

AMENDED IN SENATE MARCH 22, 2010

SENATE BILL

No. 1155

Introduced by Senators Dutton and Price

February 18, 2010

An act to amend Sections 28047, 28100, 28152, 28154, 28200, 28400, and ~~28551~~ 28404 of, to add Sections 28047.1 and 28111 to, to repeal Sections 28002, ~~28151~~, 28401, 28402, ~~28403~~, and ~~28404~~ and 28403 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 amended, 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 *or substantially* 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 SEC. 2. Section 28047 of the Corporations Code is amended
4 to read:

5 28047. “Small business firm” means a person that proposes to
6 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 eighteen million dollars (\$18,000,000) and average
9 net income after federal income taxes, excluding any carryover
10 losses, for the preceding two years no greater than six million
11 dollars (\$6,000,000).

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

14 28047.1. “Smaller business firm” means a person that proposes
15 to transact, or transacts, business on a regular and continuous basis
16 in California and, together with its affiliates, has a net worth of
17 not more than six million dollars (\$6,000,000), and average net
18 income after federal income taxes, excluding any carryover losses,
19 for the preceding two years no greater than two million dollars
20 (\$2,000,000).

21 SEC. 4. Section 28100 of the Corporations Code is amended
22 to read:

23 28100. The commissioner shall administer and enforce the
24 provisions of this division in a manner that facilitates the legislative
25 purposes set forth in Section 28004, consistent with protection of
26 investors.

27 SEC. 5. Section 28111 is added to the Corporations Code, to
28 read:

1 28111. If a licensee becomes licensed as a small business
2 investment company and is subject to regulation by the Small
3 Business Administration under the federal Small Business
4 Investment Act of 1958, the regulations under that act shall
5 supersede all of the regulatory requirements under this division
6 except those provisions required to exempt licensees from
7 regulation under the federal Investment Company Act of 1940,
8 and the provisions of Chapter 8 (commencing with Section 28550),
9 Chapter 9 (commencing with Section 28600), Chapter 10
10 (commencing with Section 28650), Chapter 11 (commencing with
11 Section 28700), Chapter 12 (commencing with Section 28800),
12 Chapter 13 (commencing with Section 28900), and Chapter 14
13 (commencing with Section 28950).

14 ~~SEC. 6. Section 28151 of the Corporations Code is repealed.~~

15 ~~SEC. 7.~~

16 *SEC. 6.* Section 28152 of the Corporations Code is amended
17 to read:

18 28152. If the commissioner finds all of the following with
19 respect to an application for a license, the commissioner shall
20 approve the application:

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

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

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

33 (d) That the directors, officers, and controlling persons of the
34 applicant are each of good character and sound financial standing,
35 that the directors and officers of the applicant are each competent
36 to perform their functions with respect to the applicant, and that
37 the directors and officers of the applicant are collectively adequate
38 to manage the business of the applicant as a capital access
39 company. For purposes of this subdivision, the commissioner shall

1 accord weight to the prior or current successful operation of a
2 commercial or investment enterprise.

3 (e) That no controlling person of the applicant is subject to any
4 act or omission enumerated in subdivision (a), (e), (f), or (g) of
5 Section 25212, or has been convicted of, or pled nolo contendere
6 to, any offense or been held liable in any civil action specified in
7 subdivision (b) of Section 25212, or is enjoined from any act,
8 conduct, or practice specified in subdivision (c) of Section 25212,
9 or is subject to any order specified in subdivision (d) of Section
10 25212.

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

16 If, after notice and a hearing, the commissioner finds otherwise,
17 the commissioner shall deny the application.

18 ~~SEC. 8.~~

19 *SEC. 7.* Section 28154 of the Corporations Code is amended
20 to read:

21 ~~28154. No license shall be transferable or assignable without~~
22 ~~the approval of the commissioner.~~

23 *28154. Except pursuant to Section 28551, no license shall be*
24 *transferable or assignable.*

25 ~~SEC. 9.~~

26 *SEC. 8.* Section 28200 of the Corporations Code is amended
27 to read:

28 28200. The organizational documents of the licensee shall
29 include the following statement:

30 (a) The activities of the licensee are limited to the promotion
31 of economic, business, or industrial development in the State of
32 California through the provision of financial or managerial
33 assistance primarily to small business firms and to other activities
34 that are incidental or necessary to carry out that purpose.

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

37 (c) The security holders of the licensee are limited, on a
38 class-by-class basis, to persons who reside in the State of
39 California, or who have a substantial business presence in the State

1 of California, and who hold not less than 80 percent of the
2 licensee's securities.

3 (d) The securities of the licensee will be sold solely to accredited
4 investors (Section 28031) and the licensee will not purchase any
5 securities issued by an investment company as defined in Section
6 3 of the Investment Company Act of 1940 or issued by any
7 company that would be an investment company except for the
8 exclusions from that definition under paragraph (1) or (7) of
9 Section 3(a) of that act, other than (1) any debt security that is
10 rated investment grade by not less than one nationally recognized
11 statistical rating organization or (2) any security issued by a
12 registered open-end investment company that is required by its
13 investment policies to invest not less than 65 percent of its total
14 assets in securities described in paragraph (1) or securities that are
15 determined by that registered open-end investment company to be
16 comparable in quality to securities described in paragraph (1).

17 (e) The licensee will engage in the transaction of business
18 pursuant to the exemption from registration under the Investment
19 Company Act of 1940 afforded to economic, business, and
20 industrial development companies as provided for by Section
21 6(a)(5) of the Investment Company Act of 1940, as amended (15
22 U.S.C. Sec. 80a-6(a)), and a license pursuant to the Capital Access
23 Company Law (Division 3 (commencing with Section 28000)).

24 (f) The investment of funds by the licensee will be limited by
25 and subject to the provisions of Section 6(a)(5) of the Investment
26 Company Act of 1940 and the Capital Access Company Law.

27 ~~SEC. 10.~~

28 *SEC. 9.* Section 28400 of the Corporations Code is amended
29 to read:

30 28400. No licensee shall engage in any business other than the
31 following:

32 (a) The business of providing financing assistance through the
33 purchase of securities of small business firms or smaller business
34 firms doing business or proposing to do business wholly or
35 substantially in this state.

36 (b) The business of providing managerial assistance (including
37 managerial and technical assistance) to small business firms or
38 smaller business firms doing business or proposing to do business
39 wholly or substantially in this state.

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

5 ~~SEC. 11.~~

6 *SEC. 10.* Section 28401 of the Corporations Code is repealed.

7 ~~SEC. 12.~~

8 *SEC. 11.* Section 28402 of the Corporations Code is repealed.

9 ~~SEC. 13.~~

10 *SEC. 12.* Section 28403 of the Corporations Code is repealed.

11 ~~SEC. 14.~~ Section 28404 of the Corporations Code is repealed.

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

14 ~~28551.~~ The commissioner shall approve an application for
15 approval to acquire control of a licensee only if, after notice and
16 a hearing, the commissioner finds that the applicant and the
17 directors and officers of the applicant shall all be subject to the
18 same conditions required of an original applicant.

19 *SEC. 13.* Section 28404 of the Corporations Code is amended
20 to read:

21 ~~28404.~~ (a) No licensee shall provide financing assistance to
22 any small business firm the primary business of which is to provide
23 financing assistance.

24 ~~(b)~~

25 *28404.* No licensee shall provide financing assistance to any
26 small business firm for the purpose of evading the requirements
27 of this division.

28 ~~SEC. 16.~~

29 *SEC. 14.* 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.~~

33 *SEC. 15.* Article 2 (commencing with Section 28820) is added
34 to Chapter 12 of Division 3 of Title 4 of the Corporations Code,
35 to read:

36
37 Article 2. Conflicts of Interest

38
39 28820. In this article, unless the context otherwise requires:

1 (a) (1) “Associate,” when used with respect to a licensee, means
2 all of the following:

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

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

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

11 (D) Any close relative of any person referred to in subparagraph
12 (A).

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

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

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

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

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

1 ~~28821. (a) A licensee shall not self-deal to the prejudice of a~~
2 28821. (a) A licensee shall not provide financial or
3 managerial assistance to, or for the benefit of, any person to the
4 detriment of a small business firm or smaller business firm, the
5 licensee, its shareholders, or partners. Unless a licensee obtains a
6 prior written exemption from the commissioner for special
7 instances in which providing financial assistance may further the
8 purposes of this division despite presenting a conflict of interest,
9 a licensee shall not directly or indirectly do any of the following:
10 (1) Provide financial assistance to any of the licensee's
11 associates.
12 (2) Provide financial assistance to an associate of another
13 licensee, if one of the licensee's associates has received or will
14 receive any direct or indirect financial assistance or a commitment
15 from that licensee or a third licensee, including financial assistance
16 or commitments received under any understanding, agreement, or
17 cross dealing, reciprocal or circular arrangement.
18 (3) Borrow money from any of the following:
19 (A) A small business firm or smaller business firm to which the
20 licensee has provided financial assistance.
21 (B) An officer, director, or owner of at least a 10-percent equity
22 interest in the business.
23 (C) A close relative of a person described in subparagraph (B).
24 (4) Provide financial assistance to a small business firm or
25 smaller business firm to discharge an obligation to a licensee's
26 associate or to make other funds available to pay the obligation,
27 except if the obligation is to an associate lending institution and
28 is a line of credit or other obligation incurred in the normal course
29 of business.
30 (5) Provide financial assistance to a small business firm or
31 smaller business firm for the purpose of purchasing property from
32 a licensee's associate.
33 (b) Without the commissioner's prior written approval, a
34 licensee's associates shall not, directly or indirectly, do either of
35 the following:
36 (1) Borrow money from any person described in paragraph (3)
37 of subdivision (a).
38 (2) Receive from a small business firm or smaller business firm
39 any compensation in connection with any financial assistance a
40 licensee provides or anything of value for procuring, attempting

1 to procure, or influencing a licensee's action with respect to that
2 financial assistance.

3 (c) (1) Without the commissioner's prior written approval, a
4 licensee shall not provide financial assistance to any business in
5 which the licensee's associate has either a voting equity interest,
6 or total equity interests, including potential interests, of at least 5
7 percent.

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

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

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

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

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

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

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

39 (3) Receive any income or anything of value from the small
40 business firm or smaller business firm unless it is for the licensee's

- 1 benefit, with the exception of director's fees, expenses, and
- 2 distributions based upon the associate's ownership interest in the
- 3 small business firm or smaller business firm.

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