Testimony of

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On behalf of the University of Wyoming and CC Technology

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and Entrepreneurship

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Rural States

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Senator Snowe and Members of the Committee:

My name is Keith Carron, founder and President of a small business start-up, the primary engine for the nation's economic growth and job creation. Thank you for offering me an opportunity to tell the story of my small business, CC Technology, in Laramie WY, and to explain the role that stock options play in the growth of my company. I do not wish to represent myself as an expert on stock options, but rather to provide you with a story of how they are used to create small businesses and why I believe the proposed FAS 123 would be detrimental to the growth and perhaps even the survival of my company.

CC Technology -- The Origin of a University Spin-Off

CC Technology was conceptualized in 1997 by two University of Wyoming chemistry professors: Keith Carron and Robert Corcoran. I use the word conceptualized, as we did not follow the traditional approach of capitalizing a company; rather we followed a plan more familiar to university professors. We initially wrote Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) proposals to the National Science Foundation and the National Institutes of Health. The proposals centered on ideas developed at the University, which we felt, had commercial potential. When the proposals were funded we incorporated as CC Technology. Being two university professors naïve about business, we added an experienced entrepreneur, Eugene Watson, to our founding team.

As I tell the story of CC Technology, I want to emphasize points concerning stock in small businesses and the role of stock options. I will summarize these points in a succinct statement at the end of this testimony. At this point it is important to understand that our business was founded with three shareholders who held 100% of CC Technology's stock.

- 100 % of CC Technology's stock was owned by its three founders.

Over our short history, CC Technology has been quite successful in writing SBIR and STTR proposals that have led to a total of over $3.7 million dollars in funding. Our technology developed through these grants has led to two important outcomes: first, intellectual property in the form of patent applications that are owned by the University of Wyoming and exclusively licensed back to CC Technology for commercial development; second, a manufacturing division of CC Technology, operating under the name Delta Nu, which designs, manufactures and sells Raman spectroscopy systems.

Allow me to first address the first outcome - a direct result of the Bayh-Dole act of 1980, which was specifically conceived to capitalize on the pool of knowledge that exists in academia. The SBIR/STTR programs have provided us the perfect avenue to take our knowledge and expertise out of academia into the marketplace. The concept of university ownership and licensing back to the inventors as a vehicle of carrying academic concepts to the marketplace has led to many successful companies and will continue to do so. The SBIR/STTR programs facilitate this movement of innovative ideas.

The second outcome, our manufacturing division, Delta Nu, has already created jobs and wealth in Laramie WY. Laramie is a university community of about 30,000 people. I believe it is fair to say that most money that comes into Laramie is through the university, directly or indirectly. Those dollars circulate around the community through local shops and services. Companies like CC Technology are rare but we are now demonstrating how such enterprise can play a vital role in bringing new wealth to Laramie by applying our knowledge and skills to the creation of high value-added products, now being sold world-wide. These "new" dollars represent significant job creation and economic growth potential for our community.

Delta Nu stemmed from our SBIR/STTR funding. Our proposals discuss new chemical assays and new instrumentation to perform the assays. The newly developed instrumentation required formation of a manufacturing arm of CC Technology. To create this new instrumentation, we hired an Electrical Engineer to assist me in the creation of a new device: a portable, inexpensive Raman system. Unknown to us at the time, this technology and instrumentation enables a major shift in chemical instrumentation, from central labs to distributed locations. Just as computers moved from central mainframe computers to portable computers (PCs), chemical sensors, too, are moving from large centralized devices to small portable systems.

When CC Technology hired its first product development engineer we moved from a company totally dependent on SBIR/STTR funding to a business capable of designing, manufacturing, and selling a product, thereby generating revenue. The R&D needed to develop our first product came from our grant funding. However, as we approached marketability of our first product, the need for working capital became clear. Our R&D payroll could be met with grant funds but not the funds needed for manufacturing, marketing and sales. At this point I wrote our first business plan and approached a local bank for a working capital line of credit. We were able to secure our line of credit with personal guarantees from the two principal shareholders. We received the line of credit because we had personal assets and no business debt. I had my first lesson in bank loans; *if you have money, they like to lend; if you don't, they won't*. We did not have a stock option plan at the time, but if we had, I believe the loss shown on our income statement due to expensing stock options would likely have resulted in our line of credit application being refused.

- SBIR/STTR companies by their nature operate at a near-zero level of profitability and expensing stock options would result in a loss on the income statement, possibly resulting in an inability to negotiate loans or outside investment to break out of the dependence on SBIR funding.

Delta Nu has grown from a single engineer to a business with 6 full-time employees and 5 part-time employees. We have a board of directors and offer full-time employees a complete benefits package. Prior to our adoption of a stock option plan for our key employees, we had grown from three shareholders (founders) to seven shareholders. It is interesting to note that of the four additional shareholders, three no longer contribute to our growth. These individuals were not restricted by a vesting period that a stock option plan usually requires. The fourth shareholder is the University of Wyoming in recognition of our licensing relationship. The vesting period of an option plan clearly is advantageous and is a key feature of our plan.

- Stock options usually include a vesting period requiring ongoing employee contributions, thereby adding value to a business after the grant is made.

CC Technology -- Our Stock Option Plan

Over the last 4 years we have had employees who have shown themselves to be key employees. By key, I mean employees who have made significant contributions to the growth of the company, who will continue to contribute significant value to the company, providing a basis for potential liquidation opportunities for the shareholders of the company. In Laramie such employees are difficult to find and are easily attracted to the high-pay “front range” of Colorado or other areas of concentrated economic activity. The alternative is to recruit employees with experience and potential from elsewhere. Retention and/or recruitment require cash. Start-up businesses usually exist in a cash starved environment - and as I am often reminded; in a small start-up company, when you are out of cash, you are out of business.

One important component in our cash preservation plan is to replace cash incentives with stock in the company. The best method for an employee is the IRS-accepted incentive stock option (ISO) plan. The ISO provides employees the opportunity to participate in the creation of wealth that is a consequence of their on-going contributions to the enterprise.

To date we have offered stock options to two key employees as a means of retention and are now considering offering options to a high-salaried employee from California whose recruitment is essential for our growth. During the interview process, we were able to show a past history of sales and excellent future prospects. But the vital selling point to this potential employee was the opportunity to be more than a tool in creating wealth for existing shareholders. We demonstrated through the offer of options that we want this individual to participate in the wealth they will help create. This is possible through an ISO.

CC Technology -- Tangibles and Intangibles

FAS 123 would require us to show our stock options as an expense on our income statement. How would that affect CC Technology?

- It would decrease profits (or increase losses)
- It would prevent or make it difficult to obtain working capital under the current method of income statement analysis.
- Culture could change, where bankers or investors neglect or suspect the expense due to stock option plans.

First, decreased profits due to stock options create a circular problem. Under FAS 123, options will be expensed, showing a decreased profitability. This in turn makes the grantee less likely to exercise the option. This makes the original assumption about the expense incorrect. Accounting stems from the root *to account for*. Accounting is a science; economic forecasting is not. Meaningful financial data is used to grow companies. This ruling adds tremendous negative value to a company that uses stock options. This decreases profits, most likely into the red or further into the red, such that investment is not possible. This makes it impossible to attract working capital investment. The company fails.

Or, the culture changes and financiers learn to ignore the expensing of stock options. After all, who knows if they will ever be exercised? Then my question is, why add something to financial statements that is not reliable or credible?

Synopsis

At this point I would like to summarize the bulleted statements and succinctly explain my views on FAS 123 and stock options.

Small companies are founded by a handful of individuals. In order to retain those employees that make significant contributions and grow, ownership in the company must be shared with those employees. The best way to include employees in the ownership is to provide options to purchase stock after a vesting period (period of sustained employment and productivity). Our small business started from a business model and seed capital provided by the United States government through the SBIR/STTR program and this model leads to balanced income statements. It is not, nor is it intended to be a source of wealth creation in and of itself. When a company wants to breakout of the grant R&D mode to commercialization it must try to maintain balanced income statements to attract working capital. The expensing of stock options adds an intangible imbalance to an income statement. Why is it intangible? The majority of small businesses fail. The expensing of options will only increase this failure rate. But the irony is that the expense will never occur because the option will never be exercised.

The creation of an ISO must be ratified by the shareholders. This informs them of the potential dilution of the value of their shares. They vote yes or no depending on their belief that the options will increase their stock value further down the road. In a true startup, the number of shareholders is small. The diluting event cannot nor should not be hidden in a hundred pages of CEO reports and beliefs and difficult to interpret financial statements. Small businesses with a handful of shareholders must be prepared to see their shares diluted by the addition of individuals who will be making the value of those shares grow.

Last of all, I would like to make a statement about the public awareness of FAS 123. I heard about it two weeks ago! A week ago I was entertained by two bankers from Wheatland, WY. They were not aware of FAS 123. They want to try to work with CC Technology and the Ex-Im Bank by offering an export working capital line of credit. The Ex-Im Bank is a government agency designed to help small companies export their products and to reduce the country's trade imbalance. Please note, the Ex-Im Bank considers a positive equity to be a requirement for assistance. Expensing stock options would greatly increase the likelihood of not receiving government assistance to help reduce the trade imbalance and this failure would all be based on an expense that may never be realized because the option is never exercised. But, my point for this story is that the bankers knew nothing of FAS 123 and my accountant never mentioned knowledge of FAS 123 to me!! Had we followed FAS 123, we would have provided these bankers with distorted income statements based on the incalculable probability of the future exercise of our options and the incalculable value of our shares at the time of exercise. My point is, why turn the rigors of accounting logic into the realm of astrology and palm reading?

It seems to me that in their zeal to address recent widely-perceived abuses of stock options by a few disreputable top level executives in an even fewer large public companies, the FASB will be creating the unintended consequence of doing significant harm to the nation's economy and competitiveness by throttling back that primary engine of growth, the struggling private small business start-up.

Thank You,

Keith Carron
Professor and CEO
University of Wyoming, CC Technology