.

17 (B) An officer, director, or owner of at least a 10-percent equity
18 interest in the business.

19 (C) A close relative of a person described in subparagraph (B).

20 (4) Provide financial assistance to a small business firm or
21 smaller business firm to discharge an obligation to a licensee's
22 associate or to make other funds available to pay the obligation,
23 except if the obligation is to an associate lending institution and
24 is a line of credit or other obligation incurred in the normal course
25 of business.

26 (5) Provide financial assistance to a small business firm or
27 smaller business firm for the purpose of purchasing property from
28 a licensee's associate.

29 (b) Without the commissioner's prior written approval, a
30 licensee's associates shall not, directly or indirectly, do either of
31 the following:

32 (1) Borrow money from any person described in paragraph (3)
33 of subdivision (a).

34 (2) Receive from a small business firm or smaller business firm
35 any compensation in connection with any financial assistance a
36 licensee provides or anything of value for procuring, attempting
37 to procure, or influencing a licensee's action with respect to that
38 financial assistance.

39 (c) (1) Without the commissioner's prior written approval, a
40 licensee shall not provide financial assistance to any business in

1 which the licensee's associate has either a voting equity interest,
2 or total equity interests, including potential interests, of at least 5
3 percent.

4 (2) If a licensee and its associate provide financial assistance
5 to the same small business firm or smaller business firm, whether
6 at the same time or different times, a licensee shall demonstrate
7 to the commissioner's satisfaction that the terms and conditions
8 are, or were, fair and equitable to the licensee, taking into account
9 any differences in the timing of each party's financial transactions.

10 (3) Financial assistance that meets either of the following criteria
11 is exempt from the prior approval requirement in paragraph (1)
12 and shall be presumed to be fair and equitable to the licensee for
13 the purposes of paragraph (2):

14 (A) The licensee's associate is a lending institution that is
15 providing financing under a credit facility in order to meet the
16 operational needs of a small business firm or smaller business firm,
17 and the terms of that financing are usual and customary.

18 (B) The licensee's associate invests in the small business firm
19 or smaller business firm on the same terms and conditions and at
20 the same time as the licensee.

21 (d) To protect a licensee's investment, a licensee may designate
22 an associate to serve as an officer, director, or other participant in
23 the management of a small business firm or smaller business firm.
24 The licensee shall identify this associate in the licensee's records
25 maintained and made available for the commissioner's review.
26 Without the commissioner's prior written approval, the associate
27 shall not do any of the following:

28 (1) Have any other direct or indirect financial interest in the
29 small business firm or smaller business firm that exceeds, or has
30 the potential to exceed, 5 percent of the firm's equity.

31 (2) Have served for more than 30 days as an officer, director,
32 or other participant in the management of the small business firm
33 or smaller business firm before the licensee provided the financial
34 assistance.

35 (3) Receive any income or anything of value from the small
36 business firm or smaller business firm unless it is for the licensee's
37 benefit, with the exception of director's fees, expenses, and

- 1 distributions based upon the associate's ownership interest in the
- 2 small business firm or smaller business firm.

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