

109TH CONGRESS
1ST SESSION

H. R. 3429

To amend the Small Business Investment Act of 1958 to establish a participating debenture program.

IN THE HOUSE OF REPRESENTATIVES

JULY 26, 2005

Mr. MANZULLO (for himself and Mr. RAMSTAD) introduced the following bill;
which was referred to the Committee on Small Business

A BILL

To amend the Small Business Investment Act of 1958 to
establish a participating debenture program.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. ESTABLISHMENT OF PARTICIPATING DEBEN-**
4 **TURES PROGRAM.**

5 (a) ESTABLISHMENT.—Section 303 of the Small
6 Business Investment Act of 1958 (15 U.S.C. 683) is
7 amended by adding at the end the following new sub-
8 section:

9 “(k) PARTICIPATING DEBENTURES.—

1 “(1) GUARANTEE OF PARTICIPATING DEBEN-
2 TURES.—The Administrator is authorized to guar-
3 antee the payment of the redemption price and in-
4 terest on a participating debenture issued by a small
5 business investment company under such terms and
6 conditions as the Administrator shall establish by
7 regulation.

8 “(2) LIMITATION ON GUARANTEE OF PARTICI-
9 PATING DEBENTURES.—A guarantee under para-
10 graph (1) shall not—

11 “(A) exceed the amount of the payment to
12 which the guarantee applies; or

13 “(B) change the timing of such payment.

14 “(3) MAXIMUM LEVERAGE.—The Administrator
15 may not guarantee a new participating debenture
16 issued by a small business investment company if
17 the aggregate unpaid principal balance of the par-
18 ticipating debentures issued by that small business
19 investment company would exceed 200 percent of
20 the leverageable capital of such company on the day
21 after the company issued or distributed the new par-
22 ticipating debenture.

23 “(4) PURCHASE OF PARTICIPATING DEBEN-
24 TURES.—The Administrator may authorize a trust
25 or pool acting on behalf of the Administration to

1 purchase participating debentures issued by a small
2 business investment company under such terms and
3 conditions as the Administrator shall establish by
4 regulation.

5 “(5) PARTICIPATING DEBENTURE DEFINED.—

6 In this subsection, the term ‘participating debenture’
7 means a debt security that is—

8 “(A) in a form prescribed by the Adminis-
9 trator that obligates the issuing company to—

10 “(i) pay any unpaid accrued interest
11 on that debt security on the date which is
12 5 years after the date on which it is issued;

13 “(ii) pay interest accrued after the
14 date that is 5 years after the date on
15 which the debt security is issued semi-an-
16 nually; and

17 “(iii) pay any other amount as re-
18 quired by this subsection and

19 “(B) subject to the terms and conditions
20 set forth in this subsection and to any addi-
21 tional terms and conditions as may be pre-
22 scribed by the Administrator that are consistent
23 with this subsection.

24 “(6) REDEMPTION.—Not later than the date
25 which is 10 years after the date on which it is

1 issued, a participating debenture shall be redeemed
2 for an amount equal to the outstanding principal
3 balance of such participating debenture plus any ac-
4 crued but unpaid interest due on such participating
5 debenture as of the date on which it is redeemed.

6 “(7) INTEREST.—

7 “(A) IN GENERAL.—Interest on a partici-
8 pating debenture is preferred and cumulative
9 and is pre-payable out of any gross receipts
10 available for distribution and is payable at the
11 scheduled interest payment dates and at the
12 scheduled or accelerated maturity of the partici-
13 pating debenture.

14 “(B) INTEREST ON PRINCIPAL BAL-
15 ANCE.—Interest on the principal balance out-
16 standing of a participating debenture shall ac-
17 crue on a daily basis, and unpaid accrued inter-
18 est shall compound semi-annually from the date
19 of the issuance of such participating debenture,
20 at a rate determined by the Secretary of the
21 Treasury taking into consideration the current
22 average market yield on outstanding marketable
23 obligations of the United States with remaining
24 periods to maturity comparable to the average
25 maturities on such securities, adjusted to the

1 nearest one-eighth of 1 percent, plus an addi-
2 tional charge, in an amount established annu-
3 ally by the Administration, as necessary to re-
4 duce to zero the cost (as defined in section 502
5 of the Federal Credit Reform Act of 1990 (2
6 U.S.C. 661a)) to the Administration of pur-
7 chasing and guaranteeing participating deben-
8 tures under this Act, which rate may not exceed
9 1.5 percent per annum, and which shall be paid
10 to and retained by the Administration.

11 “(8) PAYMENT DEFAULTS.—If a small business
12 investment company fails to pay any principal or in-
13 terest on a participating debenture when due (in-
14 cluding any mandatory prepayment out of gross re-
15 ceipts)—

16 “(A) the Administrator, in addition to any
17 other remedies available by law, may demand
18 immediate payment of the principal balance and
19 accrued interest on any participating debenture
20 issued by the small business investment com-
21 pany; and

22 “(B) the interest rate on any outstanding
23 participating debentures issued by the small
24 business investment company shall increase
25 until all payment defaults are cured or waived,

1 up to a maximum of 300 basis points, at a rate
2 of—

3 “(i) 50 basis points on the date on
4 which the small business investment com-
5 pany defaults;

6 “(ii) 50 basis points on the date that
7 is 6 months after the date on which the
8 small business investment company de-
9 faults; and

10 “(iii) an additional 50 basis points at
11 6-month intervals thereafter.

12 “(9) GROSS RECEIPTS DEFINED.—In this sub-
13 section, the term ‘gross receipts’ means any cash re-
14 ceived by a small business investment company, in-
15 cluding investment proceeds (return of capital and
16 profit), interest, dividends, and fees (other than cap-
17 ital contributed by a partner, proceeds from the
18 issuance of participating debentures, and any other
19 money borrowed by the small business investment
20 company).

21 “(10) LIQUIDATION OF SMALL BUSINESS IN-
22 VESTMENT COMPANY.—In the event of the liquida-
23 tion of a small business investment company issuing
24 participating debentures under this subsection, a
25 participating debenture shall be senior in priority for

1 all purposes to any equity interest in the issuing
2 company, whenever created. In liquidation, unfunded
3 commitments by private investors may, at the option
4 of the Administration, be applied to pay accrued in-
5 terest and principal of outstanding participating de-
6 bentures.

7 “(11) INVESTMENT OBLIGATION.—

8 “(A) IN GENERAL.—Any company issuing
9 a participating debenture under this Act shall
10 invest or commit to invest an amount equal to
11 the outstanding face value of such participating
12 debenture solely in equity capital.

13 “(B) EQUITY CAPITAL.—In this para-
14 graph, ‘equity capital’ means common or pre-
15 ferred stock or a similar instrument, including
16 subordinated debt with equity features which is
17 not amortized and which provides for interest
18 payments from appropriate sources, as deter-
19 mined by the Administration.

20 “(12) OTHER DEBT.—A small business invest-
21 ment company issuing a participating debenture
22 under this subsection shall have no debt other than
23 debt obtained through issuing participating deben-
24 tures and temporary debt (as defined by the Admin-
25 istrator) in an amount equal to not more than 50

1 percent of the company's private capital, and subject
2 to any terms and conditions specified by the Admin-
3 istrator.

4 “(13) USE OF PROCEEDS.—Subject to regula-
5 tions issued by the Administrator, a small business
6 investment company may use the proceeds of a par-
7 ticipating debenture issued by the company to pay
8 the principal amount and accrued interest due on an
9 outstanding participating debenture issued by that
10 company.

11 “(14) DISTRIBUTION OF GROSS RECEIPTS.—
12 Except as otherwise provided in this subsection, a
13 small business investment company shall utilize
14 gross receipts, from any source or however cat-
15 egorized for Generally Accepted Accounting Prin-
16 ciples or tax accounting purposes, first for the pay-
17 ment of accrued interest on participating deben-
18 tures, then for repayment of participating debenture
19 principal and contributed private capital, and finally
20 for profit distributions, as follows:

21 “(A) PAST DUE INTEREST AND PRIN-
22 CIPAL.—Gross receipts shall be used within 10
23 days of receipt—

24 “(i) to pay any past due interest
25 (whether past due by its terms or by accel-

1 eration) on a participating debenture
2 issued by the small business investment
3 company; and

4 “(ii) if no past due interest is out-
5 standing, to repay any past due principal
6 (whether past due by its terms or by accel-
7 eration) on such a debenture.

8 “(B) MANDATORY INTEREST PREPAY-
9 MENT.—If no unpaid accrued interest or past
10 due principal is outstanding on any partici-
11 pating debenture issued by the small business
12 investment company, then, not later than the
13 last day of the calendar quarter in which any
14 gross receipts are received (or, in the case of
15 gross receipts received during the last 15 days
16 of a calendar quarter, not later than the last
17 day of the subsequent calendar quarter), the
18 company shall use such receipts to prepay ac-
19 crued interest on the participating debentures
20 issued by the company. Such prepayment shall
21 be applied to such accrued interest in the order
22 in which such interest would otherwise become
23 due and payable.

24 “(C) AMORTIZATION DISTRIBUTIONS.—If
25 no unpaid accrued interest or past due principal

1 is outstanding on any participating debenture
2 issued by the company, gross receipts shall be
3 distributed to—

4 “(i) the Administrator, to amortize
5 outstanding participating debenture lever-
6 age; and

7 “(ii) private investors in the small
8 business investment company,
9 pro rata according to the ratio of outstanding
10 participating debenture leverage to outstanding
11 leverageable capital at the time of distribution.

12 “(D) POST-AMORTIZATION DISTRIBUTIONS.—If no accrued interest or principal is
13 outstanding on any participating debenture
14 issued by the small business investment com-
15 pany, and the company has no outstanding
16 leverageable capital, gross receipts shall be dis-
17 tributed as follows:

18 “(i) Unless aggregate distributions to
19 private investors under this subparagraph
20 equal or exceed aggregate contributions to
21 the capital of the company previously made
22 by private investors, gross receipts shall be
23 distributed to the Administration in an
24 amount equal to the initial profit participa-
25

1 tion percentage of the total amount distrib-
2 uted, with any remaining gross receipts
3 distributed to private investors.

4 “(ii) If aggregate distributions to pri-
5 vate investors under this subparagraph
6 equal or exceed aggregate contributions to
7 the capital of the company previously made
8 by private investors, there shall be distrib-
9 uted to the Administration an amount
10 equal to the final profit participation per-
11 centage of the total amount distributed,
12 with any remaining gross receipts distrib-
13 uted to private investors.

14 “(E) MANAGEMENT EXPENSES.—For pur-
15 poses of calculating the amount to be distrib-
16 uted to the Administration pursuant to sub-
17 paragraph (D), except as otherwise prescribed
18 by the Administration, the management ex-
19 penses of any company which issues partici-
20 pating debentures under this subsection shall
21 not be greater than 2.5 percent of the combined
22 capital of the company per year, plus, in the
23 case of a company with combined capital of less
24 than \$20,000,000, an additional \$125,000.

25 “(F) DEFINITIONS.—In this paragraph:

1 “(i) The term ‘outstanding
2 leverageable capital’ means any aggregate
3 capital contributions received by a small
4 business investment company from private
5 investors which exceed aggregate distribu-
6 tions received by the private investors from
7 the company.

8 “(ii) The term ‘initial profit participa-
9 tion percentage’ means 25 percent of the
10 leverage ratio, reduced by the weighted av-
11 erage interest rate on the participating de-
12 bentures issued by the company.

13 “(iii) The term ‘final profit participa-
14 tion percentage’ means 50 percent of the
15 leverage ratio, reduced by the weighted av-
16 erage interest rate on the participating de-
17 bentures issued by the company.

18 “(iv) The term ‘leverage ratio’ means
19 the ratio of the aggregate amount of par-
20 ticipating debenture leverage previously
21 drawn by the company (including such le-
22 verage that has been repaid) to the aggre-
23 gate amount of capital previously contrib-
24 uted to the company by private investors.

1 “(v) The term ‘combined capital’
2 means the aggregate amount of private
3 capital and outstanding leverage.

4 “(vi) The term ‘management ex-
5 penses’ includes management fees and any
6 additional salaries, office expenses, travel,
7 business development costs, office and
8 equipment rental, bookkeeping, and the de-
9 velopment, investigation, and monitoring of
10 investments paid by the small business in-
11 vestment company, but does not include
12 the cost of services provided by specialized
13 outside consultants, outside lawyers and
14 outside auditors, who perform services not
15 generally expected of a venture capital
16 company nor does such term include the
17 cost of services provided by any affiliate of
18 the company which are not part of the nor-
19 mal process of making and monitoring ven-
20 ture capital investments.

21 “(15) EXCEPTIONS TO THE ORDER OF DIS-
22 TRIBUTIONS.—Notwithstanding paragraph 15(C), if
23 no unpaid accrued interest (whether or not past due)
24 and no past due principal is outstanding on any par-
25 ticipating debenture issued by a small business in-

1 vestment company, the following exceptions shall
2 apply:

3 “(A) TAX DISTRIBUTIONS.—

4 “(i) SPECIAL DISTRIBUTION TO PRI-
5 VATE INVESTORS.—Notwithstanding any
6 outstanding principal that is not past due
7 on participating debentures issued by the
8 small business investment company, the
9 company may make a special distribution
10 of gross receipts or other cash to private
11 investors without a corresponding distribu-
12 tion to the Administration if—

13 “(I) the small business invest-
14 ment company has an investment in a
15 business that is organized as a limited
16 liability company or as a partnership
17 (referred to in this paragraph as a
18 ‘portfolio company’);

19 “(II) the portfolio company has
20 income that is taxable to the members
21 or partners of such portfolio company;

22 “(III) the portfolio company
23 makes a distribution to the members
24 or partners of such portfolio company
25 in an amount equal to the tax liability

1 of such members or partners on the
2 taxable income of the portfolio com-
3 pany assuming that each is taxed at
4 the highest combined Federal, State,
5 and local income tax rate applicable to
6 individuals anywhere in the United
7 States; and

8 “(IV) the small business invest-
9 ment company is organized as a lim-
10 ited liability company or a partnership
11 such that any income of the portfolio
12 company allocated to such small busi-
13 ness investment company is reallo-
14 cated to private investors, who are lia-
15 ble for the payment of taxes on such
16 income as if such income were the in-
17 come of the private investors, regard-
18 less of whether such investors receive
19 any cash with respect to such income.

20 “(ii) AMOUNT OF SPECIAL DISTRIBU-
21 TION.—The amount of the special distribu-
22 tion of gross receipts under clause (i) shall
23 not exceed the amount that is the dif-
24 ference between—

1 “(I) the estimated aggregate
2 maximum tax liability of the private
3 investors in the small business devel-
4 opment company for the income of
5 any portfolio company in which the
6 small business development company
7 is invested during the calendar year
8 that precedes the distribution; and

9 “(II) the aggregate amount dis-
10 tributed to such private investors
11 (other than amounts distributed pur-
12 suant to this subparagraph) during
13 the period beginning on April 15 of
14 the calendar year preceding the dis-
15 tribution and ending on the date on
16 which the distribution is made, but in
17 no circumstances more than the ag-
18 gregate amount of tax distributions
19 received by the small business invest-
20 ment company from investments in
21 portfolio companies during the same
22 period.

23 “(iii) TIMING OF SPECIAL DISTRIBU-
24 TION.—Any special distribution of gross

1 receipts under clause (i) shall be made not
2 later than April 15 of each calendar year.

3 “(B) PAYMENT OF EXPENSES.—The small
4 business investment company may—

5 “(i) use gross receipts to pay pre-
6 viously incurred expenses (including man-
7 agement fees) and other liabilities; and

8 “(ii) retain gross receipts in an ex-
9 pense reserve account in an amount which,
10 together with any existing expense reserve
11 of the company, shall not exceed the rea-
12 sonably anticipated expenses and other li-
13 abilities of the company (other than such
14 expenses and liabilities as are prohibited by
15 law) for the succeeding 12-month period.

16 “(C) PREPAYMENT.—Subject to any appli-
17 cable requirements under State law, the small
18 business investment company may use gross re-
19 cepts or other cash to prepay outstanding par-
20 ticipating debenture leverage and interest, in
21 whole or in part, without penalty, and at any
22 time.

23 “(16) RESTRICTIONS ON DISTRIBUTIONS.—

24 “(A) LIQUIDITY AND OTHER ADMINISTRA-
25 TIVE OR STATE LAW RESTRICTIONS.—No dis-

1 tribution shall be made except in accordance
2 with the liquidity requirements and other appli-
3 cable restrictions on distributions established by
4 the Administration or under applicable State
5 law.

6 “(B) CAPITAL IMPAIRMENT OR REGU-
7 LATORY VIOLATION.—If a small business invest-
8 ment company is in restricted operations or liq-
9 uidation by reason of capital impairment or reg-
10 ulatory violation, the maturity date of the par-
11 ticipating debentures issued by that company,
12 including both principal and accrued interest, is
13 subject to acceleration at the option of the Ad-
14 ministration, and, whether or not there has
15 been such acceleration, up to 100 percent of all
16 gross receipts and unfunded private investor
17 commitments may, at the option of the Admin-
18 istration, be required to be distributed to the
19 Administration until accrued interest and prin-
20 cipal on the participating debentures issued by
21 the company have been paid in full, in accord-
22 ance with any terms and conditions the Admin-
23 istrator may establish by regulation.

24 “(17) DISTRIBUTIONS IN KIND.—

1 “(A) ELECTION OF IN-KIND DISTRIBUTION
2 OF SECURITIES.—

3 “(i) PUBLICLY TRADED AND MARKET-
4 ABLE SECURITIES.—A small business in-
5 vestment company that issues participating
6 debentures may elect to make an in-kind
7 distribution of securities at any time, sub-
8 ject to applicable securities laws and regu-
9 lations, if such securities are publicly trad-
10 ed and marketable.

11 “(ii) TREATMENT AS GROSS RE-
12 CEIPTS.—For purposes of this subsection,
13 such securities shall be treated as gross re-
14 ceipts and shall be subject to the priorities
15 and restrictions applicable to gross receipts
16 under this subsection and any regulation
17 issued by the Administration that is appli-
18 cable to gross receipts.

19 “(B) TREATMENT OF ADMINISTRATION
20 SHARE.—The company shall either deposit the
21 Administration’s share of such securities with a
22 trustee designated by the Administration, or re-
23 tain the Administration’s share, if the Adminis-
24 trator so directs and with the agreement of the
25 company.

1 “(C) RETENTION OF ADMINISTRATION
2 SHARE.—If the company retains the Adminis-
3 tration’s share, it shall sell such share and
4 promptly remit the proceeds to the Administra-
5 tion.

6 “(D) VALUE OF ADMINISTRATION
7 SHARE.—For purposes of this paragraph, the
8 value of the Administration’s share is—

9 “(i) the value of the publicly traded
10 and marketable securities described in sub-
11 paragraph (A)(i), as of the date of dis-
12 tribution to the Administration under sub-
13 paragraph (B) or as of the initial date of
14 retention under subparagraph (C); and

15 “(ii) the controlling value for the pur-
16 poses of determining the remaining liability
17 of the company to the Administration;

18 “(E) ULTIMATE SALE OF ADMINISTRATION
19 SHARE.—Upon the ultimate sale of the
20 Adminsitration’s share or upon the small busi-
21 ness investment company’s ultimate sale of
22 such share on behalf of the Administration, the
23 Administration may receive an amount that is
24 more or less than the value of the

1 Adminsitration’s share under subparagraph
2 (D).

3 “(F) TRUSTEE DEFINED.—In this para-
4 graph, the term ‘trustee’ means a person who
5 is knowledgeable about and proficient in the
6 marketing of thinly traded securities.

7 “(18) TIMING OF DISTRIBUTIONS.—

8 “(A) IN GENERAL.—Subject to subpara-
9 graph (B) and paragraph (18), any gross re-
10 ceipts received by a small business investment
11 company issuing participating debentures under
12 this subsection that are not placed in an ex-
13 pense reserve pursuant to paragraph (16)(B)
14 shall be distributed by the last day of the fiscal
15 quarter in which such net receipts were received
16 by the company, except that gross receipts re-
17 ceived after the date that is 15 days before the
18 end of a fiscal quarter shall be distributed by
19 the last day of the subsequent fiscal quarter.

20 “(B) EXCEPTIONS TO TIMING OF DIS-
21 TRIBUTIONS.—Gross receipts consisting of mar-
22 ketable securities shall be distributed within six
23 months of receipt, unless the small business in-
24 vestment company has obtained the prior con-
25 sent of the Administrator.

1 “(19) REINVESTMENT OF GROSS RECEIPTS.—
2 Subject to such regulations and restrictions as may
3 be prescribed by the Administrator and the agree-
4 ment of the private investors in a small business in-
5 vestment company, any gross receipts that exceed
6 the amount required to make payments to the Ad-
7 ministration as required by this subsection may be
8 reinvested in qualified small businesses by the small
9 business investment company.

10 “(20) POST-DISTRIBUTION COMPUTATION.—
11 After distributions have been made pursuant to this
12 subsection, the Administration’s share of such dis-
13 tributions shall not be reduced or recomputed except
14 as expressly provided in this subsection.

15 “(21) NO OWNERSHIP INTEREST IN ADMINIS-
16 TRATION.—This subsection shall not be construed as
17 creating in the Administration any ownership inter-
18 est in any small business investment company which
19 issues participating debentures.

20 “(22) CONFLICT WITH OTHER SUBSECTIONS.—

21 “(A) IN GENERAL.—In the event of a con-
22 flict between this subsection and any other pro-
23 vision of this Act, this subsection shall apply.

24 “(B) SPECIFIC PROVISIONS.—In par-
25 ticular, this subsection supersedes subsections

1 (g) and (h) in their entirety with respect to all
2 matters pertaining to participating deben-
3 tures.”.

4 (b) REGULATIONS.—The Administrator shall issue
5 regulations to carry out subsection (k) of section 303 of
6 the Small Business Investment Act of 1958 (15 U.S.C.
7 683), as added by subsection (a), before the date that is
8 180 days after the date of the enactment of this Act.

○