The Florida Senate

PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Higher Education Appropriations Committee

BILL: CS/SB 1074

INTRODUCER: Committee on Higher Education Appropriations and Senator Lynn

SUBJECT: State University Research Commercialization Program

DATE: March 15, 2007 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Bryant	Hamon	HI	**Fav/CS**
2.				
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I. Summary:

The bill creates the State University Research Commercialization Program (program) to promote the commercialization of university research products in order to enhance the state's economy and public universities. The program will be administered by a not-for-profit corporation known as the State University Research Commercialization Funding Corporation (corporation). The corporation shall be governed by a board of directors. The board of directors shall consist of nine voting members.

If funding for the program is appropriated in the General Appropriations Act, a state university may apply for a State University Research Commercialization Assistance Grant (grant) through the corporation to assist in developing products and services resulting from university research. These early stage capital grants may be used by the university to secure patents, establish start-up companies, develop license agreements, attract private investment, and support other activities necessary to establish commercially viable ventures for the marketing and sale of products resulting from university research. The corporation shall periodically solicit proposals from state universities for grants. Grants may be provided in three phases: up to $50,000 for Phase One, up to $100,000 for Phase Two, and up to $250,000 for Phase Three.

II. Present Situation:

The Venture Capital Industry[1]

"Venture capital" is money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors. Venture capital is an important source of equity for startup companies.

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[1] The primary source for information in this section is the National Venture Capital Association website, available at http://www.nvca.org/def.html . Last visited March 11, 2007.

Venture capital investments typically have several characteristics, including an investment in a start-up or expansion-oriented company that has a higher level of risk than is typically associated with traditional bank lending activities; equity participation in the business by the venture capitalist; long-term investments with a 5- to10-year time horizon; and an established mechanism for the payout to the venture capitalist at the end of that time period.

Venture capitalists generally:

- Finance new and rapidly growing companies;
- Purchase equity securities;
- Assist in the development of new products or services;
- Add value to the company through active participation;
- Take higher risks with the expectation of higher rewards; and
- Have a long-term orientation.

Venture capitalists actively work with the company's management by contributing their experience and business savvy gained from helping other companies with similar growth challenges. A venture capitalist may invest before there is a real product or company organized, known as "seed investing," or may provide capital to a company in its first or second stages of development known as "early stage investing." Venture capitalists mitigate their risks by developing a portfolio of young companies in a single venture fund.

Over the past decade, a number of states have adopted programs targeting the formal venture capital industry. Programs fall into five basic categories:

- Direct Investment by state agencies to individual businesses. This type of program may be problematic, because it is difficult to find state agency staff with appropriate expertise.

- Investment by state agencies or pension funds into privately managed funds that have extensive geographical limitations (such as enterprise zone location requirements).

- Investment by state agencies or pension funds into a portfolio of privately managed funds. Investments are made in several private partnerships along with other investors. This model is effective at diversifying risk and helping focus a variety of experienced investors on legitimate capital needs of businesses.

- Private investment spurred by offering state tax credits for qualifying investments. Programs include direct tax credits for investment in qualified businesses and direct tax credits for investment in qualified venture capital funds.

- Private investment spurred by offering contingent state tax credits used as a source of value for guaranty of investment. The tax credits are contingent because they are not claimed unless the venture capital investment fails to meet a guaranteed rate of return.

Venture Capital in Florida

Enterprise Florida, Inc. (EFI) reports that in Florida, total venture capital spending was more than $555 million for 114 deals in 2003 and 2004, and that 27 venture capital firms have headquarters in Florida.

EFI also reports that since the late 1990's, venture capital investment in Florida has fallen sharply both in absolute dollar terms and as a share of the U.S. total. Despite being the 4th-most populous state, Florida ranked 13th in the U.S. in terms of venture capital investment in 2004. In 2004 Florida accounted for only $300 million, or 1.42% of the total venture capital funding in the U.S.

To date, Florida has promoted the investment of state funds in venture capital through two programs: the Cypress Equity Fund and the Certified Capital Company Act (CAPCO).

- The Cypress Equity Fund

In 1995, the Enterprise Florida Capital Partnership, Inc., created the Cypress Equity Fund as part of a strategy to help improve Florida businesses' access to venture capital. The Cypress Equity Fund's purpose is to facilitate initial venture capital investments by Florida private financial institutions and institutional investors, and provide a means to encourage national venture capital managers to consider investment opportunities in Florida. This program invests both public and private funds into privately managed venture capital funds.

The Cypress Equity Fund was designed as a "fund of funds" to invest in national private venture capital funds that, in turn, would invest in companies with high growth potential. However, investments may be made in venture capital funds located anywhere in the country and therefore are not required to target in-state companies.

The Cypress Equity Fund obtained $35.5 million in commitments. The commitment total included $20.5 million from five private financial institutions, and $15 million from the Florida State Board of Administration. The Cypress Equity Fund Management Corporation, an entity established by the Capital Development Board, is responsible for overall management of the fund. The corporation, in turn, contracts with a private equity manager to invest fund assets with national venture capital firms.

In a 1998 report on the Cypress Equity Fund, OPPAGA concluded that the fund has not contributed to achieving the goal of improving Florida businesses' access to venture capital because its investments were not targeted to in-state companies.[2]

- CAPCO

The 1998 Florida Legislature enacted the Certified Capital Company Act. This program encourages private investment in venture capital by providing direct tax credits for investment in qualified businesses. The stated purpose of this act is to stimulate a substantial increase in venture capital investments in Florida by providing an incentive for insurance

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[2] "Review of The Enterprise Florida, Inc. Capital Development Board's Cypress Equity Fund," Report No. 98-33. Available at http://www.oppaga.state.fl.us/monitor/reports/pdf/9832rpt.pdf

companies to invest in state-certified capital companies (CAPCOs) which, in turn, will invest in new or expanding businesses. Eligible insurance companies are granted insurance premium tax credits in amounts equal to investments in CAPCOs. The increase in investment capital is intended to contribute to employment growth, create high-paying jobs, and expand or diversify Florida's economy.

The Governor's Office of Tourism, Trade and Economic Development's (OTTED) 2005 review of the CAPCO program indicated that $3 million was invested in 12 new investee companies, ranging from a business that specializes in transportation of construction materials, to child-care nurseries, to pool and spa installation.[3] Another $1.8 million was invested in existing companies. As of December 31, 2005, a total of $153.4 million has been made available to the 59 investee companies, which have created 1,028 jobs.

Other Models for Public Investment in Economic Development

Florida statutes include a variety of state subsidies, tax credits, and tax exemptions targeted for economic development. Most are distributed or administered by OTTED or the Department of Revenue (DOR). However, in some cases the Legislature has established an alternative mechanism for specific purposes. Recent examples include the Innovation Incentive Program, Centers of Excellence, State University Research and Economic Development Investment Program, and Scripps Funding Corporation. Briefly:

- Chapter 2006-55, L.O.F., created the Innovation Incentive Program. The purpose of the program is to provide resources for significant economic development projects, including the location or expansion of research and development entities and innovation businesses in Florida. The law appropriated $200 million for the program for FY 2006-2007. These funds were placed in reserve by the Executive Office of the Governor. Unexpended funds for FY 2006-2007 are subject to annual appropriation.

  Section 288.1089, F.S., requires Enterprise Florida, Inc. (EFI), to evaluate applications for innovation incentive funds and to recommend eligible businesses to OTTED. OTTED must certify the applicants as qualified businesses, and then recommend qualified businesses to the Governor for approval. The Governor is required to consult with the Legislature and receive approval prior to releasing innovation incentive funds to qualified businesses.

- Chapter 2006-58, L.O.F., created the Centers of Excellence Program, which is designed to foster and promote the research required to develop commercially-promising, advanced, and innovative science and technology and to transfer those discoveries to commercial sectors. The law established the Florida Technology, Research, and Scholarship Board within the Board of Governors of the State University System to recommend to the Board of Governors methods for implementing and administering the Centers of Excellence Program. The Board of Governors was authorized to select the Centers and disburse the $30 million appropriated for this purpose.

[3] "Certified Capital Company Act" (CAPCO) Annual Report, January 1-December 30, 2005. Prepared by OTTED. Copy on file with the Commerce Committee.

- Chapter 2006-58, L.O.F., also created the State University System Research and Economic Development Investment Program to provide matching funds to eligible institutions (Florida State University, the University of Florida, and the University of South Florida) to construct and acquire science and engineering research facilities and specialized equipment to support research, foster economic development, and accelerate Florida's innovation economy. The Board of Governors was authorized to disburse the $44.1 million appropriated for this purpose, provided the eligible universities raise matching funds.

- During Special Session E in 2003, the Legislature provided for the creation of the Scripps Florida Funding Corporation (corporation), which is responsible for contracting with The Scripps Research Institute (TSRI) to establish a state-of-the-art biomedical research institute and campus in this state. The funding for the contract is provided by $310 million of the $543.5 million in federal economic stimulus funds provided to Florida under the Jobs and Growth Tax Reconciliation Act of 2003.

  OTTED was the initial recipient of the $310 million appropriation. OTTED disbursed the funds to the corporation pursuant to a funding agreement. The purpose of the corporation was to receive a lump-sum payment of $310 million guaranteeing that a funding source will be available for period disbursements to TSRI's Florida operation over a seven-year period. Undisbursed funds held by the funding corporation have been invested by the State Board of Administration. The law stipulated that undisbursed funds revert back to the General Revenue Fund only if the contract between the funding corporation and TSRI is terminated.

These four programs have the potential to improve state universities' role in technology transfer, a commercialization process through which an entity that develops a new technology, but does not have the wherewithal or desire to bring it to market, transfers that raw technology to another entity that does. A 2001 report by the Senate Commerce and Economic Opportunities Committee noted that university-to-industry technology transfer can be a key factor in building a high-skills, high-wage state economy. However, the report concluded that, by 2002, Florida universities, in general, did not appear to be performing as much technology transfer as many of their peer universities.

The report identified the importance of university-to-business transfer, reviewed the statutory and regulatory framework for technology-transfer activities, and identified the impediments to successful university-to-industry collaboration. One of the missing "inputs required to fuel the technology-transfer process" are commercialization resources, including pre-venture "seed" funding, sound business guidance, and administrative support.

III. Effect of Proposed Changes:

The bill creates the State University Research Commercialization Program (program) to promote the commercialization of university research products for the purpose of enhancing the state economy and the state's public universities. The program will be administered by a non-for-profit corporation know as the State University Research Commercialization Funding Corporation (corporation).

If funding for the program is appropriated in the General Appropriations Act, a state university may apply for funding through the corporation to assist in developing products and services resulting from university research. Universities may include joint participation in the development of products and services by a cooperating university. Funding may be used by the university to secure patents, establish start-up companies, develop license agreements, attract private investment, and to support other activities necessary to establish commercially viable ventures for the marketing and sale of products resulting from university research.

State University Research Commercialization Funding Corporation

The bill creates a not-for-profit corporation known as the State University Research Commercialization Funding Corporation. The corporation is not a unit or entity of state government. However, the corporation is subject to public meetings and records provisions, except as provided in separate legislation.

The corporation shall be governed by a board of directors. The board of directors shall consist of nine voting members, of whom the Governor shall appoint three, the President of the Senate shall appoint three, and the Speaker of the House of Representatives shall appoint three. To be eligible for appointment to the board of directors, an individual must have prior experience in early-stage business investment, corporate management, the fiduciary management of investment funds, or the commercialization of research products. Members of the board of directors shall serve for a term of 4 years.

A person appointed to the board of directors must agree to refrain from having any direct interest in any contract, franchise, privilege, or other benefit arising from a university project receiving funding from the board during the term of his or her appointment and for 3 years after the termination of such appointment. The bill provides a criminal penalty of misdemeanor of the first degree, for a person to accept appointment to the board of directors in violation of these requirements or to accept a direct interest in any contract, franchise, privilege, or other benefit granted by the institution or affiliate within 3 years after the termination of his or her service on the board.

State University Research Commercialization Assistance Grants

State University Research Commercialization Assistance Grants are established to provide early stage capital funding grants to support the commercialization of university research products. Grants may be provided under the following categories:

> (1) Phase One grants, not to exceed $50,000 per project, shall be used to assist with early market research, independent evaluation, consultation, and other initial activities which may be required to develop an initial business model for a university research product with the potential for commercialization.

(2) Phase Two grants, not to exceed $100,000 per project, shall be available to match private investment in a university research commercialization proposal which has been successfully evaluated and developed into the level of readiness contemplated for projects which have received Phase One grants. Phase Two grants shall be used to assist with the development of a complete business plan for the commercialization of a university research product. $1 dollar in private support is required to match each $1 in state funding provided for a Phase Two grant.

(3) Phase Three grants, not to exceed $250,000 per project, shall be available to match private investment relating to the implementation and execution of a completed business plan for a university research product. $1 dollar in private support is required to match each $1 in state funding provided for a Phase Three grant.

Based on the availability of funds, the corporation shall periodically solicit proposals from state universities for State University Research Commercialization Assistance Grants. The corporation shall establish guidelines prescribing the criteria and format for the submission of proposed projects by state universities. When evaluating the projects submitted for funding, the corporation shall consider the following criteria:

(a) potential return to the university;
(b) potential for the creation of high wage jobs;
(c) potential of the proposed project to address pressing needs of citizens;
(d) potential of the proposed project to enhance the economic competitiveness of the state and the university; and
(e) technical, financial, organizational & marketing feasibility of the project and its business plan.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill is designed to promote the commercialization of university research products for the purpose of enhancing the state economy and the state's public universities.

C. Government Sector Impact:

The bill does not have a direct appropriation to implement the program or to create the corporation. Funding for the program shall be as specified in the General Appropriations Act. The General Appropriations Act for fiscal year 2007-08 is currently under development.

If funding is provided, the corporation may provide grants for university commercialization projects within three phases:

(1) Phase One grants, not to exceed $50,000 per project
(2) Phase Two grants, not to exceed $100,000 per project, and
(3) Phase Three grants, not to exceed $250,000 per project.

Contracts with grant recipients shall require repayment of the grant to the program when the project generates sufficient revenues to sustain a profitable operation. Repayments to the fund would be available in future years for additional program grants or administrative costs up to the annual administrative cost limitation.

If funding is provided, the corporation must establish at least one corporate office in this state and appoint a registered agent. The corporation shall hire or contract for all staff necessary for the proper execution of its powers and duties within the funds appropriated to implement the program. The corporation may not expend more than $300,000 per year for staffing and necessary administrative expenditures, including, but not limited to, travel and per diem and audit expenditures, using funds appropriated to implement the program.

The corporation may not issue long term debt. It shall request investment of funds within the program that are not disbursed to a grantee. Funds generated by the investment may be used for additional program grants or administrative costs up to the annual administrative cost limitation.

The State Board of Administration shall provide administrative support, consisting of money and investment advice, to the corporation as requested by the corporation. In the event of the dissolution of the corporation, the State Board shall be the corporation's successor in interest and shall assume all rights, duties, and obligations of the corporation under any existing contract.

VI. Technical Deficiencies:

None.

VII. Related Issues:

Certain corporation records related to trade secrets or proprietary information related to commercialization projects would be exempt from public-records and public-meetings requirements. A separate bill (CS for SB 1076) creates these exemptions.

VIII. Summary of Amendments: