

I. Fair Exchange Model Legislation¹

The following models are not complete pieces of legislation. They are frameworks developed in response to requests from interested legislators. In a number of places I provide a note suggesting some alternatives that are not detailed, but generally refer back to one of the examples described in the sections above.

A. International Trade Rules

The following federal legislation would also make sense as a requirement in international agreements, or at least as an exemption from rules that prevent communities from giving preference to local businesses. This paper was funded by a source focused solely on the United States. However, Kenneth Thomas, an expert on international trade agreements, reviewed the Fair Exchange proposals herein and concluded that they would not violate the World Trade Organization's Agreement on Subsidies and Countervailing Measures. Furthermore, Fair Exchanges would likely pass the European Union rules for government subsidies to businesses under the Treaty of Rome because they are structured¹ like market transactions.²

B. Federal legislation to level the playing field between states and communities

Federal legislation designed to level the playing field between communities and raise the floor in negotiations with businesses would require that any community desiring federal transportation fund (*or anything else Congress could agree upon that every local government needs*) payments comply with the following:

Section 1. Enact and enforce legislation requiring that in exchange for any government investment in a private business, the citizens shall receive equity in exchange or obtain a community benefit contract backed by securities (in the form of stock, warrants or property liens) equivalent to the value of the government investment. A portion of the interest or dividends from these securities shall be used to supply the residents of the taxing entity with a stream of income or other direct benefit(s); a portion of the income shall be used to inflation proof the fund; and a portion may be used for any public purpose approved by the community trust which may include contribution to the local government. The principal shall be held or reinvested by a community trust to provide for the "long-term benefit of the community and all its citizens" as defined in the community trust agreement. (NOTE: This language should be

¹ The following is adapted from "Fair Exchange: Providing Citizens with Equity Managed by a Community Trust, in Return for Government Subsidies or Tax Breaks to Businesses", by Deborah Groban Olson, appearing in the Winter 2006 volume of the *Cornell Journal of Law and Public Policy*, going to press October 1, 2006 (the "FE Article").

² Kenneth Thomas. "Fair Exchange at the National and International Level" (October 14, 2005).

broad enough to allow experiments with a variety of positive examples described in Sections II and III of the FE Article.)

C. Federal “safe harbor” model for local laws

The following could be a safe harbor model for communities to use if Section 1 above were enacted:

“Whenever a Government invests in a private Benefited Business Entity (Company) by providing it with special benefits not given to all taxpayers in the ordinary course (hereinafter “Government Investment”), the business shall provide a quid pro quo at fair market value to the Commonwealth.

“*Benefited Business Entity*” means a for-profit enterprise in whatever form it is organized (hereinafter referred to as “Company” but not limited to enterprises organized in the corporate form).

“*Government Investment*” means any tax deduction, abatement, grant, government subsidized or guaranteed loan, license (e.g. banking and broadcasting), lease, concession, or contract, preparing and/or providing parcels of land, government contracts, and favorable utility rates, use of non-renewable resources, etc. or any other thing of value for which less than a market price is paid to the Community;

“*Quid pro quo*” means an amount equivalent to the Government Investment in corporate common stock or preferred stock or stock warrants convertible into such common stock if the Company is a stock company, or its equivalent in cash), or similar ownership rights in any other business form (hereinafter collectively referred to generally as “Company Stock”) in the Company. Said Company Stock shall have the greatest voting and dividend rights of any other class of Company Stock owned by the Company. For liability reasons, a community trust may prefer to refrain from becoming partners or LLC members with a company, and instead obtain escrow or bonds.

“*Commonweal*” means: (NOTE: Defining and structuring the “Commonweal” or “Community Trust” is the most challenging aspect of developing a Fair Exchange law.) *Here the community must decide upon a private, public or quasi-public entity that meets specific tests of bona fide interest in protecting the long-term economic, social, ecological and/or cultural interests of the local citizens. This might be the government giving the tax break. Or the community may wish to use as a model such statements of principals or objectives as the Canadian Alliance Labor Sponsored Investment Funds’ (LSIF) Statement of Alliance Principles, the language defining the Alaska Permanent Fund, the Alberta Heritage Fund or the Tennessee Valley Authority (TVA) (all described in the FE Article) or some combination or variation of these.*

This is also the place where the community must designate its “well-informed-citizen-surrogate” whether that be a set of trustees appointed by one or more elected leaders as in Alaska; a labor state or provincial labor federation, as in the Alliance LSIFs; a major cooperative federation, or a multi-party body such as the Conrail United States Railroad Act structure or leave that function to the local government as they did in Alberta.

The Commonweal or Community Trust shall provide benefits to the community generally, and (if the community so chooses) to all citizens individually as follows. (Note: Here choices must be made regarding what kinds of individual and community benefits will be provided, for example:

- a) on individual benefits (if they are to be provided): 1) dividends, savings or equity accounts for individual citizens with 2) the ability for individuals to withdraw and use the funds (for limited purposes such as for home mortgages, tuition, licensed childcare for children of working or studying parents, retirement, etc.); and 3) the ability (or not) to vote for some of the trust's leadership; and
- b) on community benefits whether to follow: 1) the social investment model of the LSIFs; 2) the endowment fund model of the Alaska fund; 3) a mixed model – such as that used in Alberta; or 4) to try something based on the TVA model.)

Community Benefit Agreement language such as that used in the State Statutory Model below might be appropriate as a safe harbor as well.

D. Model for investment of federal funds in businesses: the Fair Exchange Investment and Taxpayer Protection Act (Fair Exchange Act) of 2006 Draft, (“Fair Exchange Act”)

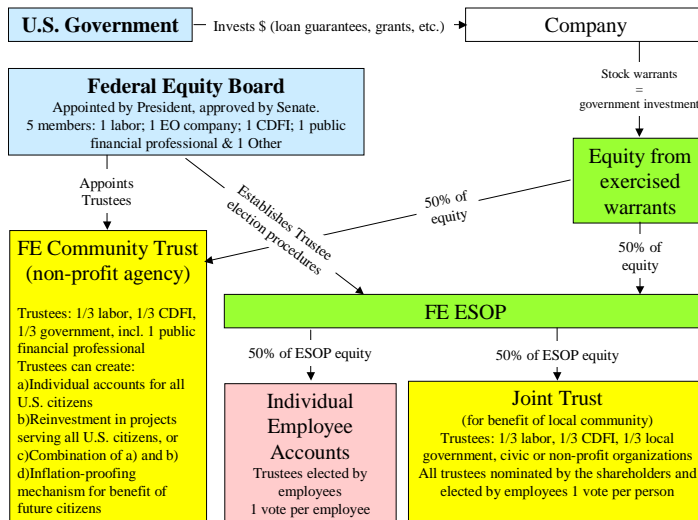
In summary, the sample Fair Exchange Act language below provides the following.

- 1) It creates a government board to negotiate and obtain equity in exchange for government subsidies to business, with a 5-member Federal Equity Exchange Board (“Equity Board”) appointed by the President and approved by the Senate.
- 2) The Board must include at least one representative from organized labor, one from a community development financial institution, one from a majority employee owned company; and one with substantial experience investing assets for public benefit or a broad based pension plan.
- 3) The fund equity is allocated equally between and managed by two bodies, the Fair Exchange ESOP (Fair Exchange ESOP), and the Fair Exchange Community Trust (Community Trust).
 - a. One half of the Fair Exchange ESOP assets are allocated to individual accounts for the Company's employees the ability for individuals to withdraw and use the funds (available to them for limited purposes such as for home mortgages, tuition, licensed childcare for children of working or studying parents, retirement, etc.); and they elect the Fair Exchange ESOP Trustee.
 - b. The other half of the Fair Exchange ESOP's stock goes to the Fair Exchange ESOP Joint Trust. The Fair Exchange ESOP Joint Trust holds its stock in a single account to be used for the benefit of current and future employees and the community. It is patient capital that sustains the enterprise and community but does not belong to any individual. Its trustees are elected 1/3 each by shareholders, employees and community representatives. The community

representatives are nominated by shareholders and elected by company employees.

The Fair Exchange Community Trust (Community Trust) is a non-profit entity whose board is appointed by the Equity Board. It decides how to allocate its half of the stock between individual and community needs and future security within certain parameters. It is the body charged with being the LSIF- type board or Alaska Permanent Fund- type trustees.) Figure 1 (below) is a diagram of the trusts created under the Fair Exchange Act, the trustee appointments and uses of funds.

Figure 1: Fair Exchange Taxpayer Investment Protection Act of 2006



Fair Exchange Act Article I – Preamble

Whereas, this Government has made loans, loan guarantees and provided other investments to private businesses since early in our history, including most railroad companies, most airlines, Chrysler, Lockheed, the savings and loan industry; and others, and

Whereas, there is no reason to believe such investments will not be sought again and again from Congress; and

Whereas, due to the increase in foreign competition in many sectors of the U.S. economy, it is reasonable to anticipate that many more businesses will seek investment from the US government in the form of grants, loans and loan guarantees, to handle the damages and risks of this new situation; and

Whereas many of the firms seeking assistance own or operate assets both within and outside the United States; and

Whereas there has been a trend of U.S. companies outsourcing much of their work outside the U.S., and

Whereas, many individual taxpayers are also harmed by loss of employment due to the circumstances that cause companies to seek government grants, loans and/or loan guarantees, tax abatements, favorable licenses, etc. (hereinafter referred to as “Government Investment”), and

Whereas, corporations, unlike individuals, may be legal persons, but do not hold citizenship in any country; and

Whereas, the primary purpose of the government is to protect had defend the rights of its citizens to life, liberty, property and the pursuit of happiness.

Fair Exchange Act Article II – Creating the Federal Equity Exchange Board

(NOTE: Much of the following language is based on the Air Transportation Safety and Stabilization Act, discussed above in the section in the FE Article regarding the airline bailout.)

IT IS HEREBY RESOLVED that the Congress of the United States shall require in exchange for any grants, loans or loan guarantees made for or on behalf of any for-profit business entity (hereinafter “ the Business”) by the United States Government or any of its agencies (hereinafter “the Government”), the Federal Equity Exchange Board (hereinafter “Equity Board”) shall obtain contracts under which the Government, the Business’ employees and all current U.S. taxpayers shall participate in gain of the participating Business and/or its security holders through use of common or preferred stock and instruments such as warrants and stock options or other appropriate equity instruments.

- A) The Equity Board’s purpose is to utilize the lending capacity of the federal government to accomplish and balance four goals:
- 1) Broadly distribute “meaningful ownership” among U.S. citizens in the same way that the Homestead Act of the 1862 made many citizens landowners and that ESOPs make employees owners;
 - 2) While lending and making loan guarantees to stabilize US businesses and the U.S. economy;
 - 3) Create a non-wage stream of income or savings for all U.S. citizens available for individuals to withdraw and use the funds (for limited purposes such as for home mortgages, tuition, licensed childcare for children of working or studying parents, retirement, etc.); and
 - 4) Make investment decisions and exercise any securities voting rights on behalf of the greatest good of the greatest number of U.S. citizens considering their need for strong sustainable communities, jobs, income, health, safety, education, a clean environment, and retirement security.

- B) The Equity Board shall include five members appointed by the President with the advice and consent of the Senate. However, there must be at least one each from a community development financial institution, one from a national labor federation, one from a majority employee owned business and one with substantial experience investing assets for public benefit or a broad based pension plan.

In carrying out the goals stated in Section 1 (above), the Equity Board may create revolving loan funds to further enable employee or community ownership programs with repaid loan funds.

- C) “Meaningful ownership” shall be interpreted by the Equity Board, but shall include both voting and property rights.

Fair Exchange Act Article III - Powers and Functions of the Equity Board, FESSOP and Fair Exchange Community Trust

A) The Equity Board shall obtain contracts under which the Government, the Business’ employees and all current U.S. taxpayers shall participate in gain of the participating Business and/or its security holders through use of common or preferred stock and instruments such as warrants and stock options or other appropriate equity instruments as follows:

- 1) In exchange for any direct grant of funds to the Business, the Business shall provide stock (or its equivalent in a non-stock business) meeting all the requirements of IRC Sec.409 (a) (with the exceptions noted in paragraph 2 below) and shall contribute qualifying employer securities, as defined in IRC Sec.4975 (e)(7) and (8), with fair market value, as defined in ERISA 29 USC Sec. 1108(e) equivalent to the value of the grant made, which shall be divided equally between:
 - a) a Fair Exchange ESOP, defined in Section A (2) below (hereinafter “Fair Exchange Fair Exchange ESOP”) and
 - b) a Fair Exchange Community Trust (hereinafter “Community Trust”), defined in Section A (4) below.
- 2) The Business shall create a qualified Fair Exchange ESOP that shall be:
 - a) An employee stock ownership plan meeting the all the requirements of IRC Sec.409 (a) (with the exceptions noted in paragraph 2(b) below) and shall contribute qualifying employer securities, as defined in IRC Sec.4975 (e)(7) and (8), with fair market value, as defined in ERISA 29 USC Sec. 1108(e) equivalent to 50% of the value of the grant made.
 - b) A qualified Fair Exchange ESOP shall include the following features in addition to the requirements noted in paragraph 2(a) above, and (where these conflict with IRC Sec. 409(a), the requirements of this paragraph shall take precedence). These requirements include:

- i. The majority of the Trustees of the Fair Exchange ESOP shall be elected on a one vote per person basis by the Fair Exchange ESOP participants, pursuant to procedures and regulations established by the Equity Board.
 - ii. Allocations to the individual accounts of individual participants in a Fair Exchange ESOP shall be made from one half of the contributed stock;
 - iii. The other half of the stock contributed to the Fair Exchange ESOP shall be allocated to the "Fair Exchange ESOP Joint Trust". The Fair Exchange ESOP Joint Trust shall hold its interest in the Fair Exchange ESOP stock for the benefit of current and future employees and the local community. Its Trustees shall be elected as follows: 1/3 by shareholders; 1/3 by the employees on a one vote per person basis; and 1/3 shall be comprised of representatives of local governmental, civic or non-profit organizations (located in communities where the Business has facilities) nominated by the shareholders and approved by vote of the employees on a one vote per person basis.
- 3) The Equity Board shall create a qualified Fair Exchange Community Trust (Community Trust) to which the Business will give the remaining 50% of the stock or equivalent required in Section a (1)(b) above.
- 4) A Community Trust shall be a non-profit agency with a board appointed by the Equity Board. Its board shall include an equal number of representatives from labor, community development financial institutions and government and at least one member with substantial experience investing assets for public benefit or a broad based pension plan.

The Community Trust is empowered to:

- a. Create individual accounts to annually allocate the equity or its income equally to each person who that year qualifies as a citizen of the U.S.; or
- b. Create a community reinvestment plan to use the equity or its income for projects that serve all the citizens of the U.S.; or
- c. Create some combination of the individual accounts and community reinvestment plan described above;
- d. Use its best efforts to create an inflation-proofing mechanism to provide a stream of income for future citizens as well as current citizens.

E. State Statutory Language Example

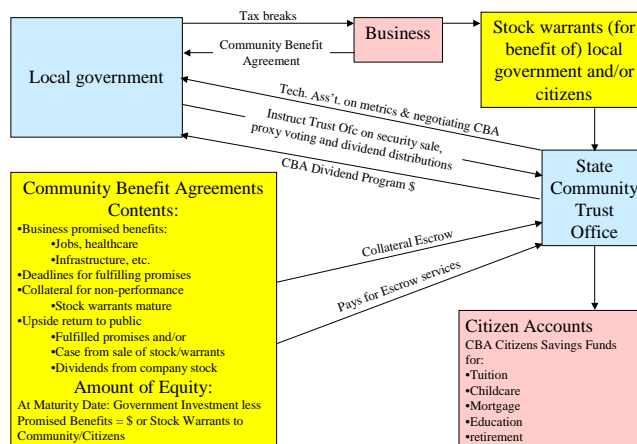
There is not a single model for Fair Exchange; it is a concept in need of pilot projects. Therefore, this single state model is not intended to be the primary state or local model, but rather one example of applying the information garnered from this article to create a model fitting a particular legislator's purposes.

The following proposal was drafted at the request of a legislative staff person. She requested a non-mandatory Fair Exchange mechanism that would enable smaller communities that lack deep financial resources to negotiate community benefit agreements and manage community trusts. A large city would probably want to create and control its own trust. A state law concerning investment of state funds might look more similar to the proposed Fair Exchange Act model for federal funds.

Creating a system that is socially useful and economically fair from our current system of government subsidies is a complex process. The new system will need well-considered legal and administrative structures. Successful Fair Exchange laws will require a strong and focused technical assistance capacity. Distressed communities and states are probably not well suited to a mandatory fair exchange policy because of the level of risk in their deals and the scarcity of potential investors. However, even in those locations, a non-mandatory fair exchange policy might be useful. There may be deals where the private investor would be willing, or the public entity would have the ability, to make a larger investment if a fair exchange contract were in place. In those cases, it may be useful to have legislation providing the format for a community benefit agreement and a state agency able to provide technical assistance or oversight that is beyond the resources of small communities (discussed further in Section V(A) below).

In summary, the sample language below: 1) creates a trustee in the state treasurer’s office who can hold stock, warrants, other securities or escrow funds negotiated in a Community Benefit Agreement, and paid for out of the trusts it manages; 2) defines a Securitized Community Benefit Agreement as a contract between a community, a business receiving special government benefits and a community trust organization in which the business promises to provide very specific benefits to the community in exchange for its investment in the Company; 3) requires the parties to agree on metrics to measure performance of these promises and firm dates by which performance is required; and 4) provides that to the extent full performance is not timely performed, a corollary percent of the security becomes permanently vested in the community trust. (See Figure 2 below.)

Figure 2: State (Trust Office) Fair Exchange Model



Example:

Whereas, this State Government and local governments within the State have made loans, loan guarantees and provided other investments to private businesses in the past and are likely to in the future, and

Whereas many of the firms seeking assistance own or operate assets both within and outside the State; and

Whereas there has been a trend of U.S. companies outsourcing much of their work outside the U.S., and

Whereas, many individual taxpayers are also harmed by loss of employment due to the circumstances that cause companies to seek government grants, loans and/or loan guarantees, tax abatements, favorable licenses, etc. (hereinafter referred to as “government largesse”), and

Whereas, corporations, unlike individuals, may be legal persons, but are not citizens; and

Whereas, the primary purpose of the government is to protect and defend the rights of its citizens to life, liberty, property and the pursuit of happiness:

NOW THEREFORE, the State of _____ hereby creates a structure enabling the State and local governments to enter into community benefit agreements with businesses. It provides a State trustee to hold collateral or escrow from companies for communities derived from community benefit agreements. Nothing herein shall prevent a local government from creating its own community trust to hold and manage such assets, nor require that the State trustee hold such assets. The trust structure is intended to provide cost savings and enhance expertise by pooling trustee services for interested communities. The trustee services will be paid on a fee for service basis by the trusts utilizing it. The trustee disperses the funds at the direction of the community government for any of the permitted purposes.

- a. The State of _____ hereby creates a statewide community trust office in the State Department of Treasury, “_____ Community Trust Office” (“Trust Office”), which shall administer assets obtained as security for Community Benefit Agreements (CBAs).
- b. Any “Community,” defined in Sec.(c) below, may enter into a “Securitized Community Benefit Agreement” (“Securitized CBA”), defined in Sec.(c) below, with a “Business”, defined in Sec.(c) below. Any Securitized CBA which meets the requirements of this statute may, upon community request, be administered by the Trust Office in cooperation with the local Community as provided in this statute.
- c. When a “Community” (*NOTE: as defined in whatever section of _____ Code defines all boards of directors for governments in _____ from the state on down to the township and school authority – citation to be added*) invests in a private business (hereinafter “Business”) by providing it with special benefits not given to all taxpayers in the ordinary course (hereinafter “Government Investment”), such as a tax abatement, a gift of land or any other thing of value for which less than a market price is paid to the Community; the

Community may enter into a securitized Community Benefit Agreement (Securitized CBA) defined as:

“A contract between a Community granting Government Investment and the Business (“Company”) may include a “Securitized CBA Security” to insure that the Community shall receive fair value in exchange for the ‘Government Investment’.

- d. The Trust Office shall hold the Securitized CBA Security in trust for the Community in accordance with the terms of the Securitized CBA.
- e. Every Security Agreement shall have one Maturity Date or series of Maturity Dates. The Securitized CBA may state specific non-Securitized CBA “Promised Benefits” (Company Promised Benefits) to be provided to the Community by the Company by no later than the Maturity Date(s) specified in the Securitized CBA;
- f. The Securitized CBA shall include metrics (meeting the requirements of Trust Office regulations *to be promulgated*) to quantify the Government Investments and any Company Promised Benefits enumerated in the Securitized CBA to enable both parties to measure partial and complete Company Promised Benefits performance;
- g. Upon the Maturity Date the Securitized CBA Security shall mature. For any portion of Company Promised Benefits not performed by the Maturity Date, that portion of the Securitized CBA Security shall become the inalienable property of the Trust Office for the benefit of the Community
- h. Unless another type of Securitized CBA Security (meeting requirements of Trust Office regulations to be promulgated) is mutually agreed upon by the parties, the Securitized CBA Security shall be corporate common stock (if the Company is a stock company), or similar ownership rights in any other business form (hereinafter collectively referred to generally as “ Securitized CBA Stock” in the Company with the greatest voting and dividend rights or preferred stock convertible into such common stock or its equivalent in cash. For liability reasons, a community trust may prefer to refrain from becoming partners or LLC members with a company, and instead obtain escrow or bonds.
- i. The Securitized CBA shall provide that no later than the closing date of the Government Investment transaction, the Company issue Securitized CBA Security warrants in the name of the Trust Office for the benefit of the Community. Said warrants shall mature on the Maturity Date(s) in the total amount of the Government Investment less the value of the Company Promised Benefits (as measured by the agreed upon metric described in Sec. (f) above) as of the relevant Maturity Date
- j. The matured warrants shall then be retained or sold by the Trust Office as directed by the Community government. A Community may direct the Trust Office to use the dividends and/or proceeds from sale of the Securitized CBA Stock for any of the following within the Community’s jurisdiction (as instructed by the Community governing Board of Directors): utility subsidy to every Community ratepayer; public parks, public schools, public safety, fire protection, environmental clean-up, arts & culture or savings funds for every citizen which may be withdrawn without penalty for tuition, licensed child care for children of working or

studying parents, home purchase, local business investment (to be further defined), retirement or health care.

Any voting Securitized CBA Stock retained by Trust Office pursuant to Community instructions shall be voted as instructed by the Community governing board.

F. Fair Exchange adds self-enforcement feature to community benefit agreements

Note that the state model, with the community benefit agreement (above), unlike the other models, does not require that the business give up any equity permanently as an upside for risk. This model is designed for those situations where the community is more interested in getting other benefits such as jobs with health insurance, than it is in getting an equity investment. The new feature this state Fair Exchange model adds to community benefit agreements is self-enforcement. Unlike a typical contract or a state clawback law, which courts would need to enforce, the equity collateral or escrow is in the hands of the community trust when the subsidy deal closes.³ Non-compliance by the business triggers maturity of the warrants, and the community trust owns stock or retrieves the escrow. Such escrows are fairly standard in substantial business contracts.

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II. Issues Confronting Potential Fair Exchange Legislation

A. The benefits of mandatory federal legislation

Given the competition for the location of new business facilities among local governments, mandatory federal legislation is the best option for fair exchange programs. One of the most difficult obstacles to implementing a Fair Exchange proposal is the competition between communities when companies are seeking locations for new facilities and jobs.⁴ There are many examples of companies asking communities to make bids for a plant, and significant examples where the community paid for far more than it received.⁵ Many local leaders and politicians see the logic of the Fair Exchange idea, but believe it is politically impossible to create any such obstacles to potential new jobs in their communities. This way of thinking has led to ever-larger public incentives and investments in private businesses, without protection.

The fact that the U.S. government required, received and made a profit on its Chrysler stock warrants is not widely known.⁶ Even more obscure is the fact that every loan and loan guarantee given by the Airline Stabilization Board required and received stock warrants.⁷ These are clear federal precedents. Furthermore, in a report by the (GAO),⁸ one of the key recommendations is for the government to get potential “upside” benefits should it decide to make such an investment again. With the change of a few words, the language of the ASTSSA could be amended to require equity in any situation where the federal government makes a loan or loan

³ Greg LeRoy, *No More Candy Store: States and Cities Making Job Subsidies Accountable* (1997) 43-54.

⁴ See generally *id.*

⁵ See *id.* at 4-5.

⁶ See §, *infra*, discussing 1979 Chrysler Corporation Loan Guarantee Act.

⁷ Testimony of Michael Kestenbaum, Executive Director of the Air Transportation Stabilization Board before the Subcommittee on Aviation United States House of Representatives, June 3, 2004, p. 2.

⁸ Comptroller General of the United States, Report to Congress: Guidelines for Rescuing Large Failing Firms and Municipalities, GAO/GGD 84-34 (1984), 17-18.

guarantee or other such investment. It need not be limited to airlines.⁹ The FEITPA 2006 model above is based on existing ASTSSA and ESOP laws.

A solution to the competition problem between states and local government would be federal legislation that required, as a condition of receiving federal transportation or other development funds, that any special government benefits to private businesses would have to be subject to a fair exchange community benefit agreement created under a local or state fair exchange law. Such laws would need to permit enforcement by “affected parties” or a federal agency in order to avoid evasion of the law through sweetheart deals between local politicians and businesses. The “Federal legislation to level the playing field between states and communities” in the above “Fair Exchange Models” section is designed to address this problem.

B. Getting initial legislation passed argues for optional and local

LSIF is private and voluntary. No individual has to put his money into it. The government makes no direct contributions with tax funds, except to provide tax exemptions for contributions by individuals.

The state statutory language example above is optional, local legislation. The legislative aide who requested it believes that the easiest way to get actual Fair Exchange laws enacted is to start small, with optional laws, and strengthen them over time as they become better known and accepted.

Communities and states that are most likely to be successful early adopters of FE, are those fast-growing, attractive communities that have sufficient demand and thus market leverage to reject subsidy seekers. Possible examples include the communities to which initially Manhattan-based businesses have been moving since 9/11, such as Stamford, CT or Jersey City; or states with increasing populations like California.

Due to competition between communities for job location, communities with less market leverage (such as the rust belt states) may seek or wait for federal legislation to level the playing field.

⁹ Compare the language in the “Model for investment of federal funds in businesses: The Fair Exchange Investment and Taxpayer Protection Act of 2005 with ATSSSA115 Stat. 230, 49 U.S.C. 40101 Sections 102 (b) and (d).