

**Tennessee Department of Economic and Community Development:
INCITE Co-Investment Fund – Public Comment Period**

Governor Bill Haslam announced the Jobs4TN plan in April 2011 to accomplish his goal of making Tennessee the No. 1 location in the Southeast for high quality jobs. As the state's primary economic development agency, the Department of Economic and Community Development (ECD) has been charged by the Governor with overseeing the successful implementation of the plan. Jobs4TN is a comprehensive plan built around four strategies, one of which is investing in innovation.

The Department's primary innovation effort is the INCITE Initiative, which stands for **IN**novation, **C**ommercialization, **I**nvestment, **T**echnology and **E**ntrepreneurship. INCITE's goal is to elevate Tennessee's profile in innovation-based economic development and drive economic growth via the creation of knowledge-based jobs. One way the Department plans to achieve this goal is by establishing the INCITE Co-Investment Fund to spur additional investment in high-potential, high-growth businesses in Tennessee.

Prior to publishing final program guidelines for the INCITE Co-Investment Fund, the Department is seeking comment on the Draft Program Guidelines provided below. ECD will accept public comments from November 28, 2011 through Friday December 9, 2011. Responses should be sent via email to Ryan Gooch, Innovation Director, at ecd.innovation@tn.gov. Please clearly identify the item or items on which you are providing comment or indicate that you are commenting on an issue that is not currently addressed in the Draft Program Guidelines.

Additionally, ECD will hold a public webinar to describe the Draft Program Guidelines and answer any questions on Wednesday, December 7, 2011 at 10:00am CT. To participate in the webinar, please RSVP via email to ecd.innovation@tn.gov.

**INCITE Co-Investment Fund:
Draft Program Guidelines**

PROGRAM OVERVIEW

1. What is the INCITE Co-Investment Fund?

The Tennessee Department of Economic and Community Development (ECD) is creating the INCITE (Innovation, Commercialization, Investment, Technology and Entrepreneurship) Co-Investment Fund (the "Fund") using \$29.7 million of federal funding Tennessee was awarded under the State Small Business Credit Initiative (SSBCI). The Fund's design has been approved by the U.S. Department of Treasury, who administers the SSBCI program. The purpose of the Fund is to increase access to seed-, early- and expansion-stage capital for Tennessee businesses. The Fund is designed to be self-sustaining and to complement Tennessee's existing capital access initiatives.

2. What is the State Small Business Credit Initiative?

The State Small Business Credit Initiative (SSBCI) is a \$1.5 billion federal program administered by the U.S. Department of Treasury to strengthen state programs that provide access to capital to small businesses and small manufacturers. SSBCI is expected to spur up to \$15 billion in new lending to small businesses and small manufacturers. SSBCI allows states, territories and eligible municipalities to create new or build upon existing state small business financing programs, including capital access programs, collateral support programs, loan participation programs, loan guarantee programs and venture capital programs.

3. What are the goals of the INCITE Co-Investment Fund?

The goals of the INCITE Co-Investment Fund are:

- Create and retain high-quality jobs in Tennessee;
- Provide Tennessee companies access to additional seed-, early-, and expansion-stage venture capital, in part by attracting and leveraging significant private capital investment;
- Accelerate technology commercialization from Tennessee research institutions to Tennessee companies; and
- Minimize administrative costs and maximize funding to Tennessee companies.

4. How does the INCITE Co-Investment Fund work?

The Fund will be set up to maximize eligibility and will not target specific investors, companies, or industry sectors. Any entity meeting the criteria of an approved investor ("Approved Investor") will be eligible to apply for Co-Investment funding for any qualified investment ("Qualified Investment"). The amount of Co-Investment funding available for a specific transaction is discussed below. Proceeds from Qualified Investments are split between the Tennessee Technology Development Corporation (TTDC) and the Approved Investor as discussed below.

5. How does the INCITE Co-Investment Fund differ from TNInvestco?

The ultimate goal of both programs is to expand access to capital for high-potential, high-growth companies in Tennessee. However, the INCITE Co-Investment Fund will function differently than the TNInvestco

Program. Under the INCITE Co-Investment Fund, any investor that meets the criteria of Approved Investor and makes a Qualified Investment will be eligible to take advantage of the program on a first come, first served basis. The Fund is funded by federal funds from the State Small Business Credit Initiative (SSBCI) managed by the U.S. Department of Treasury. Under the TNInvestco Program, ten firms were selected and seeded to make direct investments in Tennessee companies. The TNInvestco Program is funded by state funds.

6. Who administers the INCITE Co-Investment Fund?

TTDC is administering the program on behalf of ECD.

APPROVED INVESTORS

7. What are the eligibility requirements for Approved Investors?

Prior to applying for INCITE Co-Investment funding, an applicant must be certified by TTDC as an Approved Investor. Approved Investors must meet criteria one and two below:

1. Be any of the following:
 - A. TNInvestco, as certified by the State of Tennessee;
 - B. Small Business Investment Corporation (SBIC), New Market Venture Capital Company or Rural Business Investment Company, as certified by the U.S. Small Business Administration;
 - C. A person or entity that has at least \$15 million of assets under management and is deemed an accredited investor under the Securities Act of 1933; or
 - D. A person or entity that is deemed an accredited investor under the Securities Act of 1933. A person or entity approved under this Section D is only eligible to participate in Qualified Investments in which there is a participating Approved Investor as qualified under Section A, B, or C above.
2. Submit a satisfactory Approved Investor Application to TTDC. The application will be available at www.tntechnology.org. The application process will ensure that:
 - A. All Applicants: Have affirmed the legal criteria set forth in the Approved Investor application and been determined by TTDC to be an applicant acting in the best interest of the program.
 - B. Section C Applicants Only: Have invested at least \$5 million in entities that would qualify as a Qualified Business as defined in question #9 with the exception that the entities do not have to be headquartered, have their principle business operations, or at least 60% of their employees in the state of Tennessee.

Non-Tennessee entities are eligible to be certified as Approved Investors as long as they meet all required Approved Investor criteria.

8. How do you confirm that the Approved Investor has \$15 million assets under management?

All investments that the applicant has made in a non-public company as well as all uncommitted funds that are in a pooled investment vehicle are counted towards the \$15 million threshold, with the exception of investments in real property. An applicant must provide TTDC with evidence of these assets. Evidence could include SEC filings or other legal or financial documents as determined appropriate by TTDC.

QUALIFIED INVESTMENTS

9. What are the eligibility requirements for Qualified Investments?

A Qualified Investment is defined as an investment of cash by an Approved Investor in a Qualified Business for the purchase of equity, equity warrants, or debt convertible to equity. An investment by an Approved Investor in a debt instrument whose terms are substantially equivalent to terms typically found in debt financing provided by banks to profitable companies shall not be deemed a Qualified Investment.

A Qualified Business is a business that meets the following requirements:

- The business must be independently owned and operated.
- The business must be headquartered in Tennessee; its principal business operations must be located in Tennessee (or be relocating its headquarters and principal business operations to Tennessee within 12 months); and at least 60% of its employees must be located in Tennessee.
- Is not engaged in a business involving:
 - a. Real estate, real estate development and leasing;
 - b. Insurance, banking or lending;
 - c. Professional services provided by a lawyer, accountant, registered investment advisor or physician;
 - d. Oil and gas exploration and mining;
 - e. Direct gambling services;
 - f. Construction;
 - g. Accommodation and food services establishments; and/or
 - h. Retail establishments, except when the primary purpose of the business is the development or support of electronic commerce using the Internet.
- Businesses engaged in activities that are prohibited by federal law or applicable law in the jurisdiction where the business is located or conducted will not be considered qualified businesses. Included in these activities is the production, servicing, or distribution of otherwise legal products that are to be used in connection with an illegal activity, such as selling drug paraphernalia or operating a motel that knowingly permits illegal prostitution.
- Charitable, religious, or other non-profit institutions, government-owned corporations, consumer and marketing cooperatives, and churches and organizations promoting religious objectives are not qualified businesses.
- Businesses must have less than 500 existing employees.
- Businesses must have affirmed the legal criteria set forth in the Qualified Investment application and been determined by TTDC to be acting in the best interest of the program.

Additionally, Approved Investors shall not use SSBCI funding for the following prohibited purposes:

- Permitting the reimbursement of funds owed to any owner, including any equity injection or injection of capital for the business's continuance;
- Effecting a partial change of business ownership or a change that will not benefit the business;
- Refinancing existing debt where the lender is in a position to sustain a loss and the government (state and/or federal) would take over that loss through refinancing;
- Repaying delinquent state or federal withholding taxes or other funds that should be held in trust or escrow;
- Financing a non-business purpose; and/or
- Paying expenses associated with the transaction.

10. How do I certify a Qualifying Investment?

To certify a Qualified Investment, Approved Investors must complete the Qualified Investment application, which will be available at www.tntechnology.org.

11. If I am an Approved Investor, can I make a Qualified Investment in a company that I own all or a portion of?

Yes, but only if there are additional Approved Investors investing in the Qualified Investment within a one-year period.

FUNDING

12. How much funding will the Fund co-invest for a particular Qualified Investment?

Funding will be made available in three tiers: seed-stage, early-stage, and expansion-stage. Details on each tier are below. These descriptions are based on a single Approved Investor making an investment in a single Qualified Investment within a one-year period. Question #13 provides information on situations in which two or more Approved Investors plan to invest in a particular Qualified Investment within a one-year period.

Seed-Stage Funding

- Seed-stage awards will range from \$250,000 to \$500,000 per investment.
- To qualify for seed-stage co-investment funding, Approved Investors must provide at least a direct 2:1 match (67% of the total investment) to access the program.
- For example, an Approved Investor seeking \$375,000 in seed-stage co-investment funding would have to provide \$750,000 of private capital to a Qualified Investment (resulting in \$1.125 million of total capital being made available to the business).

Early-Stage Funding

- Early-stage awards will range from \$500,001 to \$1,500,000 per investment.
- To qualify for early-stage co-investment funding, Approved Investors must provide at least a direct 3:1 match (75% of the total investment) to access the program.
- For example, an investor seeking \$1.0 million in early-stage co-investment funding would have to provide \$3.0 million of private capital to a Qualified Investment (resulting in \$4.0 million of total capital being made available to the business).

Expansion-Stage Funding

- Expansion-stage awards will range from \$1,500,001 to \$3,000,000 per investment.
- To qualify for expansion-stage co-investment funding, Approved Investors must provide at least a 4:1 match (80% of the total investment) to access the program.
- For example, an investor seeking \$2.25 million in expansion-stage co-investment funding would have to provide \$9.0 million of private capital to a Qualified Investment (resulting in \$11.25 million of total capital being made available to the business).

13. What happens if two or more Approved Investors plan to invest in the same Qualified Investment within a one-year period?

If two or more Approved Investors plan to invest in the same Qualified Investment within a one-year period, each Approved Investor must indicate the other Approved Investors that are participating in the Qualified Investment within that one-year period on the appropriate section of the Qualified Investment application. In situations in which there are multiple Approved Investors investing in a single Qualified Investment, the INCITE Co-Investment funding tier will be based on the aggregate amount of investment by Approved Investors and be distributed to Approved Investors pro rata. For example, if Approved Investor #1 plans to invest \$1 million in a Qualified Investment and Approved Investor #2 plans to invest \$2 million in the same Qualified Investment within a one-year period, the total private sector investment would be \$3 million, thereby leveraging \$1 million in INCITE Co-Investment funding. Approved Investor #1 would receive \$333,333 of this funding while Approved Investor #2 would receive \$666,667 of this funding.

14. If an Approved Investor is tranching an investment, will the INCITE Co-Investment Fund reserve funds for future tranches?

No. However, an Approved Investor may apply for co-investment funding for a single Qualified Investment on multiple occasions, subject to the limitations outlined in questions #18 and #19.

15. What is the minimum total amount of funding an Approved Investor or syndicate of Approved Investors must be investing in a Qualified Investment to qualify for the program?

\$500,000.

16. If participating in a syndicate of Approved Investors, what is the minimum amount of funding any single Approved Investor must be investing in a Qualified Investment to qualify for the program?

\$100,000.

17. May an Approved Investor apply for funding for more than one Qualified Investment?

Yes.

18. What is the maximum amount of INCITE Co-Investment funding a single Approved Investor can access?

\$3 million.

19. What is the maximum amount of INCITE Co-Investment funding that can go into a single Qualified Investment, regardless of the number of Approved Investors in the Qualified Investment?

\$3 million.

20. How will an Approved Investor draw down funds from the program?

The Fund will provide capital to an Approved Investor as outlined in a written agreement between TTDC and the Approved Investor (the "Funding Agreement"), which will be available on the TTDC website at www.tntechology.org. Terms of the Funding Agreement are non-negotiable. All capital that an Approved

Investor commits to a Qualified Business as described in question #12 must be paid in full to the Qualified Business within plus or minus 14 days of the execution of the Funding Agreement. After TTDC has received notification from the Approved Investor that the Qualified Business has received these funds, TTDC will transfer the INCITE Co-Investment funds directly to the Qualified Business.

21. Who will hold the stock certificates?

Stock certificates will be registered in the name of both the Tennessee Technology Development Corporation and the Approved Investor. TTDC will hold these stock certificates in an escrow account. Approved Investors can request the stock certificates from TTDC at the time of a Liquidity Event as defined in question #23.

22. How will Approved Investors be compensated?

Approved Investors will receive a 25% carry at the time of a liquidity event. See questions #23 through #27 for additional details.

23. How is a liquidity event defined?

A liquidity event is any transaction in which the Approved Investor cashes out their interest in the Qualified Investment.

24. What happens to the proceeds from a liquidity event?

Distributions from proceeds are allocated as follows:

- A. First, proceeds from a Liquidity Event shall be split between the Approved Investor and TTDC based on their pro rata share up to the total of each's capital investment.
- B. Second, any proceeds remaining after the return of capital shall be split between the Approved Investor and TTDC based on their pro rata share.
- C. Third, 25% of the proceeds allocated to TTDC in Section B above shall be reallocated to the Approved Investor as a carried interest.

25. What will TTDC do with its proceeds from liquidity events?

Proceeds from liquidity events will be reinvested into the program until December 31, 2016, as outlined in question #27. After that time, all of TTDC's proceeds will be returned to the Tennessee Department of Economic and Community Development (ECD) unless other arrangements are made between TTDC and ECD.

26. Will Approved Investors receive a management fee?

No.

PROCESS

27. What will happen if the INCITE Co-Investment Fund is over-subscribed?

Funding will be distributed on a first come, first served basis as determined by the date and time a Qualified Investment application is submitted to TTDC. After all Co-Investment Funds are fully allocated, TTDC will stop accepting Qualified Investment applications and all existing Qualified Investment applications will be denied. At the time TTDC has received at least \$3 million in proceeds from Liquidity Events, TTDC will reopen the Qualified Investment application process until those funds are allocated. As outlined in question #25 above, this process will reoccur until December 31, 2016.

28. When will the Approved Investor application be available?

December 15, 2011.

29. When will the Qualified Investment application be available?

January 16, 2012.

30. What are the reporting requirements for Approved Investors?

In order for ECD to comply with Section 4.7 of its Allocation Agreement with the U.S. Department of Treasury, Approved Investors that have made a Qualified Investment must submit an annual report to TTDC by March 15th of every year that includes:

- A unique investment identifier number, the census tract and zip code of the investee's principal location;
- The total amount of venture capital and other financing invested or loaned, and of that amount, the portion that is from non-private support (e.g., government loan and grants);
- The amount of venture capital provided by the state-sponsored venture capital fund program;
- Date of initial disbursement;
- The business's annual revenues in the last fiscal year;
- The business's number of Full Time Equivalent (FTE) employees;
- The 6-digit North American Industry Classification System (NAICS) code for each business's industry;
- The year the business was incorporated;
- The estimated number of jobs created and the estimated number of jobs retained as a result of the investment;
- The amount of additional follow-on private financing occurring after the investment closing; and
- The amount of funding provided to target populations, as defined in question #32 below.

31. Will my applications be public information?

No, but a list of Approved Investors and their contact information will be made publicly available on the TTDC website so that Tennessee companies seeking funding are able to contact Approved Investors. The amount of co-investment funding provided to specific Approved Investors and Qualified Investments as well as TTDC's proceeds from individual Liquidity Events will be subject to open records requests.

32. What steps are ECD and TTDC taking to ensure that historically underserved communities and disadvantaged populations are aware of the program?

For the purposes of the SSBCI program, the U.S. Department of Treasury defines historically underserved communities and disadvantaged populations as small businesses (1) in low- and moderate-income communities, (2) in minority communities, (3) in other underserved communities, and (4) owned by women and/or minorities. ECD and TTDC are taking six steps to ensure these communities and populations are made aware of the INCITE Co-Investment Fund.

First, the Fund will be set up to maximize eligibility and will not target specific investors, companies, or industry sectors. Any firm meeting the criteria of Approved Investor as described above is eligible to apply for funding for a Qualified Investment.

Second, ECD will leverage its existing Business Enterprise Resource Office (BERO) to ensure that small businesses in low-and moderate-income, minority, and undeserved communities and women- and minority-owned businesses are aware of the Fund and how to access its funding. BERO provides assistance and development opportunities to small and minority- and women-owned businesses. Through BERO, ECD partners with other state agencies and small business support programs to provide information about programs, entrepreneurial support and one-on-one technical assistance.

Third, as part of the Jobs4TN Plan, ECD is conducting extensive outreach to the business and entrepreneurial communities across Tennessee in each of ECD's nine "jobs base camp" regions. ECD's 27-employee field staff will be calling on hundreds of businesses a month. ECD will provide information about the Fund to businesses during these meetings. ECD will track and monitor outreach efforts to businesses in underserved communities and disadvantaged populations, as discussed in question #30 above.

Fourth, as part of the INCITE Initiative, ECD will be supporting a business accelerator in each of the nine "jobs base camp" regions across the state. Several of these accelerators will be located in underserved communities and supporting small businesses in disadvantaged populations.

Fifth, as part of their reporting obligations under the program, TTDC will collect and report to ECD information on businesses receiving funding under the program to monitor performance of the program in providing access to capital to underserved communities and disadvantaged populations.

Finally, ECD and TTDC will leverage both organizations' existing websites to provide information on the Fund to interested small businesses. TTDC will create a Fund webpage that will make contact information for Approved Investors publically available.

FOR TENNESSEE COMPANIES

33. I am a small business. Can I directly access the program?

No, but an Approved Investor can make a Qualified Investment in your business. A list of Approved Investors will be available at www.tntechnology.org.