



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

Economic Affairs Interim Committee

58th Montana Legislature

SENATE MEMBERS

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

HOUSE MEMBERS

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

COMMITTEE STAFF

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

MINUTES

May 5, 2004

Room 137, State Capitol
Helena, Montana

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file in the offices of the Legislative Services Division.

Exhibits for this meeting are available upon request. Legislative Council policy requires a charge of 15 cents a page for copies of the document.

COMMITTEE MEMBERS PRESENT

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

SEN. SHERM ANDERSON
SEN. JEFF MANGAN
SEN. MIKE TAYLOR

REP. NANCY RICE FRITZ
REP. JIM KEANE
REP. SCOTT MENDENHALL

STAFF PRESENT

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

AGENDA & VISITOR'S LIST

Agenda, Attachment #1.
Visitors' list, Attachment #2.

COMMITTEE ACTION

The Committee:

- approved the March 11, 2004 minutes, as written;
- directed the drafting of legislation for establishing a fund-of-funds investment program;
- directed the drafting of legislation to modify existing economic development programs to improve delivery of state economic development funding;
- directed the drafting of two versions of legislation to codify Supreme Court cases impacting the Occupational Disease Act and the Workers' Compensation Act; and
- directed the drafting of two versions of legislation to consolidate Workers' Compensation Act exemptions.

CALL TO ORDER AND ROLL CALL

REP. MCKENNEY called the meeting to order at 8:00 a.m. The secretary noted the roll (ATTACHMENT #2), REP. MENDENHALL and REP. RICE FRITZ, and SEN. ANDERSON arrived after roll was taken. The March 11, 2004, meeting minutes were approved as written.

SUPREME COURT RULING ON ANTI-STACKING INSURANCE STATUTE -- BART CAMPBELL, STAFF ATTORNEY, LEGISLATIVE SERVICES DIVISION (LSD)

Mr. Campbell directed the Committee's attention to three documents in the meeting materials packet (previously mailed to the members) and asked them to examine:

- an April 21, 2004, memo to the Committee regarding this issue (EXHIBIT #1);
- a bill draft -- LC XXX (EXHIBIT #2); and
- a bill draft -- LC YYY (EXHIBIT #3).

Mr. Campbell reviewed the *Hardy v. Progressive Specialty Insurance Co.*, 2003 MT 85, 315 Mont. 107 Supreme Court decision, saying the Court found that a portion of one of the insurance code statutes was unconstitutional. LSD has traditionally taken the position that, in this type of situation, the issue is brought to the Legislature's attention. The Legislature is not required to take action, but no action would result in unenforceable statutes.

Mr. Campbell presented two bill drafts (LC XXX, EXHIBIT #2 and LC YYY, EXHIBIT #3), both of which would change the statutes to recognize the Supreme Court ruling, and asked the Committee to review and discuss them. To date, there have been no comments received from the stakeholders. Comments may be made at the June meeting. LC XXX deletes the language that the Court said was unenforceable while LC YYY adds language that says "if you charge separate premiums, then you must allow the stacking in the coverage". This is the core of what the Court was concerned about: that insurance companies were charging separate premiums but the individual received no value. LC YYY would allow the insurance companies to be clear in their approach by only charging one premium and would eliminate stacking of coverages. This would likely be the closest solution to what the Legislature intended when it passed the original legislation. The Committee may modify these drafts and there may also be additional alternatives presented at the June meeting.

REP. MCKENNEY suggested making this issue an agenda item for the June meeting, in order to allow members time to study the issue and to allow time for stakeholder comment.

VENTURE CAPITAL INVESTMENTS AND OPTIONS

Existing Investment Activities -- Bart Holaday, Adams Street Partners, said Adams Street Partners is a private equity investment manager headquartered in Chicago, Illinois. Adams Street has had a relationship with Montana since 1988. Mr. Holaday referred to his presentation (*Adams Street Partners Overview* - EXHIBIT #4) and discussed:

- an overview of Adams Street Partners - Pages 3 - 8;
- the Montana Board of Investments portfolio - Pages 9 - 11; and
- the role of venture capital in economic development - Pages 12 - 17.

Mr. Holaday noted that, of a total of over \$300 million committed from Montana to Adams Street Partners, approximately \$100 million has been invested and of that amount, \$2 million was invested in Montana companies.

SEN. TAYLOR asked how much Adams Street typically invests in a company and if there is a specific criteria used to determine investments. Mr. Holaday said Adams Street has two programs and the program Adams Street has with Montana invests only in partnerships which invest in other venture capital or buy-out firms. In that category, Adams Street may make a commitment of \$50 - 200 million. In the direct investment program, a typical-sized investment would be on the order of \$2 million. Mr. Holaday clarified that Montana is an investor in two of Adams' Street direct investment funds, so as a fund participant, Montana is a direct investor.

SEN. ROUSH asked, referring to the \$300 million Montana has committed to Adams Street, if it was likely that Montana could significantly increase the amount of venture capital invested in Montana companies. Mr. Holaday said Montana companies generally are too small to attract true venture capitalists.

SEN. MANGAN said he was surprised that of \$98 million invested, only \$2 million ended up in three Montana companies and wanted to know if that was by chance or due to a referral through the Board of Investments (BOI). Mr. Holaday said one was a referral and he didn't know about the other two companies. SEN. MANGAN asked what amount Adams Street receives from these investments. Mr. Holaday said Adams Street is paid a fee of 1% so, for example, Adams Street would receive \$200,000 from a \$20 million investment.

REP. MENDENHALL said he was trying to get a sense of why there aren't many suitable venture capital investment deals for Montana. Mr. Holaday said traditionally, the hot areas for venture capital have been places like Silicon Valley and the areas around large universities. It is a combination of factors such as population, location, and having the right infrastructure. The sole motivating objective for a venture capitalist is to get the highest rate of return. They want to go where they can get the highest rate of return for their investments. It is much harder to find companies that will yield that rate of return in rural states.

SEN. TAYLOR asked if there were many, if any, venture capital investments in agriculture. Mr. Holaday said there were very few.

REP. MCKENNEY asked how Montana can keep fast-growing companies in the state once they reach critical mass. Mr. Holaday said it was his personal view that education is key. If students are educated to be entrepreneurs who start small companies, which will provide a

living for them and those that work there, some of those companies will grow to be big and will choose to stay for personal reasons, such as lifestyle.

REP. MCKENNEY asked Mr. Holaday to clarify if he thought venture capital was an important tool but wouldn't work by itself in an economic development arena. Mr. Holaday said venture capital can create long term jobs but in connection with economic development, it shouldn't be expected to bring the high rate of return that venture capital alone brings in. Economic development and venture capital are two different activities and should not be confused.

Making Use of Pension Funds -- Mike Arpey and Kelly Williams, Credit Suisse First Boston (CSFB)

Mr. Arpey said, when considering in-state investment programs, the focal point must be on returns. Economic development won't work unless the focus is on return. Look for inefficiencies in markets, under-served markets, and places where venture capital isn't going. CSFB, he said, focuses in these areas and is the largest private equity manager in the world, having over \$31 billion dollars of private equity assets.

Creating an infrastructure in which young businesses are fostered and supported involves more than money. It requires a lot of facilitation between universities, governmental entities, and the corporate community. Businesses must be given a reason to stay. The state has to be committed to building the infrastructure and that infrastructure will attract the companies.

CSFB runs the full spectrum of private equity investments:

- It has large buy-out funds, middle market buy-out funds, venture capital funds, real estate mezzanine, etc.
- It has \$9 billion of fund-of-fund commitments in more than 500 funds.
- It has a small army of investment bankers that operate worldwide and do nothing but visit companies and research young companies.

When looking at bringing something to bear on a market like Montana's, businesses will want to have an information advantage, they will want to have resources at their disposal, they will want relationships with a huge number of firms to really make this effort work. Unless Montana gives companies a reason to be here, they will not come.

Ms. Williams, CSFB, gave her professional background and began by reviewing some of the programs CSFB has established:

- Indiana Future Fund -- a \$75 million public-private partnership, focused purely on Indiana investing;
- Oregon State -- designated \$100 million from the state pension plan to be used to make investments in the State of Oregon. It is a regionally based investment program and 80% will be invested in funds and 20% will be directly invested;
- New York -- will make direct investments in the State of New York.

Ms. Williams discussed important elements of a successful in-state approach:

- The return element is crucial. Criteria must be in place to choose the very best local and national programs. CSFB does a research report on each state for which it is hired to look for investment opportunities.

- A broad based collaboration is another essential element.
- The private equity community must participate and may have to be built up in a state like Montana.
- Clusters of innovation must be identified to understand where the opportunities are, who the drivers are, and bring them in.
- On-going education to help people understand how the process works is very important.
- When CSFB identifies an opportunity, it will invest its own capital with the state's capital, as a part of CSFB's commitment to the program.
- Proper analysis and high standards make stakeholders feel they are on a level playing field.
- Regional and national involvement is difficult to establish but helps local companies build their markets beyond their state borders.
- CSFB establishes a physical presence in the state it is working with. Whenever CSFB develops a program for a state, it opens an office there, because it feels it is essential to have someone present to manage these programs.

Mr. Arpey said:

- The first step CSFB takes is to set up an advisory board to work hand-in-glove with CSFB. The board is comprised of representatives from universities, corporations, governmental entities. The group must be small enough to be manageable but large enough to provide a good cross section of the community. It will meet on a regular basis and will set up the initial set of criteria.
- Every investment firm participating should be required to set up an office in the state and to make a time commitment to the program.
- Community outreach is utilized to bring these resources together.
- Technology is used to the advantage of the program.

SEN. MANGAN said the most overwhelming obstacle in Montana is that there is no one "on the ground" in Montana and there is a perceived lack of population and of business acumen. The push from the local economic development groups is responsible for what little movement there has been. He said he was pleased to hear that CSFB makes a commitment to the states it works with. He asked how CSFB determines if a state is a viable place for it to do business.

Ms. Williams said the frustrations articulated by SEN. MANGAN are not unusual and are heard in other states. Part of the challenge is that there are certain pockets within a country where money has been targeted. Factors include:

- Distance and travel -- these are big factors to out-of-state investors, so establishing a local network is very important. It is critical to put the spotlight on the region and make people come here.
- Research -- CSFB has the ability to look at the macroeconomic conditions going on in the state and region and has the expertise to advise the state.
- Collaboration -- collaborative efforts are essential.

SEN. MANGAN said it was very important to ensure that the local economic groups which have worked very hard on this issue in the past are involved in these processes and not overlooked. Mr. Arpey said one of the hallmarks of how CSFB works with its clients is to collaborate with them. However, standards must be set that cannot be crossed. The focus and the goal must be the investment return and the program must be run accordingly. It is important to get the

local economic development entities on board, but it is also very important that it is very clearly understood what the program is, how it works, and that the standards will be strictly followed and upheld.

SEN. TAYLOR agreed that the most important aspect is the rate of return. He asked Mr. Arpey to discuss CSFB's view of tax credits and if it thinks tax credits are a necessary element of a successful investment program. Mr. Arpey said there are a variety of ways to approach financing using tax credits but that he did not feel they were a necessary element for success.

SEN. TAYLOR asked what it would cost Montana to engage CSFB's services. Mr. Arpey said CSFB would have to research the Montana opportunities before it could provide a specific dollar amount it would require. Ms. Williams added that when CSFB does engage in a business venture with a state, it charges an annual management fee based on the amount of the capital invested and a performance fee. Also, she asked that they keep in mind that CSFB commits its own capital to the program.

SEN. TAYLOR asked what some of the critical factors were to keeping investments in Montana or attracting investors to Montana. Ms. Williams said education of the opportunities available in the state, identifying areas of excellence, and emphasizing what is unique about a state all contribute to attracting businesses. Before investors will come to do business here, however, they want to know that there are other investors here. Mr. Arpey said the interested businesses must be tied into the existing corporate community and the university community.

REP. KEANE asked what kind of a commitment CSFB requires before it will do the research plan for a state. Ms. Williams said CSFB would want to verify that the request is from an entity with the authority to request it. Research is a two step process: the first layer is a specific report on what CSFB would do for the state and the second step, within two weeks after signing a contract with that state, is to deliver a full-blown research plan.

CAPCOS -- Phillip Thomas, Advantage Capital, gave a brief history of his firm:

- AC is a private equity firm with about \$800 million under management;
- it has offices in 9 states;
- it invests exclusively in "double bottom-line projects" - where the primary focus is on partnering with public entities and investing primarily for economic development purposes; and
- also participates in the CAPCO program in 9 states (EXHIBIT #5);

Mr. Thomas said the target and specific goals must be established before structuring a program. Incentives will likely be necessary in order to attract the desired businesses. Research indicates that the most effective way to create job growth is delivering early stage capital to small, high-growth companies. There is a capital gap that exists for those kinds of companies. There is a need to find the most cost effective way to deliver the first portion of equity capital to high- growth small business. To create an incentive, you have to leverage the state resources to the best possible use.

The more targeted the investment is, the higher the level of incentive is needed. If the investment activity is to remain in Montana, then the incentives must be appropriately formulated. If investments are further targeted to small businesses, additional incentives will be

needed. In summary, it is a competitive marketplace with other states and other capital markets. Venture capital is a risky asset category. Mr. Thomas advised the Committee to be realistic and consider the best and the worst case scenarios to try to figure out what impact this will have on the state budget. Find out what the real target is, find out how much the state budget can afford in creating a program, start a trial program and improve and expand it gradually or as the state can afford.

SEN. TAYLOR asked to clarify that since the tax credits generated would be from the State of Montana, if they would have to be invested in Montana. Mr. Thomas said it does have to be invested in the State, and generally, the incentive offered is a 10% per-year tax credit for investors.

Fund-of-Funds -- Robert Heard and Stephen Ringlee, Consultants

Mr. Heard said the previous speakers had delivered very good descriptions of fund-of-fund programs. The venture capital industry operates on three levels:

- entrepreneurs -- usually young and energetic, have great ideas, and seek out capital from venture investors in order to finance their firms;
- venture capitalists -- people who invest equity capital and, from time to time, raise money themselves; and
- wholesale investors or institutional investors of venture capital.

Capital can be an extremely useful tool in attracting investors but Mr. Heard advised that research be done very carefully and that goals be clearly defined. He said it is necessary to develop a strategy based on those goals and make certain the investors are aware of and agree with the standards and investment plan. Firms that fit with the state's needs must have a good track record of success and have an interest in the kind of deals the state is interested in.

Mr. Heard discussed specifics of his program in Oklahoma:

- It created a "contingent" tax credit.
- Oklahoma, through its investment board, owns the portfolio and all of the profits go to the Investment Board. The Investment Board reinvests the profits to continue building the venture capital industry which serves the state.
- The fund-of-funds program currently operates in Oklahoma, Arkansas, and Iowa and he advises other states on models like this.

Mr. Ringlee added that Iowa is similar to Montana: both lack "critical mass", both have a rural population spread across a large area, and both consistently rank very low in terms of entrepreneurial vitality. About 4 years ago, Iowa convened a bipartisan investment working group that took a hard look at developing capital formation policies. This working group found that it was under many state restrictions and limitations, had very limited state funds (\$10 million over 5 years) available to them, and would have to rely on private funds to create its program. The working group decided to focus on good public policy and best practices nationwide and identifying what infrastructure had to be in place. It spent a year examining programs throughout the nation. It used private-industry investment models with a strong focus on internal rate of return, diversified its risk, chose managers based on track record and the likelihood of delivering sound results, and wanted to treat the State as a partner in the enterprise. It wanted a long term focus and to build an infrastructure based on entrepreneurial

activity and venture capital investing in Iowa that would outlast any state program. The Iowa program has learned several key concepts:

- 1) Implementation is everything.
- 2) The fund-of-funds model developed by Oklahoma best met Iowa's needs and requirements.
- 3) A multi-faceted approach worked the best for Iowa:
 - the \$10 million allocated by the state was used to create an early stage angel tax credit program which encourages angel investors to band together in local community groups. With some state help and training, the program began investing in early stage companies, which are now experiencing very rapid growth.
 - The Legislature passed a \$100 million fund-of-funds program that is now being implemented.
 - Iowa has developed a statewide entrepreneurial website to match entrepreneurs with investors, a television network for the same purpose, and has worked hard to involve state universities.
 - Iowa has targeted economic development activities on infrastructure and worked very hard to enhance the technology transfer function at the state universities.

The focus has been on good public policy, treating the taxpayers well, and leaving a legacy of a long-lasting program. Montana should consider these elements in its decision-making.

REP. MENDENHALL asked how it was decided in what areas expertise was needed. Mr. Heard said it was a mixture of research, science, and art and of understanding where the opportunities exist in the state. A strong network throughout the state is critical, as is collaboration, he said.

VENTURE CAPITAL OPTIONS -- AD HOC WORKING GROUP

Dave Gibson, Governor's Office of Economic Development, presented options for consideration and said two fundamental questions must be answered before moving forward:

- 1) Does Montana have a problem in expanding its economy with growth companies?
- 2) Will free markets solve the problem on its own?

Mr. Gibson distributed a worksheet for economic development options (EXHIBIT #6) and explained each of the seven options, as listed in EXHIBIT #6.

Jon Marchi, Ad Hoc Working Group, said one of the things learned from the day's presentations is that venture capital is not the solution to economic development but it is a very important piece of the process. Mr. Marchi made the following points regarding venture capital investing:

- Montana does not have a venture capital infrastructure.
- He is the only active venture capitalist in Montana, with about \$3 million invested.
- Montana needs to develop a venture capital infrastructure.
- Montana is already investing in the fund-of-funds concept, as explained by Mr. Holaday.
- Montana has a true entrepreneurial spirit, as indicated by the fact that research and development revenues are coming into the state through the university system at approximately \$200 million annually. This is a very significant contribution to economic development.

- The Montana Research and Commercialization Board has funded 61 projects and is doing a very good job of commercializing some of the research coming out of the universities. Every research and development grant being made by the Board now involves a private sector Montana company.
- The Montana Economic Developers Association (MEDA) has grown from 7 to over 200 members in 10 years. There are 55 statutes in Montana relating to economic development, so Montana has come a long way in the last ten years.
- Montana State University (MSU) in Bozeman has just been named one of the top ten universities in the United States, in terms of its entrepreneurial curriculum, by Entrepreneur Magazine.
- Risk capital is necessary to generate and support entrepreneurial firms. Montana needs more than it has and it must be professionally managed by the private sector.
- The best approach to managing this capital is to diversify, as with any portfolio, and to invest in separate venture capital funds. If Montana can do these things, it will demonstrate to potential investors and entrepreneurs the high level of commitment in this state for continued development.

REP. MENDENHALL asked Mr. Gibson which options in EXHIBIT #6 he would choose to pursue and to include in his comments the cluster study analysis. Mr. Gibson said he thought several of the options had more potential than others and discussed the options he supports:

- Option 1 -- Continuing existing programs that provide local assistance. Mr. Gibson would separate out community development issues because while they are very important, they do not significantly grow the economy.
- Option 2 -- Modify existing programs to improve delivery of state funding. Mr. Gibson recommended that Montana visit existing legislation regarding the business tax credit, provide workforce training, and strengthen the Montana Research and Commercialization Board.
- Option 3 -- Encourage angel investors through network supports. Montana is already doing this and no changes need to be made.
- Option 4 -- Develop new incentives for investing, such as tax credits. Even though Montana has a geography problem, which makes it difficult to do business, there still should be strict guidelines for investing and it should not invest in businesses that wouldn't be competitive elsewhere. If we cross that line, we create a structure of businesses that aren't competitive in the national and global marketplace and, as a result, fail eventually. Montana should provide incentives to entice investors here but that is it. The fund-of-funds method is the least intrusive approach to get some incentives to solve that problem.

Mr. Gibson added that the Governor's commitment to economic development is of critical importance. Regarding clusters, Mr. Gibson said the most important thing Montana can do is organize businesses to help themselves. This doesn't require legislation and is the best use of resources.

REP. MENDENHALL said, as he understood it, universities cannot take an equity stake in an investment. Mr. Gibson said the universities may own equity if it is given to them but they may not purchase it. There are foundations which allow them to acquire some equity and there is a debate of how much of a barrier this equity prohibition really is.

Mr. Marchi gave an example illustrating how LigoCyte Pharmaceutical signed agreements providing royalty payments to MSU so if one of its products is commercialized and becomes successful, MSU would receive a royalty from the sales.

SEN. MANGAN said he was amazed by the activity undertaken by the ad hoc working group in the last eight months and complimented the members for all their hard work.

SEN. TAYLOR asked Mr. Marchi how many private companies have been spun off as a result of private commercialization. Mr. Marchi said that of the projects his venture capital firm funded, two were firms that obtained MSU research that has been commercialized.

REP. MENDENHALL asked what the effective date was for the Workforce Training Act legislation passed in 2003 and said he was interested in seeing how many businesses have taken advantage of that. Mr. Gibson said the Act went into effect shortly after the Legislative Session. There have been seven applications and several applications will be completed soon. REP. MENDENHALL asked what qualifications a business had to have to qualify for this program and if it needed to be modified in any way to improve it. Mr. Gibson said a clearer picture will be available in the next several months but he thinks there are two fundamental policy questions that the Legislature may want to consider: The Act only applies to new jobs and doesn't apply to high risk businesses.

REP. KEANE asked for the names of the companies who are close to completing the application process. Mr. Gibson said the businesses were Montana Resources of Butte, Qwest call center in Helena, and PrintingForLess in Livingston. REP. KEANE asked if Western Energy had applied for this program. Mr. Gibson said Western Energy may not qualify because the positions are not new jobs, but replacements for existing jobs. A company must show that there are 10 new jobs before it can qualify, and Western Energy is working on that.

PUBLIC COMMENT ON VENTURE CAPITAL AND ECONOMIC DEVELOPMENT ISSUES

Evan Barrett, Chairman of the Legislative and Public Policy Committee for Montana Economic Developers Association (MEDA), MEDA has a legislative agenda for the 2005 Session which he will present to the Committee when finalized. Mr. Barrett also said MEDA has not taken an official position on any program but has developed six policy recommendations regarding venture capital. Mr. Barrett distributed and explained the policy recommendations (EXHIBIT #7).

Vern Peterson, Chair, Snowy Mountain Economic Development Corporation, said, regarding EXHIBIT #6, Option 6 (Require Board of Investment to invest directly in Montana businesses.), that he objected to having the word "require" in the language and would prefer to have the word "encourage" instead.

COMMITTEE DISCUSSION -- VENTURE CAPITAL

SEN. MANGAN had several observations and recommendations:

- This is a complicated and complex issue and professional guidance is essential.
- We need to figure out how to get capital on the ground and should consider drafting some type of fund-of-funds legislation, including a model that utilizes the pension funds.

- The CAPCO model has too many problems and he would not support pursuing this option.

SEN. TAYLOR agreed with SEN. MANGAN and said he also supported pursuing the fund-of-funds models.

REP. KEANE expressed concern over the use of tax credits and discouraged using them as a way to attract businesses to Montana.

REP. MENDENHALL said he also supported fund-of-funds legislation. He said the work done on the cluster development was important and should be integrated into the discussion on venture capital. He disagreed with REP. KEANE regarding using tax credits as incentives to attract businesses, saying that Montana must be competitive with other states.

SEN. ROUSH commented he was impressed with what he had learned at the day's meeting but said that rural communities still need help and that he also is reluctant to use tax credits as an incentive for investing.

SEN. MANGAN said he wanted to discuss Option 7 (EXHIBIT #6 - Direct the Board of Investments to negotiate contracts with investors). There is \$100 million of Montana money being used for venture capital and only 2% is being accessed by Montana companies. That is a very low number and should be increased. Until pressure is put on Adams Street, this will not change. The BOI should be encouraged to initiate discussions with Adams Street to work toward this.

SEN. TAYLOR said it was critical to have political stability and continuity. Policies that are constantly changing make it very difficult to attract businesses to Montana.

REP. RICE FRITZ said she found it to be very valuable to be able to see the differences between community development and economic development, as opposed to the problems and advantages of venture capital. A contingent tax credit is a good solution because it not only assures that Montana will not lose anything but that there will also be professional and knowledgeable input on the investments. Fund-of-funds and pension funds seem to be the most attractive options at this point in time.

SEN. MANGAN asked Ms. Williams what action would it take on Montana's part to initiate research from CSFB to see if a viable plan could be designed. Ms. Williams said the State would not have to sign a contract or pay a fee to initiate research. The State, or designated entity, would simply have to invite CSFB to begin and an initial research report would be completed. Once a contract is signed, if the State chose to continue, a much more comprehensive report would be done.

REP. MCKENNEY summarized that venture capital is a good tool but only one of several pieces necessary for a successful investment program. He **moved** that the Committee draft legislation for a fund-of-funds investment program, with staff working with the ad hoc working group, the Governor's Office, and the State Auditor's Office. The **motion passed** on a unanimous voice vote.

SEN. MANGAN **moved** to direct staff to develop sample legislation for Committee review that would implement Option 2, as written in EXHIBIT #6 (Modify existing programs to improve delivery of state funding.) **Pat Murdo, Research Staff, Legislative Services Division (LSD)**, said the Department of Commerce has a placeholder on the micro business issue. SEN. MANGAN said he trusted Ms. Murdo to draft the appropriate legislation that would not interfere with other agencies' legislation.

SEN. ANDERSON asked if there was any intent to have Mr. Barrett of MEDA present MEDA's legislative agenda. REP. MCKENNEY said MEDA would have an opportunity to present its proposals.

SEN. MANGAN'S **motion passed unanimously** on a voice vote.

SEN. MANGAN **moved** to direct staff to develop legislation to implement the ideas the ad hoc working group brought forward for Option 3, as written in EXHIBIT #6 (Encourage angel investors through network supports). SEN. MANGAN said the ad hoc working group has specific ideas on how to implement this process and that he would like to see what they would look like in bill form. REP. MCKENNEY said he didn't know how to legislate volunteer angel investors. The State can encourage this but this doesn't fit legislation. SEN. MANGAN said the State could provide assistance to angel investors by financing a business incubator and legislation could accomplish this. It is more than just encouraging people to work together, it is a mechanism for possible funding.

SEN. TAYLOR suggested changing the motion, first to do the research and get the information on how to encourage local organizations to work together. SEN. MANGAN said that was fine. SEN. ANDERSON asked for the motion to be repeated. SEN. MANGAN said he would revise his motion to direct staff to develop criteria and information on how to encourage local government entities to work together in capital and other infrastructure areas. The **motion passed unanimously** on a voice vote.

REP. KEANE **moved** to direct CSFB to initiate a research plan for the State of Montana. REP. MCKENNEY asked REP. KEANE to withdraw his motion because he didn't think the Committee had the authority to make such a request. REP. KEANE amended his motion to initiate a research plan for the State of Montana with CSFB, if this Committee has the authority to make such a directive.

SEN. MANGAN said he was in support of the motion because there is no obligation, either legal or financial. He said he would ask as an individual legislator, if there is an issue for the Committee to do so.

SEN. TAYLOR said in concept, he supports the motion but thought the motion should be postponed until the Chair could confer with leadership, the ad hoc working group, and other stakeholders.

REP. MCKENNEY opposed the motion, not because the Committee shouldn't do something like this, but because it would be moving too fast. Additional consideration should be given to this issue.

REP. MENDENHALL asked Ms. Murdo to clarify if the day's presenters had been invited to address the Committee simply for educational purposes or if the presentations could be construed as proposals. Ms. Murdo said the presenters had been invited at their own expense to inform the Committee about the different programs and options, primarily as background information. REP. MENDENHALL said he didn't think the Committee should choose to engage a presenter without further consideration.

SEN. MANGAN didn't want this issue to escalate and asked REP. KEANE to withdraw his motion but stated he intended to speak with the presenters about the fund-of-funds model as an individual legislator.

REP. KEANE withdrew his motion.

SJR 17 WORKERS' COMPENSATION STUDY -- EDDYE MCCLURE, STAFF ATTORNEY, LSD

! Options for Occupational Disease Statutes

Ms. McClure said the Committee would be asked to make a decision regarding potential legislation, as identified by the SJR 17 working Group. A worksheet describing the three options was distributed (EXHIBIT #8):

- Option 1 -- Merge the Occupational Disease Act into the Workers' Compensation Act (LC 2222);
- Option 2 -- Codify cases decided by the Montana Supreme Court (LC 6666); and
- Option 3 -- Make no MCA changes at this time.

Ms. McClure reviewed 39-71-105, MCA, provided a brief summary of the three relevant Supreme Court cases, and explained each of the three options, including the advantages, disadvantages, and costs of each.

Ms. McClure noted that the working group was not an official body and, as staff, she never voted in any of the straw votes. The Department of Labor also did not vote in the straw votes.

Ms. McClure said several members of the working group would also discuss the advantages and disadvantages of each option.

Larry Jones, Liberty Northwest Insurance, said he was not appearing before the Committee as an advocate of Option 1 (the merger option), but to provide additional information and answer questions about the option. The basic concept of this option is to combine the Occupational Disease Act with the Workers' Compensation Act. The difference between the two acts is not the underlying disease, but the cause of the disease. However, the two acts contain differing benefit levels, entitlements, and procedures which have been significantly reduced by the three Supreme Court decisions. Those who support this option believe:

- it will decrease litigation;
- that a uniform system will be simpler to administer; and
- a systematic approach will decrease the likelihood of unintended consequences.

Al Smith, Montana Trial Lawyers Association (MTLA), spoke in support of the merger option, saying it is fair for the claimants and easier to understand. A very small number of cases are Occupational Disease, so this will not result in a major change. Most of the cost of this is already in the rate structure, based upon the Henry, Schmill, and Stavenjord cases. This will reduce overall costs, as well.

Nancy Butler, Montana State Fund, provided information regarding Option 2 (codification of the three Supreme Court cases). Ms. Butler distributed a document (*Analysis of Montana Occupational Disease Draft Proposals - EXHIBIT #9*). Ms. Butler said the analysis was prepared by the National Council on Compensation Insurance, Inc (NCCI). This proposal:

- would allow for a permanent partial disability benefit;
- allow for vocational rehabilitation benefits; and
- would also clarify that the reference to 39-72-405 should be taken out of 39-72-711.

Repealers would be:

- section 39-72-405 that maximizes a payout at \$10,000;
- the statute that said no permanent partial disability should be paid;
- the statute regarding apportioned benefits;
- a silicosis benefit that is no longer necessary.

Possible disadvantages may be unintended consequences.

Most other states have some type of definition for occupational disease. Most of them also have some latitude in the claim filing process, and most of them have a general notice requirement. There are some differences in how occupational diseases are related to work and how injuries are related to work. These differences need to be addressed in the statutes.

Ms. Butler said it is her opinion that something does need to be done but urged that caution and care be used and that immediate action is not necessary. If legislation is postponed, a merger option could be developed in 2007.

Jacqueline Lenmark, American Insurance Association (AIA), presented information on Option 3 (make no change). This option makes no changes but doesn't mean that no changes should be made, just that this Committee would not bring legislation forward on this issue. Ms. Lenmark said the public policy already embodies the notion that diseases happen differently than injuries and that there might be a rational reason for them to be treated differently in certain respects under the code. That is the primary reason that advocates of Option 3 are urging a slower approach.

The advantages of this approach are:

- no unintended consequences;
- the makeup of the Supreme Court could change and the Court could reverse, amplify, clarify, expand, or constrict decisions that have already been made;
- fewer unknown costs; and
- additional time for study.

A disadvantage of this approach is difficulty in using the MCA, since case law affects implementation of the statutes.

Ms. Lenmark said the Committee can also take actions that do not involve legislation, such as to encourage the DOLI to develop a guide to the statutes, as well as the rules and decisions implementing and interpreting those statutes.

Ms. Lenmark stated that, as a representative of the American Insurance Association (AIA), she advocated that the Committee choose this approach. While there is a general feeling that there should be some addressing of the court decisions and some sort of merger, there is no consensus among the interested parties in the system about what that should look like. AIA thinks it would be more appropriate for individual parties to bring separate bills or to take a long review to reach consensus that would be helpful in creating one act. AIA endorses Option 3.

! Options for Exemptions

Jerry Keck, Administrator, Employment Relations Division, Department of Labor and Industry (DOLI), said:

- The Department has general regulatory oversight authority to monitor performance and action taken in the Workers' Compensation system. In SB 270, DOLI was directed to conduct a study with the interested stakeholders in the system on the Independent Contractor exemption process.
- A working group of 16 individuals has been established who are broadly representative of the Independent Contractor exemption process from the construction industry, organized labor, business and community interests, and Workers' Compensation representatives.
- Three meetings have been held primarily to discuss the impact of two Supreme Court decisions on the Independent Contractor exemption process and the effect on the exemption.
- The Department has, at the direction of the working group, compiled a list of all of the options discussed at the first two meetings. The Department presented the list of the seven options at the third meeting and it was decided that, if the group could not reach consensus, each proposal would be voted on. The majority opinion would be presented in report, along with some of the minority opinions.
- A sub-group has also met and presented its proposals. These proposals captured some of the ideas discussed earlier and put them forth as an overall set of principals that would be used to determine forward movement and what kind of legislation might be required (EXHIBIT #10).
- The working group will have one more meeting before this Committee meets in June and hopes to have a final consensus completed by then. If the group cannot meet full consensus, a vote will be taken on the issues where there is not consensus. The recommendations will be presented to the Committee in June.

Mr. Keck noted that the Department takes no position on the exemptions in general or on the Independent Contractor exemption, saying that the role of DOLI is to implement the statutes and exemptions, as established by the Legislature.

Mr. Keck pointed out that Item 4 (make the exemptions certificate conclusive as to the Independent Contractor status) was an issue on which there was little agreement. What has been sought from the beginning of the study is to establish a way to have certainty and fairness

in an exemption process. What they have found is that no one in the country has figured out how to have certainty as a part of that.

Ms. Murdo referred the Committee members to the worksheet for choosing action on Workers' Compensation Act exemptions (EXHIBIT #11) and to the report (*Exemptions: Do They Make Sense In A No-Fault Workers' Compensation System?*) (EXHIBIT #12). She explained that each of the options listed on EXHIBIT #11 were explained in greater detail in EXHIBIT #12 and that the corresponding page numbers were noted on EXHIBIT #11. Ms. Murdo informed the Committee, for full disclosure, that she has an Independent Contractor's license. She noted that Options 1, 2, and 3 would delete current exemptions, that Options 4 and 5 would consolidate exemptions, and that Option 6 would make no change. Ms. Murdo then explained each option:

- Option 1 -- removes all exemptions in 39-71-410, MCA, except those covered by federal law;
- Option 2 -- removes selected exemptions;
- Option 3 -- deletes all but Independent Contractors and federal exemptions;
- Option 4 -- moves nonfederal exemptions from 39-71-401, MCA, except Independent Contractors, into 39-71-118, MCA;
- Option 5 -- consolidates similar references regarding exemptions in 39-71-118 and 371-401, MCA; and
- Option 6 -- makes no changes.

SEN. TAYLOR asked if removing all but the federal exemptions would translate into lower costs for the employer. Ms. Butler said perhaps, but other considerations would have to be evaluated, such as if everyone who is purchasing a policy is getting the appropriate amount of premium and safety records.

REP. MENDENHALL asked Mr. Keck to expand on Item #4 in EXHIBIT #10 (making the exemption certificate conclusive as to the Independent Contractor status). Mr. Keck said once the Department issues an Independent Contractor exemption, it is conclusive as to the status whether they are an employee or an Independent Contractor. For many years, the Workers' Compensation Court relied upon that provision to say if a worker has the exemption, he/she is not entitled to benefits. The Supreme Court ruling took that reliability away and the exemption can no longer be considered conclusive. Item #4 would overcome the Supreme Court decision and establish once again, that the exemption is conclusive.

! Update on SB 304 Study of State Fund

Ms. Butler said the purpose of the study was to evaluate the feasibility of selling both the Old and the New Workers' Compensation Fund, to study the role of the State Fund, and to look at the feasibility of establishing assigned risk pools. The Committee has met five times and has made two decisions:

- to recommend to the Governor and the Legislature that there be no sale of the New Fund, and
- to recommend to the Governor and the Legislature that there be no creation of assigned risk pools.

The Committee will address the feasibility of selling the Old Fund and determining the role of the State Fund at the May meeting. Ms. Butler provided an agenda for the upcoming SB 304 Study Committee scheduled for May 11, 2004 (EXHIBIT #13).

SEN. TAYLOR asked if the Old Fund is currently financially sound. Ms Butler said as of the end of Fiscal Year 2003, it was financially sound. Projections for the end of FY 2004 indicate that the Old Fund will be approximately \$500,000 short of being fully sound.

COMMITTEE DISCUSSION -- WORKERS' COMPENSATION

REP. RICE FRITZ announced that she would be unable to attend the June Economic Affairs Interim Committee meeting and that SEN. ROUSH would have her proxy. REP. MCKENNEY said her request was noted for the record.

REP. MCKENNEY referred the Committee to *Possible Committee Options Identified by SJR 17 Working Groups* (EXHIBIT #8) and said the Committee would begin with Option 1 -- Merge the Occupational Disease Act into the Workers' Compensation Act.

REP. KEANE suggested having staff draft legislation for both Options 1 (the merger concept) and 2 (codify Supreme Court cases). SEN. ANDERSON said it was his opinion that the Committee was not ready to recommend a merger. He favored Option 3 (make no changes).

SEN. TAYLOR said he was not ready to commit to officially supporting an option but agreed with REP. KEANE in drafting Options 1 and 2 into proposed legislation.

SEN. ANDERSON commented that there is a distinct difference between an occupational disease and an injury. If these two Acts are merged, it will be a complex and difficult process.

REP. MCKENNEY agreed with SEN. ANDERSON that there is a difference between the two diseases. He said he would like to explore Option 2 in more detail. He asked staff if proposed legislation could be completed on Options 1 and 2 for consideration at the June meeting. Ms. McClure said proposed legislation would be prepared and ready for discussion at the June meeting.

REP. KEANE **moved** to direct staff to draft legislation for Option 1 (merger concept) and Option 2 (codify Supreme Court cases) for further consideration at the June meeting. The **motion passed** on a voice vote, with SEN. ANDERSON voting no.

REP. MCKENNEY asked for discussion on Workers' Compensation exemptions (EXHIBIT #11).

SEN. TAYLOR said he favored Option 5 (consolidation of similar references). REP. MCKENNEY felt it would be a mistake on the Committee's part to strip out exemptions and that the Committee could simplify this issue by consolidating the exemptions in the codes.

SEN. ANDERSON asked if SEN. TAYLOR was interested in Option 4 (move nonfederal exemptions) and Option 5, since they were similar, or just Option 5. SEN. TAYLOR said he would consider both options.

REP. MENDENHALL thought Option 4 had more merit than Option 5.

REP. MCKENNEY asked staff to provide additional information on Options 4 and 5. Ms. Murdo asked the Committee to turn to Pages 14 and 15 of EXHIBIT #12 (*Exemptions: Do They Make Sense In A No-Fault Workers' Compensation System?*) and explained the additional information provided there.

SEN. ANDERSON **moved** to direct staff to draft proposed legislation for both Option 4 and Option 5 for consideration at the June meeting. REP. KEANE asked that the working group be included in the process. REP. MCKENNEY agreed. The **motion passed unanimously** on a voice vote.

COMMITTEE DIRECTIVES TO STAFF

Ms. Murdo has received a draft of proposed action items recommended to the Shared Leadership for a Stronger Montana Economy (EXHIBIT #14). These action items will be presented to the Montana Board of Regents and the PostSecondary Education Policy and Budget Subcommittee meeting on May 19 in Great Falls. The public is invited to attend. Much of the information to be presented is similar to issues this Committee has studied and the Project Team would like to be certain efforts are coordinated. Ms. McClure said she would verify the meeting details and notify the Committee members.

Ms. Murdo reminded the Committee that the SB 304 Study Committee would be meeting on May 11.

Ms. Murdo said since the Committee would be considering proposed legislation at the June meeting, it would be helpful if the members would review EXHIBIT #15, *Procedure for Review, Request, and Drafting of Agency Legislation*, as adopted by the Legislative Council on January 16, 2004.

ADJOURN

With no further business before the Committee, REP. MCKENNEY adjourned the meeting at 3:30 p.m.

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