

**Economic
Development**

**and the Search
for Equity Capital**

**A Final Report of the
Economic Affairs Interim Committee
for the 2003-04 Interim**

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Table of Contents

Abstract	i
Executive Summary	iii
1. Incorporating Economic Development Issues into the Work Plan	1
2. The Need for Venture or Equity Capital	7
3. The Scope of Existing Programs	10
4. The Availability of Other Funding Sources—Venture or Equity Capital	15
5. Public Input to the Committee	18
6. Working Group Activities	22
7. Proposed Legislation on Venture or Equity Capital Issues	24
8. Proposed Legislation From Economic Developers	27
9. Summary and Conclusion	29
Appendices	
Appendix A: Draft Work Plan	30
Appendix B: Possible Topics for Committee Consideration	39
Appendix C: Draft Legislation	42
Appendix D: Montana Science and Technology Alliance Program Portfolio Summary 2003	50

Abstract

The Economic Affairs Interim Committee tackled economic development issues in the 2003-04 interim by reviewing what Montana has been doing in economic development and assessing options that could help companies in need of venture or equity* capital. Assisted by an ad hoc working group, the Committee proposed a resolution urging the Governor's Office of Economic Development to support educational and networking resources for "angel" or early-stage investor networks. The Committee heard but did not adopt bills providing tax credit incentives for investors in equity funds and legislation intended to help businesses locate or expand in Montana.

*As used in this report, venture or equity capital describes cash invested in startup companies or early-stage companies. Venture funds are a high risk type of investment made with expectations of high rates of return. Although venture and equity are not entirely synonymous in describing investments or capital, the terms will be used together when appropriate. A "venture" also may refer to a high-risk startup. A venture fund refers to a high-risk fund focused on ventures.

Executive Summary

The Economic Affairs Interim Committee tackled the broad, hot topic of economic development in the 2003-04 interim by building into its work plan a review of what the state has been doing in economic development and analyzing options that could help startup companies in need of venture or equity capital.

After examining the need for and the scope of existing programs and the availability of other funding sources, the Committee heard a broad spectrum of opinions—ranging from people who thought that the best tactic for the state is to keep hands off the process to those who saw the state as a key player in public-private partnership programs that assist private entrepreneurs.

The Committee asked a working group, which had convened primarily to look at equity capital issues, to come up with a low-cost proposal, in the form of a draft bill, that would help capital formation in Montana. Despite floods and power outages that seemed to have an affinity for striking when either the Committee or the working group met,** the Committee and the working group developed draft legislation intended to help companies with high growth potential and high-risk quotients at a projected low cost to the state. The Committee decided not to sponsor the legislation.

The Committee also reviewed recommendations from economic developers in Montana for draft legislation intended to help businesses locate in Montana or grow and expand here. The recommendations did not become Committee bills, given the Committee's reluctance to move forward without significant support from all the members.

**The Committee's October 24 meeting continued despite trickles of water streaming from the ceiling. (One floor above, a burst water pipe had drenched occupants, while below those offices, legislative services staff were scrambling to avoid steady streams of water that disrupted their work.) At the first meeting in January of an advisory group working on venture capital, ice and a second flood at the opposite end of the building triggered a fire alarm that resulted in the meeting being moved across the street. A citywide power outage resulted in no power at a bill drafting August meeting of the working group, but the group labored on in natural light.

1. Incorporating Economic Development Issues into the Work Plan

The Economic Affairs Interim Committee (Committee) for the 2003-04 interim started life much like other committees. Its first meeting on June 11, 2003, featured the following typical activities:

- review of its duties (see pp. 1 and 2 of the Work Plan, Appendix A);
- review of a study assigned to the Committee by the Legislative Council. That study, SJR 17, is the subject of its own report entitled: "Delving into Workers' Compensation and Occupational Disease: Seeking to Make the Complex More Easily Understood".
- discussion of a staff-prepared list of potential meeting topics (see Appendix B), after which the Committee decided to combine topics for future meetings; and
- discussion of a work plan, which included review of agencies assigned to the Committee,¹ topics of interest to legislators, rule review, and a proposed schedule of meetings. (See a copy of the Work Plan in Appendix A.)

Here in brief is a review of the Committee's meetings as they related to economic development:

June 11, 2003 — Economic development predominated as a theme among the topics chosen for discussion at upcoming meetings. The Committee specifically called for 1 day of a 2-day meeting in October to address economic development issues. At this meeting, Senator Sherm Anderson also requested more information about loggers and mill workers displaced because of

¹These include: the Departments of Agriculture, Commerce, Labor and Industry, and Livestock, along with the Governor's Office of Economic Development and the State Auditor's Office. An agreement with the State Administration and Veterans' Affairs Interim Committee transferred monitoring duties for the Montana State Fund to the Economic Affairs Interim Committee so that just one committee deals with workers' compensation issues.

Economic development predominated as a theme among the topics chosen for discussion at upcoming meetings.

the U.S.-Canadian softwood lumber dispute.² Senator Glenn Roush urged more attention by Montanans to regional economic development, particularly energy development in Canada. Also at this meeting, convened by Senator Mike Taylor as the senior senator on the Committee, the members elected Representative Joe McKenney as presiding officer and Senator Glenn Roush as vice presiding officer.

October 23-24, 2003 — After a day spent reviewing activities of agencies under the Committee's purview but not covered during the June 11 meeting, the Committee focused October 24 on learning various perspectives about Montana's economic development climate from economists, economic developers, and others. The meeting concluded with a discussion of a plan put forward by the Board of Regents, "Shared Leadership to Strengthen Montana's Economy". The Committee voted to write a letter to the Board of Regents in support of the Regents' spearheading of statewide efforts to promote economic development issues. The Committee also recommended spending more of its time on economic development issues and, in particular, on examining the state's role in encouraging venture capital formation and investment in Montana.

January 23, 2004 — January's meeting featured a presentation by State Auditor John Morrison and his staff, an overview of venture or equity capital, workers' compensation updates, and a joint morning session with the State Administration and

²Staff provided a report on the lumber dispute at the October 23, 2004, meeting, which resulted in a Committee letter to U.S. Secretary of Commerce Don Evans seeking a speedy, equitable resolution. The letter and all meeting minutes are available at the Committee website:

http://leg.mt.gov/css/committees/interim/2003_2004/econ_affairs/default.asp.

The committee recognized that growth in the state's economy helps all concerned, including banks.

Veterans' Affairs Interim Committee. The morning session involved state, federal, and private sector officials discussing proposed changes in federal banking regulation and how that might affect the financial services industry in Montana. In the afternoon, the Committee requested background information on past economic development funding efforts in the state, including information on missteps. The Committee also received a staff update on how the Department of Livestock was addressing requests for more meat inspectors across the state.

March 11, 2004 — Further information about economic development needs and perspectives came during the March meeting when the Committee formally included economic development as an amendment to the work plan. Highlights of this meeting included:

- perceptions from businesses in Montana that a gap remains for funding needs beyond what bank loans, friends, families, and other lenders might provide, even though existing programs, such as the federally funded, state-administered Community Development Block Grants program and the new workers' training program,³ were of great benefit;
- an emphasis by economic developers on the need for economic development tools that could help them in attracting businesses to Montana by improving their options to compete successfully against out-of-state economic development groups;
- the importance to early stage companies of "angel" investors—wealthy individuals who commit both time and equity investment to help a business grow;

³Initiated under HB 564, Chapter 567, Laws of 2003.

- recognition that growth in the state's economy helps all concerned, including banks; and
- caution urged by venture capital experts about the risks involved in venture capital. The experts also provided insights into conditions necessary for a vibrant venture or equity capital market, which include proximity to other venture capitalists.

The Committee also heard about the problems experienced and resolved under an early venture capital tax credit plan—the Montana Capital Company Act—and the successes of one form of economic development facilitation being practiced in the Golden Triangle area north of Cascade County. The Golden Triangle Enterprise Facilitation Project has raised funds for a trained facilitator who works with potential businesses in a multicounty area to steer them toward appropriate contacts.

May 5, 2004 — The May meeting featured various ways for a state to be involved in venture capital formation. A. Bart Holaday of Adams Street Partners, one of the Board of Investments investors involved in venture funds, described the volatility of these high-risk funds: two venture funds started in 1988 and 1993 had returns of 21.38% and 40.14%, respectively, but a third fund in 1999 had negative returns to date of 17.35%. Two members of Credit Suisse First Boston (CSFB) provided an overview of their investment program. The CSFB formula typically invests state money, CSFB's own money, and money solicited from other investors in venture funds. The managers of some of these funds then look at (and possibly invest) in ventures located in the state. The CSFB representatives stressed that return on investment is the most important element. Phillip Thomas, a representative of Advantage Capital, provided information about the capital company or CAPCO

The Committee decided to encourage a network of angel investors by drafting a resolution asking the Governor's Office of Economic Development to set as a priority the development of such an "angel" network.

approach in which a private equity firm invests in ventures within a state in exchange for incentives, such as tax credits. The last speakers were investors who are implementing "fund of funds" legislation in Oklahoma and Iowa. They provided perspectives on how a fund of funds relies on contingent, deferred tax credits to initiate investments and back returns. The Committee requested a bill draft incorporating fund of funds approaches. (See Appendix C for a copy of the bill draft.)

June 30 and July 1, 2004 — The June 30 and July 1 meetings combined the Committee's review of legislation proposed by agencies for which the Committee has monitoring duties with updates on the workers' compensation study and work on a venture capital bill. The State Auditor's Office included a fund of funds bill in its bill drafting requests, and the Committee urged cooperation with the drafting of that bill as a potential Committee bill. After a brief discussion, the Committee decided to encourage a network of angel investors in Montana by drafting a resolution asking the Governor's Office of Economic Development to set as a priority the development of such an "angel" network. (See Appendix C for a copy of the draft resolution.) Addressing the Committee on economic development, Representative Jim Keane emphasized the importance of doing business with companies that hire locally and that pay attention to workers' needs, particularly good pay and benefits.

September 7, 2004 — After acting on workers' compensation legislation, the Committee heard updates from a Department of Livestock official regarding requests for additional meat inspectors and heard from representatives of the Montana Association of Counties regarding its economic development

subcommittee's work. Senator Mike Taylor also provided 12 guidelines for consideration in adopting economic development legislation, including a need:

- for political and taxation stability and consistency for businesses;
- for uniform application of tax credits rather than applications benefiting certain groups;
- to expand the role of the Governor's Office of Economic Development to include more marketing and attention to the cornerstones of economic development: business financial viability; access to supplies and materials; adequate physical infrastructure; and coordination of family, social, environmental, and health factors; and
- to pass legislation that says a plaintiff who sues and loses pays the lawyer fees and court costs of both the plaintiff and defendant in lawsuits seeking more than \$60,000. This recommendation also suggested raising the threshold for claims in Small Claims Court to \$5,000 from \$1,500.⁴

Other reports at the September 7, 2004, meeting included presentations by: Jon Brumley, chief executive officer of Encore Acquisition Co., on the company's oil exploration in southeastern Montana; Mark Simonich, director of the Department of Commerce, on implementation of the Certified Regional Development Corporations established in HB 76 passed in the 2003 Legislature; and Carroll South, executive director of the Board of Investments, on a draft study by CSFB regarding the potential for venture fund investments in Montana and the Pacific Northwest. The discussion of the Committee's response to bill drafts on economic development is in Chapters 7 and 8.

⁴Senator Mike Taylor handouts, in Minutes, Economic Affairs Interim Committee, September 7, 2004, Exhibits #11, #12, and #13.

2. The Need for Venture or Equity Capital

Legislators face a dilemma: how to help the majority (55%) of businesses in the state that have fewer than 5 employees as well as those employers (45.8%) with the majority of workers (those with 50 or more employees). In essence, most businesses in Montana are small businesses (75.6% of businesses in Montana have fewer than 10 employees, and 87.8% have fewer than 20⁵). However, 4.1% of the worksites in Montana employ almost half of all employees, which means that most workers in Montana work for the few number of larger employers.⁶ These typically are public employers, including school districts, and nonprofit corporations, including hospitals. If limited funds are available for stimulating the economy, which usually is the case, then which target group can best create more wealth: the large number of small employers; the smaller number of large employers who employ more people; or venture firms that start small and have the potential to exponentially expand?

Various statutes are available to address the capital needs of both small and large employers. Small businesses, for example, may be able to tap such programs run by the Department of Commerce as business plan development assistance or manufacturing extension services. If their community has a Microbusiness Development Loan Center, a small business can access up to \$35,000 in a loan program originally funded by the state and under local operation. Hospitals can access assistance under the Montana Facility Finance Authority. Other large employers can go

The "need" for venture or equity capital in Montana comes from businesses that already are using a combination of loans and see an opportunity to expand but are uncomfortable taking on more debt.

⁵Research and Analysis Bureau, Montana Department of Labor and Industry, *Labor Day Report*, September 2003, p. 14. Information compiled from March 2001 to March 2002.

⁶*Ibid.*

before the Board of Investments to request a loan in conjunction with banks and backed by collateral put up by the company.

As described at the March 11 Committee meeting, the "need" for venture or equity capital in Montana comes from businesses that already are using a combination of loans and see an opportunity to expand but are uncomfortable taking on more debt. These businesses may prefer to take the risk of adding partners rather than more debt. Other companies likely to seek out venture or equity capital are those developing a service or intellectual property for which little to no collateral exists. These latter are typically high-risk ventures, much like software companies that must prove themselves to investors before taking the step up to the over-the-counter stock market. At the March meeting, Andrew Field, who founded PrintingForLess.com in Livingston, detailed his company's history of fast growth, including scores of good jobs that pay more than \$30,000 a year, and the need for expansion facilities. However, his company has little conventional collateral because most of its value comes from well-trained employees who work with customers from across the country to find Internet print solutions. Venture capital companies have looked at his firm's need for less than \$5 million in financing, but he has declined their offers of large investments, and they have declined to do financing of less than \$5 million because smaller investments were not worth the venture capital fund's time, Field said.

The Department of Commerce reviewed the *2003 Harris Directory of Montana Businesses* to try to determine how many businesses in Montana might fall into the category of potential users of venture capital. The *Directory* listed 3,446 Montana companies in 2003—those generally engaged in manufacturing or employing 20 or more people. (Montana has a high number of home-based and sole proprietor businesses that are not necessarily included in the *Directory* listings.) In the Bozeman area, as one example, approximately 76% of the businesses had sales in 2003 of \$500,000 to \$25 million, which generally is considered the base needed for expansion.

Not all businesses are interested in going the venture route. Many startup businesses are content with slow but steady growth with owners who retain control. Firms that are willing to go the venture route must be willing to share control with equity investors, who typically are not silent partners. The company generally needs a high potential to "go public" through a listing in the stock market, which is one of the exit strategies that venture capitalists rely on to get a high return on their original investment. As a result of the management strategies associated with the reliance on equity capital, venture businesses end up being small in number but also end up with the highest potential for returns on investment and a high potential for boosting Montana's economy through either more jobs or income gains. That makes the "need" limited but one of high risk and potentially high benefit.

3. The Scope of Existing Programs

Questions about the impact and outcome of Montana's previous investments and experiences in economic development resulted in a Committee request of staff to look at the history of economic development programs in Montana. Economic development is a large subject that generally fits into the categories of supporting community infrastructure, maintaining the existing economy, and building business opportunities. Although education, workforce training, and other factors also help a state in developing its economy, these issues for the most part were not addressed as Committee staff and staff for the Legislative Finance Committee (LFC) began examining various economic development initiatives and programs. The Committee staff report addressed selected state and federally funded initiatives providing business support.⁷ The report to the LFC, a draft copy of which was presented at the Committee's June-July 2004 meetings, covered a broader range of programs.⁸

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- ▶ ***supporting community infrastructure;***
 - ▶ ***maintaining the existing economy; and***
 - ▶ ***building business opportunities.***
-

Staff also included histories of two economic development efforts that left a bad taste among some legislators and administrators. These were the Montana Capital

⁷More information about the programs that the state has funded, either through state investments or in conjunction with the federal government, is available in the report "Studying the Past and Preparing for Future Economic Development". The report, dated April 2004, is available online at http://leg.mt.gov/css/committees/interim/2003_2004/econ_affairs/meeting_materials/5_5.asp or from the Legislative Services Division.

⁸Alan G. Peura, "Expanding the Montana Economy", Exhibit #1, July 1, 2004, Minutes.

Company Act, before it was amended to require arm's-length investments, and the Science and Technology Alliance, which sought to finance Montana companies that had products that could be commercialized.⁹ The problem with the Montana Capital Company Act was that some investors initially received tax credits for investing in their own projects. Other investments produced no new jobs and may have retained only one job. Still another problem cited by Department of Commerce staff was that under 90-8-202 and 90-8-301, MCA, a tax credit could be issued as soon as an investor made an investment in a capital company, but once 70% of a required investment had been made into eligible businesses by the capital company, the Department of Commerce was required to decertify the capital company. This left open the possibility that the remaining 30% of the tax credit capital base might not have been invested. Without a requirement for a final audit of these investments, the Department of Commerce was unable to prove that 100% of the original tax credit capital base was invested or to determine the success or failure of investments that had been made. Tax credits provided under the Montana Capital Company Act amounted to approximately \$6.7 million.¹⁰ No tax credits remain.

Problems cited for the Science and Technology Alliance (STA), which was created by the 49th Legislature (1985), related to constitutional challenges and legislative expectations for a periodic, positive return on investment, although 90-3-523, MCA, allowed deferred debt service for up to 8 years. Two court cases determined portions of the STA statutes (Title 90, chapter 3, parts 1 through 5, MCA) to be unconstitutional because state tax money cannot be used for private corporations and statutes cannot give a Board too much discretion for making what should be legislative decisions.¹¹ Following the court rulings, the Legislature amended the

⁹"Studying the Past and Preparing for Future Economic Development", *op. cit.*

¹⁰For more information on the Montana Capital Company Act, see Montana Capital Companies Annual Report to the Revenue and Transportation Interim Committee, February 13, 2004, Exhibit #10, and Teresa Olcott Cohea, "The Montana Capital Company Act", a report prepared for the Legislative Finance Committee, August 3, 1990.

¹¹See Hollow v. State, 222 M 478, 723 P2d 227, 43 St. Rep. 1435 (1986), and White v. State, 233 M 81, 759 P2d 971, 45 St. Rep. 1310 (1988).

statutes in the late 1980s and early 1990s. From 1989 to 1997, STA made loans of more than \$21.8 million. In repealing the STA statutes, the 56th Legislature (1999) assigned management of STA's outstanding obligations to the Board of Investments under 17-6-308, MCA. As of 2003, the Board of Investments had written off about \$1 million of the total STA loans, received \$6 million in repaid principal and nearly \$3.5 million in interest, and anticipates another \$15.79 million of principal being repaid.¹²

The review of selected economic development programs found, in brief, that Montana received federal grants or guaranteed loans annually of more than \$17 million for business support. Although not classified as economic development,¹³ the federally funded Workforce Investment Act of 1998 (for Job Service and related operations) supplied another \$7 million to \$15 million annually for workforce assistance. Sample federal programs provided:

- **\$8 million a year**, approximately, in federal grants under the Community Development Block Grant (CDBG) program, awarded by the U.S. Department of Housing and Urban Development. The state contributed \$317,195 from the general fund for the FY 2003-04 biennium for administration of CDBG programs to match \$340,412 in federal grant funds used annually by the state for program administration. The total CDBG program award to Montana was \$8 million in program year 2004, less funds used for state administration. The Department of Commerce splits the remaining amount, providing two-thirds for housing and public facilities and one-third for economic development. The latter third consists of grants to communities for lending to businesses, job training, and infrastructure development for business projects.

¹²Board of Investments Summary of Montana Science and Technology Alliance Program Portfolio, 2003. See Appendix D. Of the \$21.87 million loaned by the Science and Technology Alliance, \$9.8 million went to venture capital, \$1 million to job investment, and \$11 million to research and development.

¹³Montana receives federal funding for numerous projects that could be termed economic development. Those listed here assist businesses, specifically, or workers. However, Workforce Investment Act funds are not for economic development purposes but rather for laid-off or dislocated workers or for specialized help for adults and youth to obtain work.

- **\$9.5 million a year**, approximately, under the federal Rural Business Cooperative Services program operated under the U.S. Department of Agriculture. Slightly more than \$1 million went for grants. The remainder was for guaranteed loans.
- **\$7.3 million for July 1, 2004, to June 30, 2005**, a decreasing annual amount since 2002, in Workforce Investment Act funding, administered through the Montana Department of Labor and Industry. These funds are restricted to helping laid-off or dislocated workers or for retraining adults or placing youth in new jobs.

Certain ongoing state-supported economic development programs¹⁴ operate with funding certainty from the Legislature, using interest on \$140 million of the coal severance tax permanent fund:

- \$3.65 million a year for research and commercialization programs under Title 90, chapter 3, MCA;
- \$1.25 million a year for growth through agriculture programs described in Title 90, chapter 9, MCA;
- \$425,000 a year for Certified Regional Development Corporations;
- \$300,000 a year for export trade enhancement;
- \$200,000 a year for the Montana Manufacturing Extension Center;
- \$125,000 a year for small business development programs;
- \$65,000 a year for the Cooperative Development Center (now a nonprofit in Great Falls); and
- \$50,000 a year for a small business innovative research program.

The funding authority for these programs in 15-35-108, MCA, terminates June 30, 2010. The total of the annual state funding for the above programs is nearly \$6.1 million a year.

¹⁴Specific loans made by the Board of Investments under its directives in 17-6-305 and 17-6-317, MCA, to assist economic development—such as \$60 million in loans made to the International Malting Co. plant near Great Falls—are not included in the list of program funding.

Infrastructure development and educational support for elementary, secondary, and postsecondary schools also contribute to economic development, but the Committee did not look specifically at these programs, except to hear reports on the initiatives being developed under the "Shared Leadership for a Stronger Montana Economy" as initiated by the Board of Regents. The Shared Leadership program includes Montanans from the Executive and the Legislative Branches of government in addition to educators from around the state and interested participants from the private sector.¹⁵

The assistance from federal and state funds generally consists of either grants or loans. Tax credits available to certain investors under the Montana Capital Company Act (Title 90, chapter 8, MCA) expired after 1995. Equity support for businesses is problematic in Montana because the state constitution under Article VIII, section 13, prohibits investment by the state in companies, except that the Board of Investments may put pension funds in the stock market and 25% of the Montana State Fund's book value may be in equity investments. The restriction on creating a state debt in Article VIII, section 8, also constrains state assistance to obvious appropriations, loans guaranteed by collateral, or offsets against income taxes in the form of tax credits, which amount to foregone revenue rather than tax allocations.

¹⁵More information on the Shared Leadership program is available from: <http://mus.montana.edu/reports/economic/>.

4. The Availability of Other Funding Sources—Venture or Equity Capital

The Committee heard from various sources—both those in need of venture or equity capital and those investing in startup companies—that Montana is among a group of states known as "fly-over" states. Generally, venture capitalists invest in companies where their venture capital fund is located. Most venture funds and startup enterprises have centered in California, New York, and Massachusetts, with a majority of the remaining states being "flyover" states and not worth investors' time.¹⁶ Proximity makes consultation much easier and more likely to allow hands-on guidance, one of the benefits of venture capital investments as seen by the venture investors.

However, more and more states are adopting legislation to provide some form of incentive to investors in entrepreneurial companies. Generally, incentives are in the form of tax credits or deferred, contingent tax credits provided either to venture capital companies known as CAPCOs or to fund of funds investors. Both types of programs charge a management fee for handling money and distributing the investment to venture funds. Each state structures requirements for investments. Dave Bayless, a former principal in a private equity firm in Texas and a returnee to Montana who founded the Pioneer Entrepreneurs network, told the Committee in March that the more requirements placed on investments, the lower the prospect for achieving a good return on investments. Mr. Bayless also noted that local conditions can overcome the advantages of proximity and that good ideas capable of setting a business apart can flourish anywhere, but he cautioned that financing growth in the

¹⁶See Christopher Swope, "Risky Ventures" in *Governing*, April 2004. Available at <http://www.governing.com/articles/4venture.htm>.

company may be difficult in more rural areas. Gary Bloomer of TechRanch prepared a similar message regarding tradeoffs for the Committee's January meeting.¹⁷

Physical distance is not a complete bar, however. Mr. Holaday from Adams Street Partners told the Committee that Adams Street had invested in three Montana firms, one of which was referred by the Board of Investments. (Mr. Holaday said that he was not sure how the other contacts were made.) Jon Marchi of Glacier Venture Capital operates a Montana-based venture firm, which has subscribed nearly all its funds. Tom McMakin, former chief operating officer of Great Harvest Bread Co. and now of Bozeman, is creating a venture fund intended to focus on companies beyond the startup stage. A venture capital firm with offices in Seattle and Spokane, Northwest Venture Associates, plans to view deals throughout the Pacific Northwest. Although venture capital firms have contacts in Montana, those contacts do not necessarily offer the kind of assurance that comes from an investor being able to watch closely over an investment or knowing others who might similarly be involved.

One result of the Committee's review of venture formation options was a request by Board of Investments (BOI) executive director Carroll South for a study by Kelly Williams and Mike Arpey of CSFB. Ms. Williams and Mr. Arpey presented information to the Committee in March on how CSFB works with states to stimulate venture funds and funding. Mr. South provided general information to the Committee in September 2004 regarding the CSFB research. In October, after the Committee had completed its work, the BOI approved a contract with CSFB and agreed to invest \$25 million in a regional venture fund that CSFB plans to establish. CSFB is expected to raise another \$15 million to \$50 million that will be invested in Montana, Idaho, Utah, or eastern Washington. CSFB already has a contract with Oregon's \$105 million Investment Fund, which will target investments in venture capital firms and startup companies in Oregon and the Northwest.

¹⁷See "Venture Capital Options for Policymakers" at http://leg.mt.gov/css/committees/interim/2003_2004/econ_affairs/meeting_materials/1_23_meeting.asp.

One theory regarding venture investments in Montana and other states outside of Silicon Valley and other hotbeds of entrepreneurial activity is that deal flow elsewhere (both the need for money and the prospect of good returns on investment) is scarce. Without a concentration of deal flow in an area, venture funds generally must look regionally, nationally, or globally to achieve investment returns rather than limiting investments in just one state. David Gibson of the Governor's Office of Economic Development told the Committee in March of the importance attached to competition in making certain that deals funded by venture investors are nationally competitive and not just the best available locally.

Another activity springing up across the state is the informal networking of individuals called "angel" investors. These high-wealth individuals, classified by the U.S. Securities and Exchange Commission as accredited investors,¹⁸ are people—in plain language—who are able to lose money without undue harm. (For more on angel networks, see Chapters 6 and 7.) Efforts are underway in the Gallatin Valley through TechRanch, in Flathead County, and in the Missoula area, the Great Falls area, southeastern Montana, and perhaps other areas to develop networks of angel investors and provide them with information on homegrown companies worth their time and money. Development of a network of people with the expertise to assess whether a company has the potential to grow exponentially is part of a circle of benefits expected to result as angel investors become increasingly aware of deals in Montana and as entrepreneurs here learn from interacting with these investors what could improve their business.

¹⁸Regulation D of the Securities Act of 1933 includes in the accredited investor definition "a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase". Also included is "a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year". From the U.S. Securities and Exchange Commission (SEC) website: <http://www.sec.gov/answers/accred.htm>. The SEC is considering revising these standards to account for 21st century income levels.

5. Public Input to the Committee

An ad hoc working group came together in January 2004 to provide input to the Committee on whether to develop legislation to encourage venture or equity capital formation and investment and, if so, what form of incentives or assistance the state should offer. Participants varied at each meeting but consisted in general of a core group that backed state incentives for either a fund of funds venture capital program or an angel network program. An e-mail list of participants¹⁹ included people who did not provide input but who expressed interest in keeping informed about the group's work. The list included proponents of one or more bills from the 2003 Session related to venture capital. Greg Van Horssen and Jacqueline Lenmark, who supported SB 378 introduced by Senator Sam Kitzenberg in 2003, represented interests of capital companies, such as Advantage Capital. Mr. Marchi of Glacier Venture Capital and Liz Harris of Jobs Now in the Flathead Valley supported SB 465 introduced by

¹⁹The e-mail list included, as of August 2004, Kevin Barber of Northwest Venture Associates; Evan Barrett of the Butte Local Development Corp.; Brad Bauman of Golden Triangle Enterprise Facilitation Project; Carol Beam of St. Vincent Healthcare; Linda Beck of the Big Sky Economic Development Authority; Gary Bloomer of TechRanch; Lonnie Bookbinder, chief executive officer of ProteoGenesis in Hamilton; Mike Carlson of the Eastern Plains Resource Conservation and Development Area; Rosalie Cates of the Montana Community Development Corp.; Keith Colbo of the Montana Independent Bankers Association; Russ Fletcher of Montana Associated Technology Roundtable; Dave Gibson of the Governor's Office of Economic Development; Monte Giese of D.A. Davidson; Liz Harris of Jobs Now; Deborah Hayden of Gateway Economic Development Corp.; John Kramer of the Great Falls Development Authority; Roger Lang of TransAria (formerly Cutthroat Communications); Jacqueline Lenmark representing Advantage Capital and other capital company clients; Bill Lombardi of Lombardi Strategic Communications; Jon Marchi of Glacier Venture Capital; Tom McMakin of Thrive Capital; Gary Morehouse of the Department of Commerce; Margaret Morgan representing Wesco; John O'Donnell of TechRanch; Sharon Peterson of Leadership Montana; Andy Poole of the Department of Commerce; Karen Powell of the State Auditor's Office; David Senn of the Teachers' Retirement System; Mark Simonich of the Department of Commerce; Tom Simpson of Northwest Venture Associates; Ray Trumpower of Eastern Plains Resource Conservation and Development Area; Steve Turkiewicz of the Montana Bankers Association; Greg Van Horssen representing Advantage Capital and other capital companies; Anita Varone, Lewis and Clark County Commissioner; Thomas Wells at Montana Venture Law; and Mary Whittinghill of the Montana Taxpayers' Association.

Senator Jon Tester in 2003, a fund of funds bill written in cooperation with the Governor's Office and the State Auditor's Office.

Mr. Gibson of the Governor's Office of Economic Development and Karen Powell of the State Auditor's Office each contributed contacts for the working group as did Russ Fletcher, a Missoula-based entrepreneur who operates the Montana Associated Technology Roundtable. Participants on the ad hoc advisory group ranged from economic developers to interested entrepreneurs. Chapter 6 includes a report on the group's discussions.

In addition to input from the ad hoc working group, the Committee solicited comments from legislators and the public regarding what the state should be doing to improve economic development. Six people sent in comments. A seventh responded to a September 2004 news article regarding Senator Taylor's proposal on "loser pays" lawsuits. Among the responders, Senator John Cobb urged the state to set goals for economic development, including a specific target for lower unemployment and higher family incomes. He asked, "Should we set as goals to increase our many existing small businesses incomes, instead of trying to lure a large new employer to a particular community with tax incentives, only to have the company relocate after the tax incentives dry up?" He suggested, "Setting common

"Setting common goals, instead of simply funding one economic project, forces and allows everyone to bring forth their ideas. It allows every industry, every business and every group to help economic development."

goals, instead of simply funding one economic project, forces and allows everyone to bring forth their ideas. It allows every industry, every business and every group to help economic development."²⁰ The Shared Leadership program initiated by the

²⁰Senator Cobb's recommendations and comments are at the Committee website: http://leg.mt.gov/css/committees/interim/2003_2004/econ_affairs/Economic_development_postings/Eco_Dev_postings.asp.

Board of Regents similarly has suggested that Montana set quantitative goals in an effort to improve the state's economy.

Among other comments²¹ were these:

- "We have several early stage companies here in MonTEC, and one of their biggest challenges is raising equity investment. A couple of these companies have been started by entrepreneurs who successfully built companies in other states before moving to Montana. They agree strongly on the need to encourage individual investors to invest in Montana companies. They do not see much potential from traditional venture capital firms, who typically look at much larger deals than would be appropriate for most if not all companies in Montana. Instead, we need to focus on individual investors or "angels." — Dick King, President of the Missoula Area Economic Development Corp.
- "Two practicing Montana venture capitalists have provided me their opinions on the state's involvement in venture capital. Both of them independently expressed the same ideas. They both said that the state must not be in the venture capital business itself. Rather, it needs to nurture, facilitate and support private venture capital initiatives." — Deborah Hayden, Gateway Economic Development Corp.
- "We do not need more low pay, part-time jobs in XXX-Mart or YYY-Depot. We need good jobs—high pay with stability. We cannot get from here to there with a continued drain of net profit flowing from Montana to the hinterland. Business recruitment whereby the net profits are "outsourced" (exported from Montana) should not take place in preference of business recruitment of companies which are Montana-centric, e.g., whereby the net profits will stay in Montana." — Jim Miller of the Gallatin Valley.

²¹All the comments are posted in full at the Committee website referenced above.

- "Below²² is a great example of State (Indiana) government, companies and universities working together to "seed" or fund the life sciences and product commercialization. This accomplishment is the result of vision, leadership and focus. Montana needs to do something similar." — Lonnie Bookbinder, CEO, ProteoGenesis.

- (1) "Pass an "open container" law that meets criteria of the Federal Highway Administration. . . . Every \$1 million spent on construction translates into about 46 jobs." (2) "Appropriate funds to the colleges of technology so they can ramp up training programs for the construction trades. Hundreds of jobs are being created each year in construction—from carpenters to heavy equipment operators—and companies cannot find qualified workers." (3) "Tap the coal trust for infrastructure improvements at the state and local levels." — Cary Hegreberg, Executive Director, Montana Contractors' Association.

²²The reference is to an article about Indiana's Future Fund, a \$73 million "fund of funds" that invests in life sciences-oriented venture firms based in Indiana.

6. Working Group Activities

The ad hoc working group on venture capital (and on economic development more generally) first met on January 6, 2004, at the Capitol. One purpose was to help frame a presentation on venture capital for the full Committee's January meeting. Another purpose was to present to the Committee the various viewpoints held by members of the ad hoc working group. These viewpoints formed the economic development portion of the March 5 Committee meeting. Over the span of 8 months, the ad hoc working group met seven times, sometimes with the benefit of a speaker phone. One meeting that focused primarily on angel investors was at the TechRanch in Bozeman. All the other meetings were at the Capitol. The most vocal advocates supported angel networks or a fund of funds bill. Proponents of angel networks contended that the early-stage support provided by this group was preliminary to any investments by venture funds, which tend to be larger investments. Proponents of incentives to create a fund of funds bill referred to the importance of creating interest in Montana companies within a competitive context. The concept, they said, was that

Among the purposes for the ad hoc working group were to help frame a presentation on venture capital for the full Committee and to present to the Committee the various viewpoints of the working group members.

in pushing for review of Montana deals by venture funds and offering incentives, local companies would have greater access than they currently do to venture capitalists, who are accustomed to advising companies on how to tap into growth cycles.

At the June meeting at TechRanch, attendees discussed whether to pursue tax credit incentives for angel investors as well as tax credits for venture investments under a fund of funds bill that the Committee had requested at its May meeting. Mentioned during the discussion was an earlier survey conducted by TechRanch of its investors, most of whom noted the usefulness of tax credits

rather than capital gains incentives for angel investors. One respondent said that the problem in Montana for angel investors is a lack of deal flow; if good deals existed, the investor said, investment would follow without incentives. Also at that meeting, Trent Williams of Regional Technology Strategies reviewed other options presented in an RTS paper to the Governor's Office of Economic Development²³ regarding promotion and enhancement of angel investment in Montana. Among the options were to organize and facilitate angel investor networks or offer tax credits, tax exemptions, or tax-favored treatment of capital gains from investments. The report noted that investing less than \$50,000 a year in educational and networking activities would provide a boost that could lead to angel investors assuming the role in later years. Although some networking already is taking place, those who now are providing assistance said that outside support would ensure continued networking until an angel investor network takes up the work on its own.

Based on discussions of whether to provide tax credits to angel investors as well as to those investing in a fund of funds, the members of the working group at the June meeting suggested that the fund of funds approach should rely on tax credit incentives, while the approach for angel investors should center on developing educational and network support. Participants at the meeting noted that a competition in the Legislature for tax credits could hurt both approaches.

Development of fund of funds legislation began with a directive in May from the Committee to focus on a fund of funds approach, relying on deferred, contingent tax credits in a program with low to no cost for the state. The Committee asked that ad hoc advisory group members, which included staff from the Governor's Office and the State Auditor's Office, present one bill for the Committee's consideration. That bill is discussed in the next chapter.

²³Regional Technology Strategies, Inc., "Options for the Promotion and Enhancement of Angel Investment in the State of Montana", June 5, 2004.

7 ■ Proposed Legislation on Venture or Equity Capital Issues

The Committee wrapped up its work on economic development by looking at two prospective Committee bills and bill drafts presented by the Montana Economic Developers Association (see Chapter 8). The two drafts submitted as potential Committee bills were:

- a resolution (LC0249) urging the Governor's Office of Economic Development to put a high priority on the development of networks of angel investors in Montana; and
- a bill (LC5600) establishing contingent, deferred tax credits for investors in a revolving fund developed by a private-sector investor group chosen by what would be a newly created Montana Capital Investment Board.

The Committee debated at its July 1, 2004, meeting whether a resolution or a bill was appropriate for encouraging angel networks. Senator Jeff Mangan recommended that the Committee show support for the concept by requesting funding through a bill rather than urging support through a resolution. The Committee voted to move forward with the resolution with the expectation that the results would be as efficient as a bill would have been. A draft of the resolution is in Appendix C.

The fund of funds draft, as proposed to the Committee, provided for a total of \$60 million in contingent, deferred tax credits, available at no more than \$10 million a year to investors participating in a revolving fund managed by a designated investor group selected by a new Montana Capital Investment Board. An investor would hold a certificate that provides conditions for obtaining tax credits against any tax liability due under Title 15, chapter 30 or 31, MCA, or due under 33-2-705, MCA. The conditions include eligibility to use the tax credits only if a scheduled rate of return is not achieved. The Montana Capital Investment Board must approve the rate of return, outlined in a contract between the investor and the designated investor group and limited to no more than the sum of 400 basis points and the return on a U.S.

Treasury obligation with a maturity similar to the investment being made. Tax credits would make up the difference between the scheduled return and achieved returns. The members of the ad hoc working group who recommended the fund of funds structure sought to avoid constitutional concerns by deciding to exclude provisions for the state to loan money to the fund of funds, which may have violated either the constitutional prohibition against creating a state debt unless authorized by a two-thirds vote of each house of the Legislature (Article VIII, section 8) or the limitations on the state investing in private corporate capital stock (Article VIII, section 13). One section of the draft specifies that investments in the designated investor group's revolving fund are permissible for a range of regulated entities, including banks.

Among recommendations from the ad hoc advisory group was a proposal to establish a specific Montana fund within the revolving fund. The group was uncertain whether draft language in LC5600 would generate enough investment in Montana. That language says that the designated investor group's investment plan must outline how the investor group will "seek to cause" \$1 of investment in a Montana company for every \$1 invested in the revolving fund. To ensure more investment in Montana, the ad hoc advisory group's final draft recommendation for LC5600 included a Montana Evergreen Fund as a subfund of the revolving fund. The subfund also would be managed by the designated investor group, which would reinvest into Montana-directed investments any proceeds beyond those needed to pay off investors and the fund managers.

After reviewing the fund of funds bill draft (LC5600) at the September 7, 2004, meeting, the Committee heard public comments. Most were in support of the bill. Some suggested refinements, particularly on how to incorporate Montana-specific investments in exchange for credits against Montana taxes. Committee questions ranged from the number of investments likely to occur in Montana to the political appropriateness of using tax credits to attract investments that could be made for high returns out of state. Representative Nancy Rice-Fritz repeated a concern voiced by presenters at the May 2004 meeting regarding the difficulty of jointly pursuing optimal investment returns and optimal, local economic development results. Citing

the complexity of the bill draft and concerns about the potential flow of investments outside of Montana, the Committee decided (through lack of a motion) not to introduce the draft as a Committee bill even though some members noted their individual support for equity capital legislation.

8 ■ Proposed Legislation From Economic Developers

The Montana Economic Developers Association (MEDA) sought Committee support for various proposals brought forth by MEDA membership.²⁴ The Committee agreed to request drafts and consider as Committee bills the following:

- a reduction in the tax rate on new industrial and real property (in class five property) from 3% to 1% and an expanded definition of industries eligible for the lower tax rate;
- a revision of 15-24-1402, MCA, to allow an existing business to qualify for a local government property tax reduction if the business invests in significant expansions;
- a revision of Title 39, chapter 11, parts 1 and 2, MCA, the Primary Sector Business Workforce Training Act (created by HB 564 in 2003) to streamline the review process and the process for demonstrating that a business has met its loan payoff requirements. The requested changes also provide for more direct training ties with the colleges of technology.
- a revision of 15-10-420, MCA, similar to HB 596, which died during the 2003 session, to allow local governments to adopt a permissive levy of up to 2 mills for economic development under either 7-14-1131 or 90-5-112, MCA. The levy would not be subject to the mill levy cap for local governments.

Staff provided LCmed1 for the latter request, regarding exemption of local government economic development mill levies from the limitation under 15-10-420, MCA. For the first two proposals, staff incorporated both references involving an expanded definition of industries eligible for a lower tax rate into one proposal, LCmed2.²⁵ The need for MEDA and the Board of Investments to further discuss

²⁴See "MEDA Proposals for Legislation", http://leg.mt.gov/css/committees/interim/2003_2004/econ_affairs/meeting_materials/6_30.asp.

²⁵These bills are available on the Committee website under Proposed Committee Legislation.

changes to the Primary Sector Business Workforce Training Act resulted in that request being put on hold, which meant that the Committee had no legislation to review.

At the September 2004 meeting, the Committee discussed concerns that LCmed1 did not require a local vote to increase the mill levy and also noted that LCmed2 provided somewhat targeted application of tax breaks. The combination of concerns chilled any desire to accept either draft as a Committee bill among the six members present for the discussion, and no member moved to recommend the bill drafts.

9. Summary and Conclusion

From the Committee's first meeting, members addressed a broad range of economic development issues but maintained a constant focus on the state's role in venture or equity capital formation and investment. In an effort to maintain a broad perspective, the Committee solicited opinions about economic development from fellow legislators, from those participating in the Shared Leadership program being spearheaded by the Board of Regents, and from the public. A working group on venture capital voluntarily traveled multiple times to Helena (or to Bozeman for one meeting) to help shape the discussion on venture capital issues and possible solutions for the State of Montana. The working group provided to the Committee a bill draft recommending tax credits associated with a fund of funds and a draft of a resolution asking the Governor's Office of Economic Development to promote networking of angel investors. Only the resolution received unanimous support from the Committee. The fund of funds bill draft, although not supported as a Committee bill, already had been on the slate of bill requests from the State Auditor's Office and approved for drafting by the Committee. That bill draft, along with bill drafts considered from MEDA but not adopted by the Committee, are expected to be introduced by individual legislators. The Committee's expectation is that the material that the members reviewed and the testimony that they heard will result in better-informed votes and discussions during the 2005 legislative session.

Appendix A

Economic Affairs Interim Committee Draft Work Plan for the 2003- 2004 Interim

Prepared by
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Legislative Services Division
(Revised as of July 2, 2004 for final meeting date change)

I. Introduction

The Economic Affairs Interim Committee is assigned by law, 5-5-223, MCA, to monitor the following state agencies and the entities attached to these agencies for administrative purposes:

- Department of Agriculture
- Department of Commerce
- Department of Labor and Industry
- Department of Livestock
- State Auditor and Insurance Commissioner
- Governor's Office of Economic Development
- State Fund²⁶

Agriculture and ranching, tourism and commerce of all types, and the service industries all contribute in key ways to economic affairs and economic development in Montana. Over the interim, the committee will hear from the industries, the public, and state agencies about policy concerns that top their lists related to economic activity, workforce issues, and the general business environment in Montana.

²⁶Although the State Fund is administratively assigned to the Department of Administration under 2-15-1019, MCA, a Memorandum of Agreement was established during the 1999-2000 interim between the Economic Affairs Interim Committee's predecessor, the Business and Labor Interim Committee, and the State Administration, Public Retirement Systems, and Veterans' Affairs Interim Committee. The agreement was to assign State Fund to the Business and Labor Interim Committee, in part because the Business and Labor Committee had been assigned an interim study dealing with State Fund. In the 2001-2002 interim the Economic Affairs Interim Committee continued to include the State Fund in its monitoring activities. The State Administration Interim Committee and the Economic Affairs Interim Committee have agreed to a similar transfer arrangement for the 2003-2004 interim.

The proposed meeting schedule, operating within budget restrictions, is for seven meetings:

<u>General Meeting Topics</u>	<u>Date</u>
Introductory Meeting	June 11, 2003 (Wednesday)
Work Comp Study/Economic Development	October 23-24, 2003 (Thurs.-Friday)
Work Comp Study/Agency Update	January 23, 2004 (Friday)
Work Comp Study/Economic Development	March 11, 2004 (Thursday)
Work Comp Study/Economic Development	May 5, 2004 (Wednesday)
Legislation Review	June 30-July 1, 2004 (Wed.- Thursday)
Final Reports/Legislation Review	September 7, 2004 (Tuesday)

The meetings will focus on the SJR 17 study of workers' compensation and occupational disease statutes and rules, rule review, oversight, and legislative proposals from the Committee and from agencies for which the Committee is responsible.

Interim committee work is to be completed by September 15, 2004. Study reports, if written, and recommendations, including proposals for legislation, must be in final form by that date.

II. ***Statutory Obligations and Review of Duties***

5-5-215. Duties of interim committees. (1) Each interim committee shall:

- (a) review administrative rules within its jurisdiction;
 - (b) subject to 5-5-217(3), conduct interim studies as assigned;
 - (c) monitor the operation of assigned executive branch agencies with specific attention to the following:
 - (i) identification of issues likely to require future legislative attention;
 - (ii) opportunities to improve existing law through the analysis of problems experienced with the application of the law by an agency; and
 - (iii) experiences of the state's citizens with the operation of an agency that may be amenable to improvement through legislative action;
 - (d) review proposed legislation of assigned agencies or entities as provided in the joint legislative rules; and
 - (e) accumulate, compile, analyze, and furnish information bearing upon its assignment and relevant to existing or prospective legislation as it determines, on its own initiative, to be pertinent to the adequate completion of its work.
- (2) Each interim committee shall prepare bills and resolutions that, in its

opinion, the welfare of the state may require for presentation to the next regular session of the legislature.

(3) The legislative services division shall keep accurate records of the activities and proceedings of each interim committee.

The Economic Affairs Interim Committee Duties

A. Rule Review

Each interim committee is responsible for reviewing rules promulgated by the agencies that the committee monitors. Committee legal staff will review the agency rulemaking notices and provide regular updates. According to the Montana Administrative Procedure Act (MAPA), the committee charged with reviewing agency rules may:

- request agency rulemaking records for ensuring compliance with MAPA;
- submit recommendations regarding the adoption, amendment, or rejection of a rule;
- require that a hearing be conducted;
- participate in proceedings;
- review the conduct of administrative proceedings.

Action item: The Committee is encouraged to determine how active it will be in reviewing agency rules during the interim. Among the options are:

- a) a written report by legal staff at each meeting of proposed rules and adoption notices for each agency monitored by legal staff for the Committee;
- b) oral summary reports at each meeting on topics that legislators have flagged as important or of concern, with copies of letters sent by legal staff to an agency regarding legal concerns with a rule;
- c) periodic updates on issues that Committee members have requested or that are considered by staff to be particularly important to the Committee's interim work or that a member of the public has requested be placed on the Committee agenda.

B. Program Monitoring

Pursuant to 5-5-215, MCA (Duties of Interim Committees), the Committee shall monitor the operation of assigned agencies with specific attention paid to:

- identifying issues likely to require future legislative attention;
- improving existing law; and
- seeking the input of citizens regarding the operation of agencies.

Action item: Committee members are encouraged to make suggestions about which activities of which agencies they would like additional information. Prior to the second meeting, planned for October 24, 2003, the Committee is encouraged to decide if reports by each agency to the Committee should be focused on particular issues or should be a broad overview.

C. Draft Legislation Review

Draft legislation review is intended for both the interim committee's suggested legislation and for legislation to be proposed by agencies monitored by the Committee. The agencies are expected to have submitted their proposals to the Governor's Office by June 2004. Interim legislative committees then review according to Joint Rule 40-40(5)(a): "Unless requested by an individual member, a bill draft request submitted at the request of an agency must be submitted to, reviewed by, and requested by the appropriate interim or statutory committee." More information will be available closer to the review dates.

In 2001-2002, the Economic Affairs Interim Committee handled the following bill requests:

Department of Agriculture	7 (4 bills became law, 2 drafts canceled)
Department of Commerce	4 (3 bills became law, 1 draft canceled)
Department of Labor and Industry	7 (7 bills became law)
Department of Livestock	0
State Auditor and Insurance Commissioner	22 (12 bills became law, 4 drafts canceled)
Governor's Office	9 (2 bills became law, 7 drafts canceled)
State Fund ²⁷	0
Total:	49 (28 bills became law, 14 drafts were canceled, 7 bills died in the process)

III. *Study Activities*

The Legislative Council on May 22, 2003, assigned Senate Joint Resolution No. 17 to the Economic Affairs Interim Committee. As background, SJR 17 was requested by Sen. Jon Tester as a response to concerns from the insurance industry that the workers' compensation and occupational disease statutes are confusing and cost too much time and money for compliance.

SJR 17 proposes to:

²⁷See footnote 1.

—Clarify a patchwork of work comp laws (which may save time and money in compliance).

—Review statutes in conjunction with administrative rules for simplification and clarity.

—Assess definitions and concepts in light of changing employment practices and court cases.

—Review existing exemptions for discrimination or failure to meet the intent of work comp policy.

The Economic Affairs Interim Committee also has the opportunity to address recent Supreme Court decisions on workers' compensation to determine if statutory changes are advisable and to determine whether administrative rules that seek to implement court decisions might instead be incorporated into new legislation. One court case, in particular, raises a question of whether the Workers' Compensation Act and the Occupational Disease Act might be merged. In *Stavenjord v. Montana State Fund*, decided April 1, 2003, the Supreme Court's majority opinion, written by Justice Terry Trieweiler, said in part: "...we conclude that the disparate treatment of disabled workers based simply on the length of time over which their injury or disease is sustained is not rationally related to that legitimate government interest." The government interest referenced is "to provide a wage loss benefit which bears 'a reasonable relationship to actual wages lost as a result of a work-related injury or disease.'" The length of time over which the injury or disease is sustained refers to the work comp definition of injury and the Occupational Disease Act's reference to disease that develops over time. (Injury is defined in 39-71-119, and occupational disease is defined in 39-72-102(10).) For the court case, see:

<http://www.lawlibrary.mt.gov/dscgi/ds.py/Get/File-20509/01-630.wp9.pdf>

Accordingly, the work plan for SJR 17 proposes some key tasks:

- Review **administrative rules and statutes** (excluding benefits)
 - for clarity, duplication
 - what were reasons for adoption and do they meet the overall work comp policy?

- Review recent decisions from work comp/occupational disease court cases and their impact on **concepts**
 - differences between work comp and occupational disease
 - exclusive remedy

- types of cases/sections of law or administrative rule being challenged
- Review **terms, definitions, exemptions**
 - stakeholder analysis/suggestions (employers, employees, Dept of Labor, others)
 - possible joint meetings with SB304 committee and SB270 committee
- Selectively compare how nearby states legislate or decide court cases regarding workers' compensation and occupational disease
 - differences, similarities, e.g.: occupational disease vs. injury, exclusive remedy
- Determine other stakeholder concerns

IV. *Other Interim Activities*

The Committee's opportunity to "accumulate, compile, analyze, and furnish information" related to assignments and to existing or prospective legislation means that guest speakers may be scheduled to provide information on economic development or other relevant topics, depending on availability of budget funds. The Committee may want to invite economists who have studied Montana's employment, for example, to address a Committee meeting, perhaps in conjunction with economic development officers from the regional economic development organizations.

The Committee also will be responsible for receiving information on studies required under SB 315, a study by the Office of Economic Development (if funds are available) of conditions affecting railroad freight competition in Montana, and SB 304, recommending a study to determine the feasibility of selling the State Fund and creating an assigned risk pool.

V. *Member Issues*

A convergence regarding Sen. Jeff Mangan's request to look at issues related to Venture Capital, Sen. Mike Taylor's request for a history of state expenditures related to economic development programs, and the Committee's stated interest in participating where appropriate in activities related to the Regents' proposal for a coordinated state economic development plan has meant that economic development has taken a larger portion of staff time. The Committee directs staff to coordinate the economic development activities and research being done on behalf of the Committee with the development of a statewide economic development plan coordinated by the Regents and to keep the Committee apprised of activities related to the coordinated statewide economic development plan. The

Committee will continue to address economic development issues as one of two major topics for the remainder of the schedule. Member-proposed activities may be proposed and addressed as meeting time allows.

VI. Staff Recommendations for Additional Activities

Given the Committee's overall interest in economic development, the staff recommends that the focus remain on economic development as related to: venture capital; prospective changes in state programs related to economic development; and the proposal initiated by the Board of Regents for a coordinated state economic development plan. Additional activities will be proposed to the Committee as meeting time allows.

VII. Tentative Interim Calendar

In addition to an organizational meeting, staff recommends that the Committee meet six times during the interim and encourages the Committee to adopt the following meeting calendar, subject to change.

1. October 23-24, 2003
2. January 23, 2004
3. March 11, 2004
4. May 5, 2004
5. June 30-July 1, 2004
6. September 7, 2004

Meetings will be in Helena, unless Committee members request another location. If a different location is selected, the Committee may need to reassess priorities to accommodate changes. Members are encouraged to decide early in the interim whether meetings should be scheduled outside of Helena, due to the fact that those days require additional resources and logistical demands to ensure adequate space and notice to the public.

VIII. Web Resources

Information about the Committee is available through the legislative website, under Committees, Interim, Economic Affairs. At that site, staff will post information regarding Committee activities, minutes, agendas, study reports, and relevant information. The site also provides links to the websites of agencies for which the Committee is responsible.

Legislative Services:

<http://leg.mt.gov/css/default.asp>

IX. Matrix for Prioritizing the Focus of Meetings

The following table provides a brief description of the Committee's involvement over the course of the interim. The columns highlighting priority are designed to spur discussion and offer the members an opportunity to choose how best to allocate their time. It is anticipated that choosing the highest priority column for each activity will seriously tax the Committee's time, staff resources, and budget. However, the table is an estimate and is fluid enough to allow for flexibility and resource reallocation.

ACTIVITY	HIGH PRIORITY	MEDIUM PRIORITY	LOW PRIORITY
<i>RULE REVIEW</i> <i>Chosen option</i>	Instruct staff to present regular updates on all proposed rule notices at each scheduled meeting.	Instruct staff to consult with the Committee presiding officer on rule review issues that are of particular interest to the members and schedule updates as necessary.	Respond to rule review requests from the public or legislators as those requests arise throughout the interim. XX
<i>AGENCY MONITORING</i> <i>Chosen option</i>	Develop a schedule for agencies to present a systematic review of programs administered, allowing for separate issues to be developed and discussed as needed. XX	Instruct staff to develop a formal list of questions, to be approved by the Committee, and allocate time for each agency to address the specific questions.	Request background information from agencies and additional information when the Committee becomes aware of issues associated with agency performance.
<i>DRAFT LEGISLATION REVIEW</i> <i>Chosen option</i>	Work throughout the interim with agencies as they begin to prioritize legislative proposals.	Develop a formal review/comment process for draft legislation proposed by each agency.	No formal review process developed; overview of concepts on each piece of legislation presented. XX

ACTIVITY	HIGH PRIORITY	MEDIUM PRIORITY	LOW PRIORITY
<p><i>ASSIGNED STUDY - SJR 17</i></p> <p><i>Chosen option</i></p>	<p>Full Committee participation with staff and stakeholder input from meetings outside committee. Updates of outside meetings, with periodic committee decisions on next steps.</p> <p>XX</p>	<p>Subcommittee appointed. Periodic updates of subcommittee activities throughout the interim with final recommendations being made at the May or June 2004 meeting.</p>	<p>Staff reports, limited discussions before subcommittee; final recommendations made by subcommittee, based on findings and conclusions.</p>
<p><i>MONITORING IMPORTANT ACTIVITIES</i></p> <p><i>Chosen option</i></p>	<p>Outline a schedule of topics to be addressed at each meeting.</p>	<p>Staff prepares "white papers" on topics of interest. Discussion by Committee.</p>	<p>Topics limited to those presented by interested persons who ask to be on agenda.</p> <p>XX</p>
<p><i>MEMBER ISSUES</i></p> <p><i>Chosen option</i></p>	<p>Identify member issues early in the interim and assign staff or working group for member issues. Develop related legislation.</p> <p>XX</p>	<p>Instruct staff to research issues and prepare options as issues arise; present findings for Committee consideration, possible legislation.</p>	<p>Address member issues as time allows and include in "monitoring important activities."</p>
<p><i>STAFF Recommendations</i></p> <p><i>Chosen option</i></p>	<p>Incorporate ongoing issues into regular schedule.</p>	<p>Add ongoing issues for discussion as time permits</p> <p>XX</p>	<p>Provide background information in packets.</p>

Appendix B

Possible Topics for Committee Consideration over the Interim

(Only 4-5 meetings open for speakers. Issue briefs limited to time needed for research. Audit is a request. Issues should be considered in terms of policy at state level. Some issues may overlap other committees.)

Topic	Background Info	Speaker	Issue Brief	Audit, Other
Workforce Training Issues	Chamber of Commerce Dept. Labor and Industry			
Economic Development Involving University System (Patents, Competition, etc.)	MUS report Regent Mercer's outline			
Venture Capital Programs — Is there a state role?	Department of Commerce Office of Economic Dev. Venture Capital experts			
Effectiveness of Microbusiness Development Loans	Department of Commerce Reg'l Econ. Dev. Orgs			
Effectiveness of Tax Credits, Other Incentives	Economists at MSU, UM, elsewhere?			
Cluster Study	Office of Economic Dev.			
Business Recruitment - State's Role	Office of Economic Dev. Dept. of Commerce			
Tourism Promotion efforts - effectiveness and need	Department of Commerce UM Institute Tourism/Rec.			
Implications for Montana of Mad Cow Disease	Department of Livestock, Stockgrowers Assn.			
Genetically Modified Organisms - Implications for MT agriculture	Department of Agriculture Organic Farmers, Farmers pro and con, Researchers at MSU, UM			

Topic	Background Info	Speaker	Issue Brief	Audit, Other
Country of origin labeling - Feed lots - Niche markets	Department of Livestock, Grocery Stores			
Economic impacts to agriculture of ethanol plants (update to progress)	Department of Agriculture, Department of Transport.			
Economic implications of fossil fuel energy proposals (coal- bed methane, coal generation, oil/natural gas on Rocky Mountain Front)	Industry advocates Chambers of Commerce Reg'l Economic Dev Orgs Conservationists UM, MSU Economists			
Economic implications of alternative energy developments in MT	Industry advocates Chambers of Commerce Reg'l Economic Dev Orgs Conservationists UM, MSU Economists			
Economic Implications in MT of WTO Ruling on Canadian Lumber	MT Logging Assn. UM Forestry School World Trade Council			
State Auditor's Study on Home Insurance Rates	State Auditor Industry Reps.			
Economic Effects in MT of proposed federal contracting, (nat'l parks, etc.)	Federal Agency Reps. Independent Contractors			
Local impacts of federal limits re: Liability insurance for Asbestos Claims	Congressional Delegation Libby representatives Industry representatives			
Liaison with Legislative Council's study on medical malpractice insurance rates	Legislative Council			

Topic	Background Info	Speaker	Issue Brief	Audit, Other
Status of Organized Labor in Montana	AFL-CIO MEA-MFT, Others			
Family farm/ranch survival and real estate in MT	Departments of Agriculture & Livestock, Land trusts, Realtors, Ranch/Farm owners			
Effect of Energy Rate Hikes on Business/Consumers	PSC Energy/Telecom Cmte, REAs			
Level of Ag Value-Added	Experiment Stations			

7/8/03

Appendix C

Draft Legislation

Draft Resolution for Developing an Angel Investor Network

Introduced By *****
By Request of the *****

A Joint Resolution of the Senate and the House of Representatives of the State of Montana urging the Governor's Office of Economic Development to set as a high program priority the pursuit of funding for and the ongoing oversight of a pilot project that develops nonprofit groups and networks of individual or accredited or "angel" investors willing and financially able to provide seed capital for startup businesses in Montana; and urging the Governor's Office of Economic Development to place a high priority on coordinating throughout the state and with the Board of Regents the training and educational programs provided by all levels of government, education, and the private sector to businesses in Montana.

WHEREAS, Montana is a large state with limited concentrations of wealth and few avenues to share investment information regarding entrepreneurial, startup, Montana-focused business opportunities; and

WHEREAS, Montana in 2003 had more than 2,000 manufacturing companies with sales between \$500,000 and \$25 million, a group representative of companies likely to seek out equity financing; and

WHEREAS, the U.S. Office of Technology Policy ranked Montana in 2000 as 33rd in the nation among states, both for amounts of venture capital funding invested (\$15 million) and for a 3-year sum of initial public offering funds raised (\$13 million); and

WHEREAS, Montana's rural nature and geographic isolation from traditional venture capital investors mean that Montana businesses may be off the radar screen for typical venture capital funds; and

WHEREAS, Montana's University System, nonprofit organizations, and state agencies are working both separately and collaboratively to provide a range of services to startup businesses.

NOW, THEREFORE, BE IT RESOLVED BY THE SENATE AND THE HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA:

That the Governor's Office of Economic Development:

(1) assign a high priority to developing, in collaboration with private organizations, and educating groups of accredited or "angel" investors, as defined in Regulation D of the Securities Act of 1933 or Rule 501 of the Securities and Exchange Commission, if these individuals are willing to contribute money or personal time to the growth of Montana businesses that have the potential to provide an above-average return on investment;

(2) seek out funding opportunities and grants to initiate a pilot project that provides assistance to private organizations to develop or further develop at least four geographically distinct groups of "angel" investors in Montana; and

(3) coordinate the activities of Montana's education system, nonprofit organizations, and state agencies involved in educating investors and entrepreneurs.

BE IT FURTHER RESOLVED, that the Governor's Office of Economic Development report any findings, conclusions, comments, or recommendations to the appropriate interim committee prior to the convening of the 60th Legislature.

- END -

Draft Bill for Creating a Montana Equity Fund of Funds

LC 5600
Introduced by *****
By Request of *****

A Bill for an Act creating the Montana Equity Capital Investment Act; creating a Montana Equity Capital Investment Board; providing duties of the board; providing tax credits to investors in the Montana equity fund or their assignees; providing for private-sector organization and management of the Montana equity fund; providing for distribution of proceeds earned from Montana equity fund investments; providing for transfers of tax credits; requiring approval of state securities commissioner for exemption as security; amending sections 33-2-705 and 90-1-112, MCA; and providing an effective date.

Be it enacted by the Legislature of the State of Montana:

NEW SECTION. Section 1. Short title. [Sections 1 through 16] must be cited as the "Montana Equity Capital Investment Act".

NEW SECTION. Section 2. Purpose. The purpose of [sections 1 through 16] is to benefit Montana by attracting out-of-state venture investment funds interested in providing equity capital and near-equity capital to Montana entrepreneurs and economic innovators in Montana. Through investment incentives, the state seeks to nourish creation of a private seed and venture capital industry in Montana to fund academic, technological, and innovative startup companies. A further purpose is to develop lead local investors with which out-of-state venture investors can partner in a way that strengthens the state's economy and builds a significant, permanent capital resource available to serve the needs of Montana businesses in a way that minimizes the use of state funds or tax credits.

NEW SECTION. Section 3. Definitions. As used in [sections 1 through 16], unless the context requires otherwise, the following definitions apply:

- (1) "Board" means the Montana capital investment board provided for in [section 4].
- (2) "Certificate" means the document authorized by the board for which contingent, deferred tax credits may be available pursuant to a contract between the board and the designated investor group.
- (3) "Certificate holder" means the person to whom a tax credit initially is allowed pursuant to [section 8] and any person

who receives a tax credit allocated under [section 8] under a transfer agreement that meets the registration and verification requirements provided for in [section 6].

(4) "Designated investor group" means the investor group selected by the board pursuant to [section 5].

(5) "Equity capital" means cash invested in common or preferred stock, royalty rights, limited partnership interests, limited liability company interests, and any other securities or rights that evidence ownership in private business.

(6) "Investor" means any individual, corporation, partnership, limited liability company, or other legal entity organized under state or federal laws that has contracted with the designated investor group and invested in the Montana equity fund.

(7) "Montana equity fund" means the private investment fund to be organized, capitalized, and administered by the designated investor group, pursuant to [section 10]

(8) "Montana evergreen fund" means the private investment fund to be organized, capitalized, and administered by the designated investor group as a subfund of the Montana equity fund with investments to be made in primary sector businesses as defined in 39-11-103. These businesses must be headquartered in Montana or have 50% of gross sales receipts from products principally produced in Montana or services provided from a Montana location.

(9) "Near-equity capital" means cash invested in unsecured, under-secured, subordinated or convertible loans or debt securities.

(10) "Person" means an individual taxpayer as defined in 15-3-101 or a corporation as defined in 15-31-101.

(11) "Proceeds" means revenue arising from the designated investor group's investments net of contractual obligations to investors and fees obligated to the designated investor group.

(12) "Tax credits" mean credits allowed pursuant to [section 8] and available to a certificate holder against tax liabilities imposed by Title 15, chapter 30 or chapter 31, or by 33-2-705.

NEW SECTION. Section 4. Montana capital investment board.

(1) There is a Montana capital investment board. The board has the authority to carry out activities provided in [sections 1 through 15].

(2) The board consists of five voting members appointed by the governor. Members must be selected based upon demonstrated expertise and competence in the supervision of investment managers, in the fiduciary management of investment funds, or in the management and administration of tax credit allocation programs. Members may not have an interest in the designated investor group or in any person to whom a tax credit is allocated and issued by the board.

(3) Board members shall serve staggered 4-year terms as provided in 2-15-124.

(4) The board shall meet at least once a year.

(5) The governor shall designate a presiding officer.

(6) The governor may, after a hearing, remove a member for neglect of duty or other just cause.

(7) Vacancies must be filled in the same manner as the appointment of the original members.

(8) Members must be compensated for expenses and mileage, as provided in Title 2, chapter 18, part 5, but members may not receive a director's fee, per diem, or salary for service on the board.

(9) Liability of members of the board is limited as provided in Title 2, chapter 9, part 1.

(10) The board is attached to the department of commerce for administrative purposes as provided in 2-15-121.

NEW SECTION. Section 5. Duties of the board -- appointment or termination of designated investor group -- investment plans -- rulemaking -- public meetings -- exceptions.

(1) The board may hire and fire staff, engage consultants, expend funds, contract, or terminate a contract.

(2) (a) The board shall solicit investment plans from investor groups for the raising and investing of equity capital and near-equity capital pursuant to [sections 1 through 16]. An investment plan must address:

(i) the applicant's philosophy and process;

(ii) evidence of probable success in building equity capital;

(iii) past experience and expertise in the design, implementation, and management of venture capital investment programs or in capital formation;

(iv) a plan for achieving the purposes of [section 2]; and

(v) a plan for achieving Montana investment as described in [section 10(2)].

(b) The board shall select, certify as the designated investor group, and contract with the one investor group considered best qualified to organize, capitalize, manage, and direct the Montana equity fund and the Montana evergreen fund and to make investments in private seed and venture capital partnerships or entities based on the investment plan provided for in subsection (2) (a).

(3) The board shall monitor the implementation of the investment plan provided for in subsection (2) and may terminate the contract of the designated investor group for lack of compliance with the contract, including but not limited to the specifications for Montana investment in [section 10].

(4) The board shall approve the designated investor's scheduled rate of return to the certificate holder and the payout periods for the scheduled rate of return. The scheduled rate of return may not exceed the sum of 400 basis points and the return on a U.S. Treasury obligation that has a maturity similar to the investment being made by the certificate holder. These rates, whether fixed rates or variable rates, must be reasonable and prudent, based on competitive market rates.

(5) The board may adopt rules to implement [sections 1 through 15].

(6) (a) Except as provided in subsection (6) (b), the meetings of the board are public.

(b) The board may close the portion of a meeting that involves information related to trade secrets or proprietary information of investor groups that is protected under Title 30, chapter 14, part 4.

NEW SECTION. Section 6. Tax credit registration and verification system. The board shall develop, in conjunction with the department of revenue, a system for registration of tax credits allowed or transferred under [section 8] and a system that permits verification of the validity of a tax credit or a tax credit transfer pursuant to [section 8].

NEW SECTION. Section 7. Fee -- state special revenue account. (1) The board shall charge the designated investor group

an annual fee that is reasonable and commensurate with costs for implementation of [sections 1 through 15].

(2) Fees collected under this section must be deposited in an account in the state special revenue fund to the credit of the board. The funds deposited in the state special revenue account may be used only to defray the expenses of implementing [sections 1 through 16].

NEW SECTION. Section 8. Contingent, deferred tax credits.

(1) (a) A total of \$60 million of tax credits is available to certificate holders. No more than \$10 million of tax credits may be claimed in a year.

(b) In calculating the \$10 million of tax credits that may be claimed in a year, the board shall notify the department of revenue or the state auditor, as applicable, of all tax certificates presented for redemption in each year and the amount of current or past tax liabilities, as described in subsection (5), against which the tax credits are to be applied.

(c) Tax credits must be allocated on a first-come, first-served basis.

(d) Expired tax credits do not count against the aggregate calculated in subsection (1)(b).

(2) A tax credit may not be claimed prior to July 1, 2010, or after July 1, 2031.

(3) Tax credits may be claimed or redeemed by a certificate holder only in accordance with conditions set forth in the certificate issued by the board.

(4) The certificate must state the amount of the tax credit and the tax year in which the tax credit may first be claimed or redeemed as provided in this section and [section 9].

(5) Subject to subsection (2) a tax credit may be carried forward by the holder up to 12 years and may be carried back against up to 3 years of tax payments made by the certificate holder. Tax credits carried back against a prior year's paid taxes do not generate an interest obligation to the taxpayer by the state.

(6) (a) The amount of tax credits certified for use by investors in the Montana equity fund is limited to an amount that offsets a shortfall in the scheduled returns of invested capital at rates of return in the contract between the designated investor group and the investor as approved by the board.

(b) The certificate must contain the conditions for claiming a tax credit, including:

(i) the scheduled rate of return for the holder and all predecessors of the holder of the certificate;

(ii) the formula by which a shortfall in returns of invested principal and interest is to be calculated;

(iii) the upper limit of tax credits available under the certificate; and

(iv) the dates by which the tax credits may be first redeemed and last redeemed.

(7) A holder of a certificate may transfer the certificate and the associated tax credits.

(8) An individual may claim the tax credit of an investor group, including a partnership, limited liability company, C. corporation, S. corporation, estate, or trust electing to have income taxed directly to the individual. An amount claimed by the individual must conform to the provisions of this section and be based upon the pro rata share of the individual's earnings from the partnership, limited liability company, C. corporation, S. corporation, estate, or trust.

NEW SECTION. Section 9. Redemption of tax credits. (1)

When a certificate holder submits a certificate for redemption, the board shall request documentation from the designated investor group regarding a shortfall in the scheduled rate of return listed on the certificate. The board shall calculate the amount of the allowable tax credit based upon the specifications in the certificate and the documentation from the designated investor group.

(2) The board shall notify the department of revenue or the state auditor, as applicable, of the maximum amount of a tax credit that may be claimed by a certificate holder who has presented a certificate for redemption.

NEW SECTION. Section 10. Designated investor group duties

-- contract with board. (1) The designated investor group shall organize, capitalize, and administer the Montana equity fund **and a Montana evergreen fund** pursuant to its contract with the board.

(2) The contract between the board and the designated investor group must contain the following language as part of the designated investor group's implementation plan regarding

investments in the Montana equity fund: "For every \$1 invested by the Montana equity fund in its aggregate portfolio of fund investments, the designated investor group shall seek to cause a minimum of \$1 of equity capital or near-equity capital investments to occur in businesses that are headquartered in Montana or have 50% of gross sales receipts from products principally produced in Montana or services provided from a Montana location".

(3) The contract language between the board and the designated investor group also must identify the investments required in subsection (2) as made:

(a) by the Montana equity fund directly;

(b) by investors in the Montana equity fund who have invested in the Montana equity fund without receiving a tax credit certificate; or

(c) syndicated investment partners of the investors in the Montana equity fund.

(4) The designated investor group may receive fees for its services. Fees paid to the designated investor group may not be used for lobbying, governmental relations, litigation of the contract with the board, or penalty payments to the state.

(5) A contract between the designated investor group and the board must include:

(a) terms under which the designated investor group will share with the state any proceeds. The board may allocate no more than 10% of the proceeds to the designated investor group exclusive of fees.

(b) the term of the contract, which may exceed 7 years, and the effective date of the terms;

(c) provisions for allocating the proceeds, pursuant to subsection (2); and

(d) the timing of distributions.

(6) Distribution of the proceeds must be as follows: 75% to the Montana evergreen fund; up to 10% to the designated investor group, and the remainder to the general fund.

(7) The contract must include provisions for a transfer to a new designated investor group all investments in the Montana equity fund and the Montana evergreen fund upon termination of a contract.

(8) The contract must contain a termination clause for the Montana equity fund and the Montana evergreen fund providing for the liquidation of investments in both funds 50 years after

organization of the Montana equity fund. At termination, the proceeds from both funds must be deposited into the general fund.

(9) The designated investor group shall submit to the board for review the contract between the designated investor group and investors.

NEW SECTION. Section 11. Restrictions on investment. The designated investor group may not, without permission of the board, invest:

(1) more than 25% of the Montana equity fund or the Montana evergreen fund in any one company, its affiliates, and its subsidiaries.

(2) in a business venture if its investment in combination with investments by investors in the Montana equity fund exceeds 49% of the business venture's ownership at the time of the investment decision.

NEW SECTION. Section 12. Annual audit. (1) Each calendar year, the designated investor group shall provide to the board a financial audit performed by an independent auditor of:

(a) the investments made by the designated investor group through the Montana equity fund and the Montana evergreen fund; and

(b) the redemption of claiming of tax credits available to investors in the Montana equity fund.

(2) The designated investor group shall pay the cost of the audit.

(3) The audit must be delivered to the board, the governor, and the legislative audit committee annually.

(4) The audit must include a valuation of the assets owned by the Montana equity fund and the Montana evergreen fund as of the end of each year and a description of how the designated investor group has implemented the Montana investment plan described in [section 10].

NEW SECTION. Section 13. Annual report. (1) The designated investor group shall publish an annual report, which must include:

(a) a summary of the annual audit of the Montana equity fund and the Montana evergreen fund conducted pursuant to [section 11];

(b) a review of the designated investor group's progress in implementing its investment plan; and

(c) the number of certificates and the amount of tax credits claimed or redeemed under [section 9].

(2) The designated investor group shall provide copies of the annual report to the governor, an appropriate interim committee of the legislature, and the board.

NEW SECTION. Section 14. Permissible investments.

Investments in the Montana equity fund are permissible investments under applicable state laws for banks, credit unions, and insurance companies.

NEW SECTION. Section 15. Application for securities exemption. The designated investor group shall apply to the commissioner for an exemption under 30-10-104(11) for any securities transaction undertaken pursuant to [sections 1 through 15].

NEW SECTION. Section 16. Equity capital tax credit. There is allowed a credit against taxes otherwise due under this chapter as provided in [sections 1 through 16].

NEW SECTION. Section 17. Credit for equity capital investment. There is allowed a credit against taxes otherwise due under this chapter as provided in [sections 1 through 16].

Section 18. Section 33-2-705, MCA, is amended to read:

"33-2-705. Report on premiums and other consideration -- tax -- tax credit. (1) ~~Each~~ (a) After deductions pursuant to subsection (1)(b), each authorized insurer and each formerly authorized insurer with respect to premiums received while an authorized insurer in this state shall file with the commissioner, on or before March 1 each year, a report in a form prescribed by the commissioner showing:

(i) total direct premium income, including policy, membership, and other fees, premiums paid by application of dividends, refunds, savings, savings coupons, and similar returns or credits to payment of premiums for new or additional or extended or renewed insurance;

(ii) charges for payment of premium in installments; and

(iii) all other consideration for insurance from all kinds and classes of insurance, whether designated as a premium or otherwise, received by a life insurer or written by an insurer other than a life insurer during the preceding calendar year on account of policies covering property, subjects, or risks located, resident, or to be performed in Montana, with proper proportionate allocation of premium as to property, subjects, or risks in Montana insured under policies or contracts covering property, subjects, or risks located or resident in more than one state;

(b) ~~after deducting~~ Deductions are allowed from the total direct premium income for applicable cancellations, returned premiums, the unabsorbed portion of any deposit premium, the amount of reduction in or refund of premiums allowed to industrial life policyholders for payment of premiums direct to an office of the insurer, all policy dividends, refunds, savings, savings coupons, and other similar returns paid or credited to policyholders with respect to the policies. As to title insurance, "premium" includes the total charge for the insurance. A deduction may not be made of the cash surrender values of policies. Considerations received on annuity contracts may not be included in total direct premium income and are not subject to tax.

(2) Coincident with the filing of the tax report referred to in subsection (1), each insurer shall pay to the commissioner a tax upon the net premiums computed at the rate of 2 3/4%.

(3) That portion of the tax paid under this section by an insurer on account of premiums received for fire insurance must be separately specified in the report as required by the commissioner, for apportionment as provided by law. When insurance against fire is included with insurance of property against other perils at an undivided premium, the insurer shall make a reasonable allocation from the entire premium to the fire portion of the coverage as must be stated in the report and as may be approved or accepted by the commissioner.

(4) With respect to authorized insurers, the premium tax provided by this section must be payment in full and in lieu of all other demands for any and all state, county, city, district, municipal, and school taxes, licenses, fees, and excises of whatever kind or character, excepting only those prescribed by this code, taxes on real and tangible personal property located in this state, and taxes payable under 50-3-109.

(5) Insurers paying a premium tax under subsection (2) and holding a certificate pursuant to [sections 1 through 16] may redeem the certificate as a credit against the premium tax after excluding the portion of premiums identified in subsection (3).

(6) The commissioner may suspend or revoke the certificate of authority of any insurer that fails to pay its taxes as required under this section.

~~(6)~~ (7) In addition to the penalty provided for in subsection ~~(5)~~ (6), the commissioner may impose upon an insurer who fails to pay the tax required under this section a fine of \$100 plus interest on the delinquent amount at the annual interest rate of 12%.

~~(7)~~ (8) The commissioner may by rule provide a quarterly schedule for payment of portions of the premium tax under this section during the year in which tax liability is accrued."

{Internal References to 33-2-705:

7-21-3710 x	15-31-101x	33-2-311 x	33-2-708 x
33-2-710 x	33-2-724x	33-11-110 x	33-22-1513 x
33-27-118 x}			

Section 19. Section 90-1-112, MCA, is amended to read:

"90-1-112. Policy -- purpose. (1) It is the policy of this state to:

(a) strengthen the foundations of the state's business environment and diversify and expand existing economic endeavors to achieve long-term economic stability;

(b) cooperate with business enterprises, local governments, other public organizations, and the federal government and use all practical means and measures, including financial and technical assistance, to:

(i) establish an economic climate in which the state's natural resources and agricultural operations remain constant contributors to the state's economic welfare;

(ii) articulate a coherent economic development vision for the future; and

(iii) take a proactive role to ensure that Montana has the flexibility and resources to be an effective competitor in the changing global marketplace.

(2) The purpose of 2-15-218, 2-15-219, ~~and~~ 90-1-112 through 90-1-114, and [sections 1 through 16] is to provide a vision and a direction through the development of strategies and

initiatives to ensure that the state's role in expanding the economy takes place in an orderly and effective manner."

{Internal References to 90-1-112:
2-15-218* 90-1-112* 90-1-114*}

NEW SECTION. Section 20. {standard} Codification

instruction. (1) [Sections 1 through 15] are intended to be codified as an integral part of Title 90, and the provisions of Title 90 apply to [sections 1 through 15].

(2) [Section 16] is intended to be codified as an integral part of Title 15, chapter 30, and the provisions of Title 15, chapter 30, apply to [section 15].

(3) [Section 17] is intended to be codified as an integral part of Title 15, chapter 31, and the provisions of Title 15, chapter 31, apply to [section 16].

NEW SECTION. Section 21. {standard} Severability. If a part of [this act] is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of [this act] is invalid in one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

NEW SECTION. Section 22. {standard} Effective date. [This act] is effective July 1, 2005.

- END -

Appendix D: Montana Science and Technology Alliance Program Portfolio Summary 2003*

<u>Company Name</u>	<u>Date</u>	<u>Date of</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Notes</u>	
<u>Funded</u>	<u>Last Draw</u>	<u>Loaned</u>	<u>Paid (1)</u>	<u>Paid (1)</u>	<u>Remaining</u>		
<u>VENTURE CAPITAL LOANS</u>							
ChromatoChem, Inc.	12/01/89	03/28/90	\$350,000	\$2,650	\$850	\$347,350	Final payment not due until 12/4/2006.
Gateway Software	01/01/90	06/12/98	509,150	334,150	296,000	175,000	Company paid 4 of its debentures. Final one due 6/12/2008.
Nurture, Inc.	08/01/89	06/29/95	1,225,000	719,786	11,563	505,214	Hold warrants for stock; expires 6/28/05.
Lattice Materials	01/01/90	12/16/91	555,000	555,000	448,426	0	Completed. Company paid back all debentures.
Mycotech, Inc.	04/01/91	11/09/95	1,211,013	350,000	837,635	861,013	MSTA sold one debenture. Next one due 3/28/2004.
Optima Industries	07/01/91	01/04/94	700,000	139,500	160,500	560,500	Completed.
Ultrafem, Inc.	11/01/91	10/20/92	700,000	209,698	-	490,302	Completed. Company filed bankruptcy. Wrote off balance.
TMA Tech/Schmitt Industry	10/01/91	03/08/95	1,455,956	179,383	36,738	1,276,573	Company makes quarterly payments.
Northern Rockies Venture Fund	09/01/93	12/12/96	1,000,000	-	32,200	1,000,000	Debenture not due until 1/26/2005.
Glacier Venture Fund, L.P.	04/01/95	01/04/99	1,000,000	-	-	1,000,000	Debenture not due until 4/26/2006.
Positive Systems	02/01/94	03/30/98	550,000	3,853	9,342	546,147	Payments of \$4,398/mo. from 6/30/2003 to 3/31/2023 on 1st loan. Payments of \$8,133/mo from 4/1/2005 to 3/31/23 on 2nd loan.
Keep It Simple Systems, Inc.	04/01/96	04/22/96	75,000	30,357	-	44,643	Payments of \$594/mo until principal is paid.
Pasta Montana	07/01/96	01/17/97	350,000	337,449	102,514	0	Negotiated payoff. Wrote off \$12,551 principal (closed 10/2001).
Safe Shop Tools	02/01/97	06/30/99	162,500	-	-	162,500	Debenture not due until 2/6/2004.
Subtotal Venture Loans			9,843,619	2,861,826	1,935,768	6,969,242	
<u>JOB INVESTMENT LOANS</u>							
Spectrum Pool Products	09/01/95	01/16/96	400,000	400,000	64,161	0	Completed. Company paid off debenture.
Yellowstone Ace Hardware	10/01/95	01/22/96	100,000	100,000	18,922	0	Completed. Company paid off debenture.
Pasta Montana	07/01/96	01/17/97	500,000	480,198	167,552	0	Negotiated payoff. Wrote off \$19,803 principal (closed 10/2001).
Subtotal Job Investment Loans			1,000,000	980,198	250,635	0	
<u>RESEARCH & DEVELOPMENT LOANS</u>							
Deaconess Research Institute	11/02/92	12/07/94	500,000	251,779	287,416	248,221	DRI makes quarterly payments.
McLaughlin Research Institute	11/18/93	05/04/95	500,000	105,777	71,415	394,223	MRI makes annual payments of \$25,727.
University Systems			10,027,506	1,850,246	954,754	8,177,260	University System--annual payments of \$300,000.
Subtotal R&D Loans			11,027,506	2,207,802	1,313,585	8,819,704	
Total			\$21,871,125	\$ 6,049,826	\$ 3,499,988	\$ 15,788,946	
(1) Through March 8, 2004							
*Montana Board of Investments							