



PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

Economic Affairs Interim Committee

58th Montana Legislature

SENATE MEMBERS

GLENN ROUSH--Vice Chair
SHERM ANDERSON
JEFF MANGAN
MIKE TAYLOR

HOUSE MEMBERS

JOE MCKENNEY--Chair
NANCY RICE FRITZ
JIM KEANE
SCOTT MENDENHALL

COMMITTEE STAFF

PATRICIA MURDO, Research Analyst
BART CAMPBELL, Staff Attorney
EDDYE MCCLURE, Staff Attorney
DAWN FIELD, Secretary

MINUTES

March 11, 2004

State Capitol, Room 102
Helena, Montana

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file in the offices of the Legislative Services Division. **Exhibits for this meeting are available upon request. Legislative Council policy requires a charge of 15 cents a page for copies of the document.**

COMMITTEE MEMBERS PRESENT

REP. JOE MCKENNEY, Chair
SEN. GLENN ROUSH, Vice Chair

SEN. MIKE TAYLOR

REP. JIM KEANE
REP. SCOTT MENDENHALL

COMMITTEE MEMBERS EXCUSED

SEN. SHERM ANDERSON
SEN. JEFF MANGAN

REP. NANCY RICE FRITZ

STAFF PRESENT

PATRICIA MURDO, Research Analyst
BART CAMPBELL, Staff Attorney
EDDYE MCCLURE, Staff Attorney
DAWN FIELD, Secretary

AGENDA & VISITORS' LIST

Agenda, Attachment #1.

Visitors' list, Attachment #2.

COMMITTEE ACTION

- approved the January 23, 2004, minutes as amended;
- approved pursuing Option #2 and Option #3 as proposed on page 11 of the SJR 17 and the Occupational Disease Act report (EXHIBIT #1);
- changes in the Committee Work Plan Meeting dates (EXHIBIT #5);
- changes in the Committee Work Plan Staff Recommendation for Additional Activities (EXHIBIT #5);
- changes in the Committee Work Plan Member Issues (EXHIBIT #5)

CALL TO ORDER AND ROLL CALL

REP. MCKENNEY called the meeting to order at 8:33 a.m. The secretary noted the roll, SEN. ANDERSON, SEN. MANGAN, AND REP. RICE FRITZ were excused.

SJR 17 WORKERS' COMPENSATION STUDY

Background of Occupational Disease -- Eddy McClure, Staff Attorney, Legislative Services Division (LSD), reviewed her report, *Senate Joint Resolution No. 17 and the Occupational Disease Act*, with Committee members (EXHIBIT #1). The report provided information on the:

- historical background and rationale behind the creation of both the Workers' Compensation and Occupational Disease Acts;
- constitutional challenges raised against the Occupational Disease Act and subsequent decisions by the Montana Supreme Court based on those challenges; and
- options for simplifying and clarifying the Occupational Disease Act in response to SJR 17 and recent Supreme Court decisions;
 - Option #1) Making no changes in the Occupational Disease Act;
 - Option #2) Merging all or a portion of the Occupational Disease Act into the Workers' Compensation Act;
 - Option #3) Addressing only those parts of the Occupational Disease Act identified as having legal problems by the Montana Supreme Court; or
 - Option #4) Rewrite and simplify the Occupational Disease Act prior to merging the Act with the Workers' Compensation Act.

Ms. McClure also gave an update on the February 23, 2004, working group meeting that focused on identifying options. A non binding "straw vote" was taken and Option 2, *Occupational Disease "Merger" Concept - LC 2222* (EXHIBIT #2), received the most votes. Option #3, *Occupational Disease Option Addressing Court Decisions Only - LC 6666* (EXHIBIT #3), received the second highest number of votes. Ms. McClure said Option #4 would be very time consuming and that she and the working group did not think time allowed for this type of an undertaking. She said presentations on Option #2 and #3 would be given by working group members.

REP. MCKENNEY asked why there is a difference between Workers' Compensation benefits and Occupational Disease benefits. Ms. McClure said she did not know what the rationale was to separate these benefits but said it was likely due to a difference in the medical conditions based on the severity and type of injury.

Options on Implementation of Court Cases Regarding Occupational Disease

Larry Jones, Attorney, Liberty Northwest, explained the *Occupational Disease "Merger" Concept - LC 2222 (EXHIBIT #2)*. He likened the Workers' Compensation rules to a game of Monopoly with no intuitive logic or fairness. It was designed to provide a safety net to injured workers and their families and to provide medical treatment to them.

He said his qualifications as an expert on Workers' Compensation issues result from:

- serving as a Clerk in the Workers' Compensation Court;
- serving as a Hearings Examiner for the Workers' Compensation Court;
- representing injured workers before the Court;
- representing insurers of employers; and
- regularly litigating these cases and advising adjustors on claims.

Based on this experience, Mr. Jones said he is certain about two things regarding the Workers' Compensation system:

- 1) It is impossible for a lay person to understand the system by going to the statutes.
- 2) It is malpractice for an attorney to practice Workers' Compensation by relying on the statutes.

Mr. Jones said the system is broken in the sense that the law is supposed to be accessible and predictable and in his opinion, it definitely is not. The Supreme Court decisions, in the cases of Henry, Stavenjord, and Schmill, have had the effect of saying the court does not care what causes the Occupational Disease condition, but only how the injured worker is treated. The injured worker must have the same procedural safeguards and the same benefit entitlement as if under the Workers' Compensation Act. Option 2 attempts to address the unintended consequences created by these decisions by:

- including, in any changes, all of the OD references previously under the OD Act and move them into a single unified act because if this is not done, the employer is exposed to a direct suit under tort liability;
- addressing the issue of "insidious onset" to clarify when the claim filing period begins or, if notice to employer is required, when the notice to employer period begins;
- clarifying filing period rules regarding the issue of "latent injuries";
- creating an "employer responsibility" statute addressing the issue of multiple employers and which employer/insurer will be liable for paying claims by an injured worker. The Occupational Disease Act already requires this and this proposal expands that requirement to cover the Workers' Compensation Act as well.

Mr. Jones emphasized that injured workers be treated the same so that everyone is subject to the same procedural requirements and receive the same benefit levels. He said this would greatly reduce the likelihood of litigation.

SEN. TAYLOR asked if costs would be lowered if this proposal was implemented. Mr. Jones said a cost analysis had not been done yet but would be the next step taken by the working group, if the Committee wished to pursue this proposal.

REP. KEANE stated that this issue is about injured people who need treatment and not about lowering costs. The goal should be working toward work comp as the exclusive remedy, which will protect both the injured worker and the employer. The solution must be based on what is fair, not cost.

SEN. TAYLOR clarified that his concern about the cost factor is that if some of these proposals are codified, that the number of lawsuits may be decreased and that is how costs may be lowered. Mr. Jones said a systematic analysis of cost has not been done but that Jerry Keck from the Department of Labor and Industry may have figures from earlier studies that may give a rough indication of how the costs may change.

REP. MENDENHALL asked why the option of rewriting and simplifying the existing laws was not considered by the working group. Mr. Jones said it could have been done but that the working group thought this was not only very time consuming but beyond the charge of SJR 17.

REP. MCKENNEY asked who pays for Occupational Disease benefits. Mr. Jones said the benefits are paid through the premium collected by each insurer. REP. MCKENNEY asked who oversees the Occupational Disease claims. Mr. Jones said the insurance companies, the State Fund, and Third Party Administrators (TPAs) all handle the claims. Occupational Disease and Workers' Compensation are under the same insurance policy.

Al Smith, Montana Trial Lawyers Association (MTLA), read a letter outlining the MTLA's general support for these proposals (EXHIBIT #3). The letter also addressed several concerns regarding the proposals. Mr. Smith said the proposals are a good first step forward but are not a finished product.

Jerry Driscoll, Montana AFL-CIO, referred to EXHIBIT #2, Page 2, NEW SECTION, and said he did not recall the working group discussing (2) (a) and (b) and suggested adding language to clarify who is liable and that the injured worker be paid within 30 days.

Dean Blackaby, Claimant's Attorney, commented that the notice provisions requirements are different for Occupational Disease than for Workers' Compensation. He cautioned that a 30 day notice for an Occupational Disease may create an environment in which a worker will file a claim just to be safe.

REP. KEANE said the Committee needs to consider that in the working environment, workers are discouraged from filing claims and that there should be a remedy for a worker who has a claim and was not allowed to file.

Jacqueline Lenmark, American Insurance Association (AIA), stated that she would be presenting an explanation of Option 3, the *Occupational Disease Option Addressing Court Decisions Only - LC 6666* option (EXHIBIT #3). She asked if she should include the AIA's position on the proposals in her presentation or if the Committee would prefer to hear the AIA's position at a later time.

REP. MCKENNEY asked that she explain the proposal from a neutral position as a member of the working group and to present the AIA's position at a later time.

Ms. Lenmark said this option deals with the decisions made in three specific Montana Supreme Court cases and discussed each case and the remedy that Option #3 would provide:

- Henry v. State Fund: Section 1. of LC 6666 - amends Section 39-72-701, MCA, and incorporates the decision in the Occupational Disease Act;
- Stavenjord v. State Fund: Section 1. of LC 6666 - amends Section 39-72-701, MCA, by inserting equal protection language into 39-72-701, MCA, and repeals sections 39-72-405 and 39-72-703.
- Schmill v. Liberty Northwest Insurance: repealed Section 39-72-706, MCA, on grounds of equal protection.

Ms. Lenmark said Section 2. of LC 6666 amends Section 39-72-711, MCA, to allow lump sum and compromise settlements. The Occupational Disease Act, as it is currently enacted, does not allow this. Since it has become a practice in settlement of these claims to allow lump sum and compromise settlements, an amendment was included to reflect this.

Ms. Lenmark also:

- pointed out the effective date in Section 3., which addresses implementation of the Act and clarifies which claimants would come under the amendments that would be incorporated if this bill were to be enacted and implemented.
- said the purpose of the bill was to be very precise in its application and intended only to address those three specific Supreme Court cases.
- provided cost information and said these costs have already been put into rates that insurers are charging to employers for the insurance. Any cost that would be associated with retroactive application of these decisions have not been put into the rate data and will have to be absorbed by insurers in their surplus and reserves. The information was obtained from the National Council on Compensation Insurance (NCCI).
- Stavenjord decision: NCCI filed a 1.1% overall price increase in July 2003, which equates to a \$1.9 million cost to the system annually. The State Fund increased its rates by 1.5% as a result of this filing. That is the future cost of the Stavenjord decision and the benefits given to claimants by the Stavenjord decision are being implemented by insurers.
- Schmill decision: resulted in a 0.3% price overall increase and was not specifically included in the most recent filing by the NCCI with the Insurance Commissioner because the amount is too small to trigger an increase.
- Henry decision: had no cost associated with it because it was a benefit that was being implemented at that time.

Ms. Lenmark said she would like to comment on two other questions raised earlier:

- Who regulates the Occupational Disease Act: the Workers' Compensation Act and Occupational Disease Act are generally combined into one insurance policy that the insurers issue. Regulation for insurance companies is with the Commissioner of Insurance. Regulation of the benefits under the two Acts are regulated as one through the Department of Labor and Industry.
- Why the benefits in the Occupational Disease Act are different than the benefits that are granted under the Workers' Compensation Act: that is a historical tradition that has been enacted and carried forward in law and is being adjusted by the Supreme Court decisions. It is not anomalous to Montana and has happened in many states when some diseases began to be recognized as having an occupational origin. As medical science caught up with and understood the origin of the diseases, the Acts changed. Many states have only one act.

REP. KEANE asked Ms. Lenmark to discuss Option #4. She said Option #4 would require the creation of both Acts from the ground up: creating one act to combine the principles of both the Occupational Disease Act and the Workers' Compensation Act, and the Supreme Court decisions that affect both of them.

Ms. Lenmark said she would now like to make comments on the proposals as the representative of the American Insurance Association (AIA).

The AIA supports Option #1 and Option #3 at this time, and asks that the Committee take no other action on the Occupational Disease Act because:

- if nothing is done to the Occupational Disease Act, claimants still receive benefits and employers still bear cost of the benefits and there is no unintended consequence to insurers or employers;
- the AIA is concerned about the scope of the project should Option #4 be pursued and recommends that this type of an undertaking wait until the next interim to allow adequate study time; and
- a number of members were not present for the straw vote, so there is not consensus within the working group.

If the Committee feels it must take action, the AIA position is to do nothing except incorporate the Supreme Court decisions.

Matthew Cohn, Montana State Fund, said the position of the State Fund is similar to the AIA.

As a representative of the State Fund, he agreed with many of the points made by Ms. Lenmark. He agreed there was not consensus among the working group members and said the position of the State Fund's first and second recommendations are:

- 1) no action, or
- 2) limit action to incorporating the Supreme Court cases.

SEN. ROUSH asked **Kevin Braun, Department of Labor and Industry (DOLI)**, if historically the Occupational Disease Act and Workers' Compensation Act have always been under the same policy. He asked Mr. Braun to also comment on asbestosis and silicosis issues and if these conditions would be covered under these Acts. Mr. Braun said to his knowledge, the Occupational Disease Act and Workers' Compensation Act have always been combined under one policy. With regard to the asbestosis, Mr. Braun said that depending on the timeliness of the filing, it would be covered under the Occupational Disease Act and that silicosis is covered by a separate section.

REP. KEANE asked Mr. Braun if family members of a worker suffering from asbestosis are also covered under the Act, in the event they are also diagnosed. Mr. Braun said if the worker brings the asbestosis into the home, the family members would not be covered under the Occupational Disease Act or any of the other provisions and would have to file a tort claim and sue for benefits.

Ms. McClure said she wanted to clarify that the straw vote taken at the February meeting was not intended to gauge whether or not the members liked the ideas or were in favor but simply to see if the ideas should be committed to paper for further development. She agreed there was no consensus among the members and said she did not intend to mislead the Committee by

implying that there was consensus. She said it was the Committee's decision to make the final determination of what options would be pursued.

Other Workers' Compensation Issues

Larry Jones said he wanted to relay concerns from insurers regarding the Recreation Exemption to Employment in the Workers' Compensation Act. He referenced testimony given by George Willet, Showdown Ski Area, at a previous meeting that this provision was very detrimental to those in the hospitality businesses. This statute, as interpreted by a recent Supreme Court case, provides the industry very little guidance of what is and is not an employer benefit. This was not the intent of the legislation. The hospitality industry is very concerned about the scope of the statute as provided by the Montana Supreme Court and would like the Committee to define key terms of recreational activity. Their rationale is that an employer does not have control over employees while they are on break and should not be responsible for injuries occurring while the employee is engaged in recreational activities.

REP. MCKENNEY asked if there is a difference between a paid or unpaid break. Mr. Jones said as he understands the law, there is no difference.

PUBLIC COMMENT

Shawn Bubb, Montana Self Insurance Association, Director of Insurance Service for the Montana School Boards Association, commented that the self insurance association supports the comments and positions as expressed by Ms. Lenmark and Mr. Cohn.

Larry Jones, Liberty Northwest, said he wished to express a different opinion from that of Ms. Lenmark and Mr. Cohn on the common fund and retroactive application of those cases. Mr. Jones said he did not see any linkage between what this Committee is doing and those cases. He also said it is possible that there will be new litigation if the statutes change (the merger option) but because of the procedural differences that exist, he would guarantee new litigation if the Committee does nothing. Unintended consequences may occur but are unavoidable with new legislation and efforts will be made to mitigate them. He said Option #3 is more of a band aid than a permanent solution.

COMMITTEE DISCUSSION

SEN. TAYLOR said that while this is a very complicated issue, he would still like to have a clearer picture regarding the cost and effects of implementing these proposals. He suggested that the working group create a pros and cons format of the options for Committee members to review.

REP. KEANE encouraged the working group to continue working toward consensus and said he realized that the groups' efforts could never make the system perfect but could improve it.

REP. MCKENNEY said as he understood it, the Committee has four options to consider:

- do nothing, knowing there is a problem;
- merge the Workers' Compensation Act with the Occupational Disease Act;
- limit the action to dealing with the Supreme Court cases; and
- a complete overhaul of the system.

REP. MCKENNEY said in his opinion, an overhaul (Option #4) is beyond the charge of this Committee and he would not recommend pursuing Option #1 but would support further work on Options #2 and #3.

SEN. TAYLOR **moved** to pursue Option #2 (*Occupational Disease "Merger" Concept - LC 2222*) and Option #3 (*Occupational Disease Option Addressing Court Decisions Only - LC 6666*), including a report on cost factors. REP. KEANE said if there was going to be an evaluation of costs if changes were made, there should also be an evaluation of what the costs would be if nothing was done. SEN. TAYLOR said that was a good point and said that language was included in his motion. The motion **passed unanimously** on a voice vote.

APPROVAL OF THE MINUTES

Pat Murdo, Research Analyst, LSD, said REP. KEANE had notified her that Rep. Fisher was referred to as Sen. Fisher in the morning joint SAVA/EAIC meeting minutes. She said the minutes had been corrected to reflect that Rep. Fisher was properly identified. With no further discussion, the joint SAVA/EAIC minutes were approved as amended. The Economic Affairs Interim Committee afternoon minutes were approved as written.

COMMITTEE ISSUES

Ms. Murdo informed the Committee members that an issue had arisen regarding the Board of Regents Shared Leadership Plan on Economic Development which needed to be addressed. The issue is that, in the effort to have a cooperative approach to economic development, none of the entities involved is exactly clear who is in charge. The Regents and Executive Branch are taking the lead but the Legislature is being asked to be involved. Because the Executive Branch does not have authority over the Legislative Branch, the question of staffing for this group is complicated. The Directors at LSD request that if this Committee wishes to have Ms. McClure and Ms. Murdo involved as staff with this group, then it must be more specifically written into the Committee Work Plan. Ms. Murdo referred the members to the Draft Work Plan, Member Issues, Section 5, Page 4 (EXHIBIT #5). She said she had added specific language to the Work Plan to reflect this request and asked members to review and comment on this language.

Ms. Murdo asked the Committee members to also look at Staff recommendation, Section 6, Page 5, and said she had adjusted language there as well to reflect this Committee's involvement with the Regents Shared Leadership Plan on Economic Development.

Ms. Murdo reviewed the meeting calendar and said there were three meetings remaining in the interim:

- May 5 - will primarily deal with economic development and venture capital issues;
- June 24 & 25 - proposed agency legislation will be finalized; and
- August 20 - proposed Committee and other legislation will be finalized and Final Reports will be presented.

Ms. Murdo suggested that if the Committee wished to make changes to the meeting schedule, today would be a good time to do it. She reviewed the staff work load she and Ms. McClure were responsible for that require staff time:

- economic development issues - including the work with the Regents;

- SJR 17 Workers' Compensation Study;
- Committee Planning; and
- legislative drafting.

REP. MCKENNEY asked to change the June 24 and 25 meeting date to accommodate his wedding plans. SEN. TAYLOR suggested changing the date to June 30 and July 1. He asked to change the August 20 date to August 19, in order to allow the Committee the possibility of continuing the meeting on August 20, in case additional time is needed for reviewing proposed legislation. He also asked to have a memo drafted to all economic development entities, inviting them to present ideas for economic development. Ms. McClure said waiting until the August meeting would not allow staff adequate time to draft bills resulting from that meeting. She suggested limiting these presentations to the May meeting.

Ms. Murdo said SEN. TAYLOR's suggestion for a memo would generate interest and that a portion of the agendas could be set aside in both the May meeting and the June meeting dates for listening to presentations from these people.

Ms. McClure invited Committee members to attend the April meeting of the SJR 17 working group and asked if the Committee wanted a report from this group at the May or June meeting. REP. MCKENNEY asked her to report on the meeting at the May meeting.

SEN. ROUSH **moved** to make the suggested meeting date changes in the Interim Calendar, Section 7 of the Work Plan (EXHIBIT #5), as discussed by the Committee. The **motion passed unanimously** on a voice vote.

SEN. TAYLOR **moved** to approve the language inserted by Ms. Murdo in Staff Recommendations for Additional Activities, Section 6 of the Work Plan (EXHIBIT #5), regarding staff involvement with the Regents Shared Leadership Plan in Economic Development. He said Ms. Murdo's language outlined the need for involvement very well and stated that in the future the Economic Affairs Committee should be directed to be the legislative coordinator of economic affairs, because, as legislators, the Committee has the ability to affect the outcome of such efforts. SEN. ROUSH concurred with SEN. TAYLOR's motion and commented that this Committee's charge is economic development and that in recent years it has not been included in economic development meetings held by other groups also working on these issues.

REP. MENDENHALL agreed with SEN. ROUSH that this Committee should be more actively involved and engaged in economic development activities being held around the state. He said there were many meetings he would like to have attended, had he had been informed of them.

The **motion passed unanimously** on a voice vote.

REP. MENDENHALL **moved** to approve language added by Ms. Murdo in Member Issues, Section 5 of the Work Plan (EXHIBIT #5), regarding Committee and staff involvement with the Regents Shared Plan on Economic Development, with an additional sentence stating that "member-proposed activities may be proposed and addressed, as meeting time allows". The **motion passed unanimously** on a voice vote.

SEN. TAYLOR asked for clarification regarding the memo he suggested earlier in the discussion on economic development. He said it was his understanding that the memo would be sent to

other legislators and prospective committees, to present economic ideas to the Economic Affairs Committee starting in May. REP. MCKENNEY said that was correct. Ms. Murdo asked if the memo was to include legislators only or to include the economic development groups. SEN. TAYLOR said he wanted to include the Chamber of Commerce, the Board of Regents, the colleges and universities, the Executive Branch, etc.

GOLDEN TRIANGLE ENTERPRISE FACILITATION PROGRAM -- ALLEN UNDERDAL, TOOLE CO. COMMISSION, & SEN. JERRY BLACK

Sen. Black reviewed an economic development approach known as the Golden Triangle Enterprise Facilitation Program:

- The program for northern Montana began in June of 2000 when the Sirolli Institute was invited to attend an economic development program in Pondera County;
- The Golden Triangle Enterprise Facilitation Program (GTEFP) was formed as a result of that meeting;
- The program operates as a regional concept, and is similar to and fits in well with what the State is presently trying to do; and
- The program receives funds primarily from donations of individuals, businesses, cooperatives, plus county and city governments.

Sen. Black said it was shocking to him to see the number of business failures in his region. The failures were the result of not only the low population and a poor economic base, but more importantly, the result of not having a solid working business plan, proper financing, marketing skills, or accounting or financial information necessary to operate a business correctly. Other businesses in that same economic climate have thrived due to sound business practices. What sets the GTEFP apart from other programs is that it works with current businesses within the area who want to grow and expand their business, but who may not have the expertise on how to accomplish that growth. The GTEFP also helps entrepreneurs who want to start a local business to develop that business and get it started. It is very difficult to entice business to northern Montana and the GTEFP's networking approach has been very successful in doing this. The GTEFP wants to develop a strong working relationship with the Governor's Office of Economic Development and the Department of Commerce for both technical and financial information.

Allen Underdal, Toole County Commissioner, Director, Golden Enterprise Facilitation Program, discussed the reasons why this approach has been successful in this area:

- northern Montana has a declining population;
- a similar situation exists all across the Hi-Line of Montana;
- there are economic development agencies in each county, sometimes several;
- GTEFP fills a niche of supporting entrepreneurs, something that other programs don't always do;
- the June 2000 meeting describing the Institute approach had approximately 200 attendees, many of whom were very excited and wanted to explore this further;
- a steering committee of about 35 people from a five-county area began meeting on a monthly basis to investigate this program;
- the steering committee was impressed with findings and made the decision to raise funds, recruit board members, contract with the Sirolli Institute, and implement the program;

- The Sirolli Institute helped select and train board members and recruited and helped train the facilitator.

Mr. Underdal explained that enterprise facilitation compliments other economic development approaches that focus more on business attraction, retention, or expansion, either through recruitment or by building infrastructure such as highways, sidewalks, sewers, enterprise zones, revolving loan funds, or a tax relief program, etc. Instead of doing those things, an enterprise facilitation program tries to attract local people with ideas for new businesses.

Mr. Underdal outlined the duties and responsibilities of GTEFP board members:

- to introduce the facilitator to 10 individuals that they know personally, in order to create a network of people interested in economic development;
- to hire and supervise the facilitator; and
- to review with the facilitator any potential clients and determine who can mentor or help the client with their enterprise.

Mr. Underdal said the GTEFP operates in a four-county group: Pondera, Teton, Glacier, and Toole Counties, and on the Blackfeet Reservation. It has a \$75,000 annual budget and after several years, the budget will drop to \$60,000.

Steve Horowitz, Facilitator, GTEFP, said:

- to date, the Project has dealt with approximately 120 businesses or people interested in starting businesses;
- the largest percentage of clients are from Glacier County;
- a hands-on approach helps to teach clients the expertise they need to succeed; and
- Teton County has the strongest economic base and has a lower rate of request for services.

Mr. Horowitz has discovered that intercommunity interaction on a business level is lacking. He has worked to network complementary local businesses to use as resources for each other and also acts as the "hub" of the project. As facilitator, he works with 30-50 board members in the four different counties who network throughout the region.

Mr. Horowitz explained that the initial visit with a client is spent listening to the client's proposal, inventorying what is already in place, and then assessing how well the client is maximizing those factors that are common to all businesses: marketing, financial management, product and service expertise. He asks them questions about what they are doing, to help them understand what their shortcomings are, and to identify what resources are lacking. He then works to connect them to the greater network of resources in the area.

COMMITTEE QUESTIONS

REP. MENDENHALL asked how the GTEFP contrasts with a Small Business Development Center (SBDC) circuit rider program. Mr. Horowitz said the difference is mainly the approach and how the programs connect with the clients. He offered three examples of differences:

- The SBDC approach requires the client to take the initiative to make contact. The client meets individually with the SBDC on a scheduled basis. The GTEFP does not want an individual to try to do a business all by themselves and encourages the client to create a "team", using the GTEFP network for support and resources.

- There is community support for the GTEFP program because the funding comes from the local businesses and individuals. The communities have "bought in" and are interested in the client's success, resulting in more personal interaction and interest.
- The GTFEP takes a personal approach with the clients because the facilitator personally acts as a mentor to the client and maintains close contact throughout the process. The SBDC does not offer this level of contact to the client. The facilitator doesn't meet with the client on a regularly scheduled meeting, but instead meets with the client as often as the client feels it is necessary.

Mr. Horowitz said he considers some of his successes to be businesses that never got started. He explained by saying he never tells a client that their dream or idea is a bad idea. Instead, he asks them questions about how much money they have to make from the business, how they plan to market their businesses, to identify the market available to them, etc. The idea is that the client will be the one to realize that their idea is not feasible and either make changes in the plan or abandon it altogether. Mr. Horowitz said all of the services offered by the GTEFP are strictly confidential.

SEN. TAYLOR asked what the program costs to administer, who has paid the cost to date, and if the program is given additional funding by the State, will private industry continue to fund it. Mr. Horowitz said the annual budget is about \$80,000 and will decrease to about \$60,000 in 2006. He said the GTEFP has raised about \$210,000 to date and has been in operation about 20 months. He said, as the facilitator, he is asking for any help that is available and would like to have the State as a partner, even at a 50% level so the Program can spend more time on getting businesses going.

SEN. ROUSH commented that the level of community participation in this program is commendable and that he would like to see the State assist with this program.

REP. MCKENNEY commented that once the local community is on board, it becomes an emotional investment for the community as well.

Mr. Horowitz also provided a GTEFP brochure for the Committee members (EXHIBIT #6).

COMMITTEE UPDATE

Ms. Murdo provided Committee members with a letter from Sheila Stearns, Commissioner of Higher Education, which was sent to Montana business leaders as a part of the Board of Regents Shared Leadership Plan for Economic Development (EXHIBIT #7). The letter was intended to update the business community on the efforts made to date and invite them to become involved.

Ms. Murdo asked the members to review the Montana Economic Development Scorecard previously mailed to them (EXHIBIT #8). Ms. Murdo said the members could fill in the sheet as the afternoon speakers presented their information and that it would help identify how the different programs fit into the economic development efforts and would also help identify areas of weakness.

BOARD OF INVESTMENTS (BOI) REVIEW -- CARROLL SOUTH

Mr. South, Executive Director of the Board of Investments, said it was important for the Committee to understand what the Board of Investments could or could not do, relative to equity type investments:

- The Board can make venture capital investments with pension funds, as permitted under the Montana Constitution and state law. All of the pension fund investments are done through Adams Street Partners, located in Chicago, Illinois. The State of Montana has a \$200 million commitment to Adams Street and, as of this date, Adams Street has drawn down \$82 million.
- The Board cannot make equity investments with the Coal Tax Trust Fund. That is precluded by both the Constitution and state statute. Therefore, the only avenue available at this time is Adams Street.
- BOI cannot under the prudent expert principle, ask Adams Street to invest specifically in Montana businesses.
- Montana does send strong potential venture capitalists to Adams Street and asks them to review their offerings. This is an attempt to get some of that money back into Montana.

Mr. South went on to say that venture capital is a very expertise-intensive investment activity. In order for venture capital efforts to be effective, efforts can't be isolated to a specific state or region. The most successful venture capital programs are those that not only have national contacts, but international contacts as well, because the most important aspect of venture capital investing is the exit strategy. If the exit strategy is lacking, it will not be a profitable venture. The exit strategy is generally an Initial Public Offering (IPO) or a large firm buyout. The major players in the venture capital industry know who the large corporations are that may be interested in these new companies. They also know the investment bankers who can offer an opinion of whether that company is right for an IPO.

Mr. South also said the Committee needs to be aware of the efforts made by the Board of Investments to invest the Coal Tax Trust funds (CTT) in Montana businesses. Under the constitutional and statutory provisions, a commercial loan program (partnership with commercial banks), a value-added loan program (subsidized interest rate loans for job retention and job creation), and infrastructure loan program (money lent to local governments to provide infrastructure improvements to attract more businesses) are administered by the Board of Investments. These loans do not resemble venture capital in any shape or form: the law requires the Board to make these loans in partnership with a financial institution and the entity seeking the loan must make the loan request through a Montana bank first. The bank evaluates the request and if it is considered a viable request, the bank then approaches BOI with the loan request. This helps the Board avoid risky loans. The Legislature made an attempt about ten years ago to allow for riskier investments through the creation of the Science and Technology Board, authorizing the investment of \$12.5 million of the CTT into venture capital investments in the State. It ultimately made \$10.8 million worth of venture capital investments but in fact, they were not true venture capital investments. The instrument used to make those investments is called a convertible debenture. It is like a loan but at some point in time, the holder of that debenture has an opportunity to convert it to equity. When the Board made the loans with convertible debentures, the loan language stipulated that the loans could not be converted. This caused problems for the businesses and for the Board after inheriting them and there have been other problems associated with these loans as well. They are not considered to be a successful endeavor by the Board.

Mr. South said even though the Board is approached by venture capitalists wanting it to make individual investments with their companies, it is not done because the Board does not have the expertise and can't afford to hire an expert to act as an advisor. Contracting with Adams Street has helped to overcome the lack of venture capital investments, to some extent.

SEN. TAYLOR asked Mr. South to further discuss his expectations for the venture capital return from the Adams Street investments. Mr. South said the expectation is about a 15% return. Venture capital has done very poorly in the last two years, but up until two years ago Adams Street had an annual rate of return of about 18%. The last two years it has gone in the negative but a 15% return is still expected.

REP. KEANE asked Mr. South to discuss the International Malting loan and to explain when the funds will be distributed to the International Malting Company. REP. KEANE commented that when the State loans money to a company and the company does not live up to the terms of the loan, efforts should be made to make certain the taxpayers aren't taken advantage of. Mr. South reviewed the situation for the Committee:

- The Board of Investments agreed to lend \$33.6 million to the company that is building the international malting barley plant in Great Falls.
- Pursuant to state law, any entity receiving a loan from the Montana Board of Investments for a project in which contractors are hired, must include language in the loan agreement requiring the contractor to hire Montana workers first, if all else is equal.
- Two international companies are working on this project and they have hired a lot of out of state contractors and this is the source of the controversy.
- On October 30, 2003, the Board wrote a letter to the malting barley company asking them to:
 - ▶ clarify and prove that they are including that language in their out of state contractor contracts; and
 - ▶ verify they are checking to make sure that the contractors hired are Montanans.
- The company responded only a week ago. They represented that, in fact, they did include that language in their contracts and that most of the people hired under those contracts are Montanans.
- On behalf of the Board, Mr. South responded to that letter by saying that the Board would have to review those contracts and review the good faith effort made to comply with Montana law before any funds could be disbursed.
- To date, the company has not requested funds, nor has there been any disbursement of loan funds.

REP. KEANE said he thought the company has been less than truthful in their affairs and asked Mr. South to scrutinize the company's records very carefully.

SEN. TAYLOR asked Mr. South, regarding the Science and Technology Board's investment fiasco, to suggest language that could prevent something like it from happening again. Mr. South said venture capital investments are risky by nature. He did not know of any language that could prevent a similar situation from happening again.

VENTURE CAPITAL DISCUSSION

History of Montana Capital Company Act -- Gary Morehouse, Regional Development Bureau Chief, Business Resources Division, Department of Commerce (DOC), reviewed

for the Committee the history of the Montana Capital Company Act. Mr. Morehouse reviewed the following:

- the Act was created in 1983;
- was intended to provide tax credits to capital companies that would in turn make debt and equity investments in Montana businesses;
- the Act was originally administered by the Board of Investments;
- oversight was transferred to the DOC in approximately 1992;
- originally there were 13 capital companies but all have been decertified and are inactive;
- the last tax credits were issued in 1995; and
- the last remaining active company was Glacier Venture Fund, which has been decertified.

Mr. Morehouse also discussed several administrative issues regarding the Montana Capital Company Act:

- there is no provision for tracking investments over time so long term success or failure of the Act is difficult to determine;
- the companies were only required to invest 70% of the investment capital. The company could be decertified at this point, but would have received tax credits for 100% of the investment capital. The State had no way to track whether the full 100% was invested; and
- the large investments that were made back into the capital company's own companies was of concern but this was corrected to some extent in 1991 when the Legislature adopted conflict of interest requirements and placed a restriction on percentage ownership to create more of an arms' length program.

Mr. Morehouse reviewed the history of Glacier Venture Funds for the Committee:

- The fund was formed in 1994 and received \$750,000 in tax credits. Its initial investment base was \$1.5 million.
- Glacier Fund received a Science and Tech loan of \$1 million and invested another \$0.5 million of private funds that received no tax credits;
- It invested a total of \$1.2 million, including a statutorily required 10% investment of \$150,000 in a rural county business, PrintingForLess.com, in Livingston.
- The Glacier Venture Fund invested in four businesses:
 - ▶ LigoCyte Pharmaceutical in Bozeman;
 - ▶ PrintingForLess.com in Livingston;
 - ▶ Implemax Equipment in Bozeman; and
 - ▶ Phillips Environmental Products in Belgrade.

Mr. Morehouse also reported on Glacier Springs Capital Company, a Great Falls company, which through administrative and court action, finally invested \$750,000. The State recovered \$40,000 in penalties and interest.

SEN. TAYLOR asked if the DOC tracks the number of jobs created by these investments and if they are not created, what is the end result. Mr. Morehouse said this is a separate issue from the Capital Company Act. The Community Development Block Grant program for example, grants funds to a community and it makes the loan to the business. The amount that is loaned is dependent on the number of jobs originally proposed. Since the success or failure of a company cannot always be controlled, the actual number of jobs created may be higher or lower than projected. The DOC tracks every job and every individual that comes and goes over a

two-year period, so the estimates at the beginning are converted to actual numbers at the end of the period.

SEN. TAYLOR asked Mr. Morehouse to suggest what he thought could be done to improve administration or to prevent a similar situation from happening again. Mr. Morehouse suggested:

- ensuring that the private sector decisions made are independent of politics;
- greater oversight;
- requiring that the State receive the same return on the invested funds as the private company;
- requiring some connection to jobs, in terms of how much is risked, because most of the programs have a cost per job requirement; and
- the private sector risk should equal the State's risk.

Venture Capital Overview/Discussion -- Dave Bayless, Small World Networks, Inc.

Mr. Bayless shared a framework useful in understanding entrepreneurial businesses:

- 3% to 5% of entrepreneurial businesses are associated with approximately two-thirds of the net job growth;
- there are gaps in the provisions and availability of entrepreneurial capital; and
- there are different kinds of entrepreneurial capital, particularly in regard to how different types of investors differ in their strategies, some relying on contracts and contractible risk, and others on noncontractible risk. Geography also plays a role.

Mr. Bayless also said:

- local conditions play a very important role in entrepreneurial growth;
- most of these businesses start out very small with a high degree of uncertainty and therefore are not good candidates for traditional lending sources;
- there is a gap from the demand side;
- from the supply standpoint, there is a tendency for loose language concerning different forms of "entrepreneur" and "capital";
- geographic proximity makes it more difficult and less attractive for venture capital companies located elsewhere to invest in Montana businesses; and
- local investors are best.

SEN. ROUSH asked if Montana's political (investment laws, tax base, etc.) climate discourages outside investors and if physical location and distance obstacles are also factors in discouraging investors. Mr. Bayless said distance is a large factor and said it would be critical to an out of state investor to have access to a person in Montana who is familiar with local economic conditions and could be trusted to oversee the investment.

REP. MENDENHALL said he was interested in further discussion of local condition factors. Mr. Bayless said there is no magic list of factors that absolutely have to be present in a community, that some communities are just more adept in building on their strengths and local advantages, and these factors differ a great deal from community to community.

REP. MENDENHALL asked Mr. Bayless if he was familiar with the work that has been done in Montana on cluster development and if he saw any correlation between the two concepts, as far as a specific area having any sort of an advantage. Mr. Bayless said he was aware of the work

and was interested in cluster analysis. He added that he has also been critical of its use in certain areas where it has been abused.

REP. MENDENHALL asked, given Mr. Bayless' analysis and understanding of Montana, what action he thought Montana should take. Mr. Bayless replied that what he was doing was focusing on "a niche within a niche" in the private equity realm and that his hope is to earn a living doing that. He said his goal was to become a bridge to others by sharing knowledge and becoming a trusted link in helping companies connect.

REP. KEANE asked Mr. Bayless if he was of the opinion that venture capital is a "niche market" and if so, did he think state government belongs in that market. Mr. Bayless said the State, through its policies, attitudes, and linkages, is in essence, already in the business. It influences peoples' perceptions and has the ability to convene people. In terms of risk capital, of which venture capital is a component, it makes the most sense to think less in terms of dollars and technology and more in terms of people, relationships, and trust in information. The extent to which state government can play a role, in education for example, is a worthwhile service. As to the direct investments in venture capital, there are other states who are not trying to become venture capitalists directly but are looking for ways to invest in the funds of private firms who see opportunities in places like Montana. There are firms that have an interest in technology businesses in the Rocky Mountain region, including Montana, or will have a physical presence in Montana. The State should be open-minded about how it might participate in appropriate funds. REP. KEANE asked if that meant that Montana should be participating not so much as an investor, but more in the role of facilitator? Mr. Bayless said that is what he has tried to do and sharing information and facilitating relationship-building is where he started.

REP. MCKENNEY said Bozeman has been identified as a leading city in entrepreneurship and asked what specific assets Bozeman is using to accomplish this. Mr. Bayless said Bozeman's success has a great deal to do with its geographical location and that Montana State University is also a key attractor and a resource critical to investors.

SEN. TAYLOR asked how many companies in Montana use or have used venture capital as a tool in getting started. Mr. Bayless said institutional, professionally managed, 10-year limited partnership, pension-funded, Silicon Valley-style venture capital is involved in the start up stages in less than 1% of the companies formed in the developed world. When looking at emerging growth companies, about 5% of businesses fit the broader risk capital mode, including angel investors, quasi-angel, and other forms of capital. A small number of firms have a disproportionate impact.

Presentations & Roundtable Perspectives on Business Financial & Policy Needs

Venture Capital Users -- Andrew Field, PrintingForLess.com (PFL), Livingston, MT, and Tom McMakin, Thrive Capital,

Mr. Field briefly described his company, PrintingForLess.com and said:

- he started it in 1996 and soon realized that the Montana market was too small for what he wanted to do with this business;
- he made the decision to try selling online;

- he quickly had to seek additional capital in order to expand to meet the increase in orders;
- technical service representatives require intensive training and it is expensive to provide: a 15-week training program, software, etc., workspace. It costs about \$20,000 to create one new job;
- he has visited with many venture capitalists and has determined that his company does not meet the desired venture capital investment profile because it is too small to bother with, from a venture capitalists' point of view;
- PFL is not a good candidate for traditional lending institutions either (bank financing);
- he has patched together financing from several state programs and training grants and said this allowed him to hire faster than he would have been able to otherwise;
- he has added 17 jobs since November 1, 2003, and plans to add another 6 in April of 2004. These are good jobs: the pay averages \$35,000 - 45,000/year and includes good benefits;
- he hopes to have over 100 employees by the end of 2004 and then will face the challenge of finding a new facility.

Mr. Field suggested that the debate not focus on strictly venture capital, but rather look at smaller businesses needing smaller amounts. There is a real need in Montana for businesses in this size market. Opportunities to sell nationwide are large and the PFL payroll is expected to total over \$4 million in 2004.

Tom McMakin, Thrive Capital, said he was CEO for Great Harvest Bread Company in Dillon before going to work for a venture capital firm. He has since formed his own late stage venture fund and is currently in the process of closing on the first round of about \$20 million in capital.

Mr. McMakin said:

- there is an important distinction to be made between economic development and venture capital;
- there are lots of companies in Montana that could use growth equity capital;
- where those business will find assistance and funding is a question of economic development;
- the measure of success is how many jobs have been created and if the efforts have lifted the State economically; and
- the venture capital question is: are there high growth companies that can be invested in and that will provide a quick return investment.

Mr. McMakin said he:

- looks for companies with great teams, proven business models, defensible niches, expanding markets, and exit strategies;
- thinks there are many smaller companies in Montana in need of private capital but that Montana can never support a thriving venture capital community because there are not enough large investment opportunities; and
- he would encourage the Committee to consider the private equity needs of Montana businesses and that venture capital is but one form of private equity.

Mr. McMakin said several other points must be considered:

- a distinction between technology and non technology firms must be made because often venture capital firms focus on technology - Montana has little need of this type of investment;

- the relationship between proximity and capital - the larger and more successful a company is, the more it is able to attract money from long distances;
- the early stage companies that are just now breaking even are poised to accomplish great things and will never attract money from out of state - there is a need to develop a homegrown network of investors that can support relative early stage technology and non tech companies and grow them to the point where out of state money will take a look at them.

SEN. ROUSH asked if Montana needs to put more money in the existing programs, in order to help these companies achieve that kind of growth. Mr. McMakin said one of the points he was trying to make is that while local businesses will likely never attract venture capital, venture capital still plays a role in Montana. He cited the example of the angel network set up through TechRanch in the Gallatin Valley, which pairs investors with entrepreneurs in need of capital. He said anything the State could do to encourage this type of situation would benefit small businesses statewide. He closed by saying that education is also important because people need to know how to make themselves more attractive to institutional capital and how to position themselves.

SEN. TAYLOR asked Mr. Field why his employees required such expensive and intensive training and if the state colleges and universities are providing qualified graduates. Mr. Field said the education received at the colleges and tech schools are very helpful and allows a shorter training time, but a new employee still requires training in the subject matter and expertise specific to the business.

SEN. TAYLOR asked what law or laws would create economic development in Montana. Mr. McMakin said building a bridge between great high-growth companies and existing pools of capital should be the focus and that legislation could do little to impact that. The role for government to play is to use its ability to bring people together. A state business plan competition would cost nothing and would generate great ideas.

SEN. MENDENHALL summarized that there is a need to distinguish between venture capital and how pertinent that actually is to Montana, and the need for funding in the range of \$500,000 - \$2 million for Montana businesses. REP. MENDENHALL asked, if Montana is going to seriously address the issue of growth equity capital, should it concentrate on pairing the right investors with the companies with growth potential that will create good paying jobs and increase the tax base. Mr. Field responded he thought that was a good plan because in his experience in participating in the Pioneer Entrepreneurs in Bozeman and in keeping in touch with other small business owners and CEOs in the area, he has seen a gap between the federal Community Development Block Grant (CDBG) level of funding and the venture capital level of funding. The businesses falling into this gap are in need of funding ranging between \$1 and \$3 million. The biggest challenge would be for the investor to get his money back out of the investment. Unless an investor can see a likely exit scenario, it will be difficult to attract an initial investor. Mr. Field said possible solutions would be to offer "hybrid" investment opportunities (something that is equity but can later be paid back as if it were debt but doesn't sit on the balance sheet as debt) or if the Board of Investments encouraged professional firms to look harder at Montana.

Economic Developers' Perspectives

Representatives from the Montana Economic Developers Association -- Liz Harris, Jobs Now, Inc., and John Kramer, Great Falls Development Authority (GFDA)

Ms. Harris said she measures economic development success by three benchmarks:

- the number of new jobs that are created (recruitment, expansion of an existing business, or nurtured entrepreneurship);
- the amount of the new payroll put in the economy; and
- the new tax base that is created by the new business.

Ms. Harris said capital and entrepreneurship are inexorably tied together. She said she hoped the Committee members were familiar with the National Governors' Association Guide to Creating Entrepreneurship and that it lists eight suggested areas where government can play a role in creating entrepreneurship:

- access to capital and tax credits(critical);
- reducing the capital gains tax;
- mentoring of entrepreneurs;
- streamline securities regulation;
- one-stop licensing for businesses;
- building intellectual capacity at the universities and increased funding of K-12 education; and
- continuing to improve the tax environment.

Ms. Harris said Montana is a small state and must work together and that the role of this Committee as a convener is key to the success of economic development. Ms. Harris briefly described two new businesses to her area that will provide 465 jobs.

Mr. Kramer, GFDA, distributed and discussed a table outlining the different financial and marketing needs of a small business through the stages of prototype development, first tier development, and second tier development (*Retail and Local Service* - EXHIBIT #9). Mr. Kramer said a new business needs a lot of assistance in finance, marketing, and managerial training. Businesses at this stage of development are usually funded through relatives, credit cards, or home equity loans. If the business is launched and survives the initial period, the financial assistance needs increase, the technical support needs remain, and the need for an accountant and a marketing consultant increase. In most cases, the business can't afford to pay for these things and that is why the failure rate is so high. The critical aspect of micro loan lending is having highly professional people staffing the program with the resources to hire technical assistance. A strong aggressive micro loan program is needed in Montana and it should be encouraged by giving incentives to private sector banks who invest, as other states have done.

Mr. Kramer said the second page of EXHIBIT #9 deals with venture capital and the most critical factor is to have professional management of the fund. There is a lower failure rate for venture capital funds managed by professional managers. Other states have encouraged that type of management by giving significant tax credits to the investor, allowing the investors to hire a professional manager. Montana can attract venture capital if it offers the right incentives. Having an opportunity to have a fund manager who know hows to manage and how to tap other funds would be a huge advantage.

SEN. TAYLOR asked for suggestions on how to best convince legislators of the importance of funding economic development programs. Ms. Harris responded that she is designing and

publishing a brochure titled, *25 Incredible Things About Montana That You Don't Know*. She said the list is intended to inform everyone of the success that is going on in Montana and, hopefully, encourage interest in more development.

Mr. Kramer strongly recommended a three-day economics course for all legislators before the next legislative session in order to make certain that all legislators have a full understanding of Montana's economic position.

REP. MENDENHALL asked how the states who use a professional fund manager place that individual into the structure of the venture capital program. Mr. Kramer said incentives are offered to encourage the private sector to invest: the management group gets a percentage of the return on the fund. By making the return tax exempt, there was a greater return back to the management group. They also received state and federal tax credits.

REP. MCKENNEY asked if the Montana Economic Developers Association (MEDA) is currently working on similar venture capital legislation to introduce in Montana. Mr. Kramer provided a document outlining the position of the MEDA regarding venture capital and suggestions for workable venture capital laws (EXHIBIT #10).

REP. KEANE agreed with Mr. Kramer that Montana legislators do need to be educated about economic development issues. He said Montana does not take advantage of the educational and training opportunities that surrounding states use for legislators. REP. MCKENNEY commented that term limits have curtailed the depth and breadth of knowledge retained in the legislature.

Technology Transfer Perspectives -- Tony Rudbach, University of Montana, Assistant Vice President, Research & Economic Development, and Larry Hall, President, S & K Electronics

Mr. Rudbach said technology transfers work for the benefit of the universities, the inventors, and the general good of human kind. Since much of the research is supported by taxpayer dollars, the benefit of the research should be used for the public good as expeditiously as possible. Since the research is also carried out at facilities and by scientists supported by Montana taxpayers, the technology transfer offices in the university system attempt, whenever possible, to use the intellectual property generated to create jobs and to help the Montana economy. They do this by trying to license the intellectual property of Montana companies. Both U of M and MSU have created incubators for these companies. The other piece of this puzzle is to provide a source of equity to help these companies get started, as already discussed today. Larry Hall, General Manager and President of S & K Electronics, has licensed two U of M patents. He will outline some of the problems and benefits of being a recipient of technology transfer from the university system.

Larry Hall, President, S & K Electronics Representative of Business with Tech Transfer Background described a history of S & K Electronics' experience with technology transfer. Technology transfer has allowed growth of several products within the company. Current technology being developed involves trying to find unexploded ordinances, land mines, and other explosive materials. The issue is how do we take research and transition it into product. We are trying to utilize federal funds, our funds, and venture capital funds. Any company in the State is eligible to work with the universities in transferring technology. Montana is working at it

harder than other states. In trying to make it easier: think of ways the State can reduce royalty costs. University systems assistance is very critical, he said, adding that funding the university system is important. He urged support of new ideas and getting them into production.

SEN. TAYLOR asked how many proprietary patents stay in the state, how many companies give money to the university system to work on projects and once a project is developed, does it go out of state or stay in state. Mr. Rudbach sought to clarify that the information doesn't necessarily relate just to the patent but to contractual work as well. He said results are about 50/50 for U of M. Usually U of M gets more money from out of state, and we have very active research programs. Between the two universities, we spend over \$150 million per year in sponsored programs for research. This does attract interest from companies. We do contract work for small Montana companies, so in terms of volume of work or dollars that come in, the majority is from out of state but as far as numbers of contracts, it is about equal. SEN. TAYLOR asked Mr. Rudbach if he thought Montana is doing a good job of directing ideas into Montana versus letting them go out of state. Mr. Rudbach answered that he thought Montana could do a better job. It is a matter of resources that are available to carry out these programs. More resource would be more productive, because if you put more in, you would attract more out of state money.

REP. MENDENHALL asked Mr. Rudbach to comment on the universities' ability or nonability to take an equity position in a company that has had the university develop or work on its patents. Is an equity position possible here and, if not, why. Mr. Rudbach said both the Montana Constitution and state law prohibit using state resources to acquire equity in a company. He said there are gray areas. This would be an excellent issue for legislation, he said, suggesting legislators modify rules to allow the universities to exchange use of facilities for equity - not necessarily putting in State dollars directly, but through in-kind contributions for which the university could obtain equity. REP. MENDENHALL asked if that ability existed, would it help obtain greater resources to help you do the things you would like to be able to do. Mr. Rudbach said absolutely.

REP. MCKENNEY asked if a university has an equity stake in a private company and the company goes into bankruptcy, would the university be on the hook for the liability. Mr. Rudbach said if the university owned an equity position, it would not be responsible for that company's liability and debt but certainly would lose any investment made in the company. He thought the State should be willing to take that risk in order to grow the economy.

HOW VARIOUS BUSINESS ASSISTANCE VERSIONS WORK

Angel Investors-- Gary Bloomer, TechRanch, provided a copy of his discussion points regarding angel investing (EXHIBIT #11):

- financing stages for growth companies;
- a definition of angels;
- what types of businesses and opportunities an angel investor is attracted to;
- issues for Montana to consider; and
- Mr. Bloomer's personal opinions and thoughts regarding angel investing and its impact in Montana.

Venture Capital Provider -- Jon Marchi, Chairman, Glacier Venture Capital, said he is also Chairman of Big Sky Airlines, a past president of the Montana Ambassadors, and is currently

serving as Chair of the Legislative Committee of the Montana Ambassadors. Mr. Marchi discussed his credentials and perspective as a venture capitalist in Montana and first discussed what he thinks Montana is doing right, including:

- the Work Force Development Program, excellent assistance in the CDBG program, the Research and Commercialization program;
- John O'Donnell's Bridger Private Capital Network Company, a Bozeman angel investing company, is up and running and appears to be on track;
- the state-wide business plan competition, based at U of M, does a good job;
- research done by the universities are fundamental to the growth of our economy; and
- the Glacier Venture Fund is invested in four companies ranging from Livingston and Belgrade and due to the entrepreneurial attitude in that area, all are working very well. From a venture capitalist perspective, Montana State University is a tremendous asset to this success and has worked very hard for the state. To grow the kind of companies that will pay higher than average wages, a technology base must be available to the companies.

Mr. Marchi said after listening to the afternoon discussion, he had identified three issues for consideration:

- does Montana have a need for venture capital money;
- if so, how much is available to Montana residents, entrepreneurs, and businesses; and
- if there is a need and there is not sufficient venture capital equity money available in the state, then what is the best solution.

Mr. Marchi said the need has been well defined and the majority of Montana's needs fall in the \$500,000 - \$2 million range. Perhaps that cannot be considered "true" venture capital money but efforts should still be made to attract venture capital to Montana. Capitalists look for investments in areas where there is a venture capital infrastructure. Glacier Venture Capital is the only active venture capital fund in Montana right now and it needs assistance. Its investment companies are growing so fast that their cash flow can't keep up with payroll and other expenses. Equity capital would help. Glacier Venture Capital is going to do what is called a Series B round, which is the second round in investing to raise about \$500,000. If there was a better venture capital infrastructure in Montana, these companies would be able to find the needed capital.

Mr. Marchi said Glacier Venture Fund maintains a "deal log" to keep track of potential investments. It has considered 88 deals in Montana alone and has actually invested in only five. He said the point he wished to make is that there is sufficient demand/deal flow in this state for venture capital money.

Mr. Marchi also provided information from the Montana Board of Research and Commercialization:

- it has funded 61 proposals totaling \$16.6 million of grant money in the last four years;
- these funds can be awarded only if it can be shown that the product can be commercialized;
- the Board had funding requests for 156 proposals adding up to over \$43 million in that same four year period;
- in their last funding cycle, they accepted 52 applications for assistance, which is a new high; and

- these are companies that are specifically trying to commercialize technology created in Montana and are in great need of funding because the demand far exceeds the supply.

Mr. Marchi said the State of Oklahoma has been very successful in developing a venture capital infrastructure through a contingent deferred tax credit model in a Fund of Funds. The type of company Oklahoma will invest in typically has revenues of \$500,000 to \$25 million annually. Gary Morehouse of Commerce did an analysis of how many companies like that are operating in Montana. His analysis revealed that Montana has 2,020 companies with revenues in that range and all would be venture, seed, or equity capital candidates.

Mr. Marchi said that a Price Waterhouse survey revealed that for the last nine years, Montana's share of out of state venture capitalists' investments average about \$2.1 million a year, which is the equivalent of about 1/1000th of 1% of the \$18.2 billion invested nationally by venture capitalists. Based on population, Montana should be getting \$7 to 8 million per year.

Mr. Marchi provided a map (Business 2.0 magazine, January/February edition, EXHIBIT #12) illustrating where venture capital money is being invested nationally and said Montana has a good market of venture capitalists surrounding it and could attract some of this money.

Mr. Marchi discussed possible solutions for Montana and said if a venture capital infrastructure is going to be built in this state, there are three points to consider:

- there is no need to reinvent the wheel but rather, adapt and change the wheel to accommodate Montana's unique needs;
- don't take revenue from other state programs, which means a need to be creative with funding; and
- rely on private-sector investors to make this work.

Mr. Marchi suggested two additional ideas for consideration:

- invest Public Employee Retirement System funds in a Fund of Funds. Oregon finalized legislation investing \$100 million of their public employees retirement fund (which equaled one-quarter of 1% of the total \$43 billion fund) into a Fund of Funds. Oregon also selected a Fund of Funds manager, and required that 80% will be invested in Oregon companies.
- Revisit SB 465 from the 2003 Legislature, which was a Fund of Funds concept and authorized contingent deferred tax credits. Other states have done this with success but he stressed that professional management is a key element of that success.

Bank Capital Perspective -- Keith Colbo, Montana Independent Bankers (MIB),

commented briefly that many of the previous speakers had clearly defined the role of banking and what traditional banks can do in the areas discussed today. As a highly regulated industry, banks are restricted to what they can participate in and the loans they can make. MIB represents about 40 members of a wide range of sizes in the State of Montana. The financial community supports venture capital and angel networks very strongly. It is good for bankers because at some point, some of these companies will become good candidates for traditional lending.

Mr. Colbo said one issue that frequently comes up is the Community Reinvestment Act (CRA). It was adopted in 1977, is regulated by the federal government, and provides a public rating of banks' interaction in the community. Banks are examined periodically and CRA reviews those

bank records and focuses on help provided to low and moderate income individuals. Montana banks have a very high rating under CRA examinations. The independent banking community, the financial community, and the State of Montana support working with the Committee in this arena and the development of venture funds and the angel network.

SEN. TAYLOR asked Mr. Bloomer about the impact of a capital gains tax credit versus tax credits for investment. Mr. Bloomer said as far as tax credits versus a capital gains tax deduction, it is a tertiary issue as far as most investors are concerned. If tax credits create a slightly better investment, that is good but should not be a major consideration.

SEN. TAYLOR asked Mr. Marchi to comment on the same question. Mr. Marchi said he had served on the Governor's Income Tax Advisory Committee several years ago and said he thinks the capital gains tax rate is critically important.

PERSPECTIVES OF STATE INVOLVEMENT - WHY AND HOW -- TOM MCMAKIN, THRIVE CAPITAL

Mr. McMakin said a working group has met twice recently and summarized what has been discussed to date:

- agreed that there is a need for private equity capital in Montana; and
- agreed there are pools of capital available to serve Montana companies so there is not a need to create new pools, but a bridge must be built between the existing pools and Montana companies; and
- Montana's size and population will make the growth slower than that of other states but it would still be worthwhile to facilitate the link between existing capital and companies.

Mr. McMakin asked the Committee for approval to explore policy options defined at the February 20, 2004, meeting of the working group (EXHIBIT #13). Mr. McMakin said the group selected four key topics for further study and said if the Economic Affairs Committee requests more information, the group will provide speakers to provide additional information at the May meeting.

PUBLIC COMMENT

Lonnie Bookbinder, said he had personally conducted a six-month market research project on the needs, opportunities, and interest in the concept of growing biomedical businesses in Montana. He said he has found that there is a tremendous amount of interest, a large opportunity, and a great need for the State of Montana to explore the biomedical business opportunity. He stated that after completing this research, it was his opinion that Montana has little to no chance of attracting an existing venture capital company and that Montana has the interest and resources to create one for itself. He suggested targeting the \$500,000 to \$2 million range and suggested creating it using resources from the four or five major communities in Montana. Mr. Bookbinder said providing tax credits is critical, facilitating venture capital is fundamental, as is clearing the way for angel investors to step forward. Mr. Bookbinder said it was his wish to help facilitate this process by helping to bring university technology forward, and to understand it, maintain it, and build it here. He said efforts should be coordinated with the doctors and hospitals as well as with entrepreneurial companies, and existing companies.

COMMITTEE DISCUSSION

REP. KEANE asked to revisit the issues discussed earlier regarding the international malt barley processing plant being built in Great Falls and said:

- The company has not lived up to its promises and has been a very poor corporate citizen.
- They have issued contracts to out of state companies and plan to hire foreign workers from Bulgaria as well.
- This is an outrage and Montana must not allow this.

REP. KEANE proposed sending a letter to Senator Baucus, Senator Burns, and Representative Rehberg asking them to revisit the visa classification regarding bringing welders to Great Falls.

REP. MCKENNEY said since there was no longer a quorum present, the Committee could not take any official action. He also said he could not support any action until he had additional time to assess the situation. He suggested REP. KEANE bring this issue up again at the May meeting after the members have time to investigate the matter.

SEN. TAYLOR asked, in light of the fact there was not a Committee quorum present, that the Committee suggest that the venture capital working group continue its work and have additional information ready to present at the May meeting. He said he would specifically like it to present concrete documentation of other states' programs and the name of a contact person in each state.

REP. KEANE suggested examining how state laws and regulations could be changed in order to prevent the situation at the malting plant from occurring again. REP. MCKENNEY agreed.

REP. MCKENNEY expressed his thanks to the venture capital working group members and said their expertise and knowledge were crucial to the decisions to be made by the Committee. He asked them to continue with their work and made two suggestions:

- proposed solutions should not take any funds away from existing programs; and
- to provide additional information on private sector management.

SEN. TAYLOR asked if the May meeting would also allow time for other economic development proposals. Ms. Murdo said there would be a representative from Adams Street on the agenda and would discuss how other states structure their contracts for venture capital. SEN. TAYLOR said he thought the Committee should make time for those who have proposals. REP. MCKENNEY said he would firm up the Committee agenda. Ms. Murdo said the June meeting had time built into the agenda for economic development proposals also.

REP. MCKENNEY said the two main issues before the Committee are the Work Comp simplification and venture capital issue. Ms. Murdo asked if she should invite a representative from International Malting to address the Committee on the workforce issues. REP. KEANE said he would like to have Jerry Driscoll from the AFL-CIO. REP. MCKENNEY said he would discuss this further with REP. KEANE and others before making that decision.

ADJOURN

With no further business before it, the Committee adjourned. The next meeting will be held in Helena at the State Capitol on May 5, 2004.

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