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### The Ideal Deal: How Local Governments Can Get More for Their Economic Development Dollar

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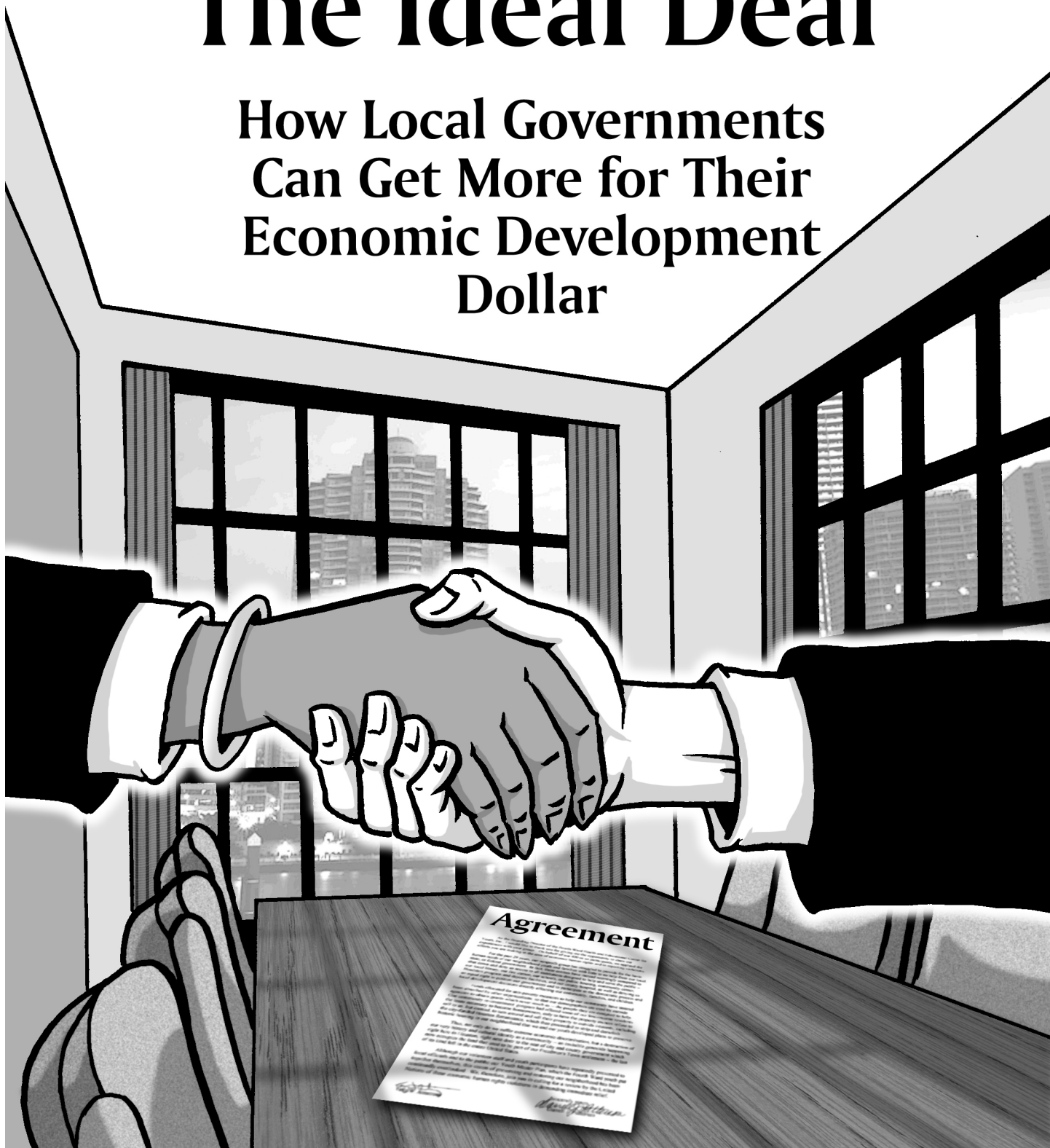
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# The Ideal Deal

How Local Governments  
Can Get More for Their  
Economic Development  
Dollar



**Good Jobs First  
and the University of Illinois at Chicago  
Center for Urban Economic Development**

March 2007

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# **THE IDEAL DEAL: HOW LOCAL GOVERNMENTS CAN GET MORE FOR THEIR ECONOMIC DEVELOPMENT DOLLAR**

by

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UIC Center for Urban Economic Development

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# INTRODUCTION

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American states and municipalities have provided private companies with economic development incentives -- property tax abatements, low-interest loans, grants for expansion -- since this country's inception. Over the last twenty years the practice has grown exponentially, and with this growth has come more complex public financing instruments like Tax Increment Financing (TIF). Today, it is safe to say that every city, county, and state offers some kind of incentive to prospective and existing businesses. The average state provides more than 30 different kinds of economic development subsidies, many of which are administered by local or regional bodies.

With this growth has also come heavy criticism from taxpayers accusing the public sector of giving away too much for too little. Total state and local spending for jobs is now estimated at more than \$50 billion a year.<sup>1</sup> In the *Time* magazine cover story entitled "What Corporate Welfare Costs" the authors found that federal, state and local incentives cost "every working man and woman in America the equivalent of two weekly paychecks" each year.<sup>2</sup>

It is not clear what taxpayers are getting in return. Studies have revealed that state and local incentives are often not cost-effective mechanisms for economic development because subsidized

companies often relocate or fail to create the jobs and other public benefits promised.<sup>3</sup> Critics point to empirical evidence that incentives cost more than the public benefits they create and redirect monies from other important public goods like infrastructure and education. And there is anecdotal evidence suggesting that incentives poison inter-jurisdictional relations, contribute to sprawl, favor large businesses over small, strain the planning capacity of local government, and are subject to cronyism and abuse.<sup>4</sup> Good government advocates and libertarians alike regularly call for an end to such practices.

But demands for federal legislation that would eliminate the practice of incentives have been largely ignored. Critics admit that, despite their general distaste for incentives and the competitive inter-jurisdictional relations they create, such programs are difficult to condemn across the board. Incentives, along with zoning and land use regulations, are one of the few sources of bargaining leverage that local governments have over developers and businesses. They use the leverage in attempts to strategically influence site-location decisions and the magnitude of private investment. Whereas some jurisdictions are held hostage to demands of businesses and sign off on expensive

long-term commitments, other states and cities are able to negotiate better agreements. These local governments absorb relatively little risk and commit relatively little up-front investment in relation to the public benefits created.

Our position is that if economic development agencies intend to continue the practice of offering incentives, they should do it in a smarter manner. Administrators must focus their energies not on rolling out the red carpet for any interested party, but on ending up with deals that make fiscal sense and protect the agency (and the taxpayers) in the event of a breach by the incentive recipient. Some of this might come by pushing for more detailed statutes and ordinances that govern the incentive relationship. But the most important opportunity -- and most often squandered -- is the negotiation and drafting of individual contracts. That government agencies often overlook opportunities for promoting the public good in this process should come as no surprise: while such contractual mechanisms have been used in Europe for decades, they have only recently become accepted practice in the United States.

Without a comprehensive guide to drafting contracts that make incentive recipients more accountable to taxpayers and residents, economic development departments must either reinvent the wheel every time they wish to grant an incentive or rely on standardized "boilerplate" contracts that may not offer them the protection they need because they are old or do not sufficiently account for the particularities of the deal. Conversations with practitioners reveal that, especially in smaller municipalities and counties, they waste time calling

around to other local governments or negotiating with their legal departments over exact wording. Even when they are seeking to make incentives more economically efficient, practitioners lack adequate information about the different legal mechanisms and techniques that would allow them to do so.

This handbook is designed to provide local economic development practitioners with an important tool. It takes the reader step-by-step through the different elements of contracts that treat public incentive packages as a *quid pro quo* for public benefits. Each section discusses a different element of the ideal deal: valuation of public costs and benefits, performance standards, disclosure and oversight, and enforcement. In each section we provide detailed examples of model provisions used by local governments in their incentive legislation, ordinances, and contracts -- information that has not before been obtained or recorded in any systematic way. These examples are meant to both illustrate the key principles for negotiating ideal deals and also serve as templates for actual contract language. They are supplemented with commentary culled from interviews conducted with local government officials, academic studies, and reports by watchdog organizations around the country.

Giving away tax revenues with few strings attached is not an effective way of meeting policy objectives or managing public finances. Following the best practices provided in this handbook is a first step toward designing legally enforceable contracts that can protect public interests and more widely distribute the benefits of economic development.

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# BACKGROUND

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Development incentives and regulatory environments matter less to companies when deciding between distinct regions of the country. The availability and cost of skilled labor, occupancy costs, proximity to key customers and suppliers, transportation and utility costs, and the whims of corporate executives are more important at this stage. Once a company has narrowed its choice of location to a particular region, however, it begins to consider the tax burden and physical characteristics of potential sites. The site location decision could be a relatively private affair: the business purchases land, hires a developer and employees, and pays whatever taxes it is determined to owe. Aside from obtaining the requisite building permits and complying with existing zoning and environmental regulations, the business could have little contact with the public sector.

Negotiations ensue only if the business wants something more from local government, or the local government wants something more from business. What that “more” is is often contested because public and private responsibilities in economic development are not fixed and unchanging. The principle, for example, that a city should not be responsible for the development costs of individual businesses (because this falls squarely

within a private realm) is difficult to support given the long history of public assistance to business. The recent history of intense incentive use has blurred the boundaries of public and private roles making it impossible to defer to principle or precedent. Every case, therefore, must be negotiated on its own merits.

While contracts will vary, it is clear that without legally enforceable one specifying the obligations of the respective parties, an economic development incentive will be considered a gift and not part of a *quid pro quo* exchange. This distinction is not just semantic; it is difficult, if not impossible, to tell someone how to use a gift. Consider the following three examples:

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The Triangle Corporation decided to move equipment out of its Diamond Tool plant in Duluth, Minnesota after the city issued \$10 million in Industrial Development Revenue Bonds to finance the corporation’s acquisition and modernization there. When the City of Duluth sued, the court found that “while the parties discussed a restriction which would have required Triangle to guarantee certain employment levels at the company. . . the party’s final agreement did not contain specific employment levels.” Any provision to tie



the incentive to the jobs was therefore unenforceable.<sup>5</sup>

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When the township of Ypsilanti and the County of Washtenaw, Michigan sought to recover \$13.5 million of a much larger package of tax abatements from General Motors (GM) Corporation after GM announced plans to close its auto assembly plant and consolidate production in Arlington, Texas.<sup>6</sup> The company had employed 4,500 workers at its Willow Run plant.

The local governments claimed that GM had made a binding promise to produce cars at Willow Run in return for the tax abatements. Although the trial court judge ruled in their favor, GM got the decision overturned on appeal. The appellate court held that public statements by GM that were previously interpreted as promises were actually “expressions of hopes or expectations that operations would continue at Willow Run.” The appeals court suggested that any company would “tak(e) advantage of statutory opportunities” to obtain a tax abatement and that GM had made no real assurances of continued employment.

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The City of Roanoke, Virginia authorized a grant of \$500,000 to First Union National Bank to train 200 new workers and retain 359 existing jobs.<sup>7</sup> First Union signed a contract with the City to keep all of these jobs in its downtown branch for at least five years. After one year the bank had drawn down \$326,000 of the grant, yet there were not only no new jobs, the bank had actually reduced the number of previously existing ones. It subsequently

announced that it would close the entire downtown loan servicing operation.

Luckily, the City of Roanoke had signed a contract with First Union that specified the number of jobs the bank had promised to create and maintain and the period of time over which this promise was to be binding. In addition, the contract contained provisions which required that the bank pay the city \$400 for each job it did not create. When the bank failed to create the promised number of jobs, it refunded the money it owed and modified the contract with the city to create jobs in a different neighborhood branch.

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The experiences of Duluth, Ypsilanti, and Roanoke make clear that contracts play an important role in holding companies to their promises of job creation and local investment. Contracts – also known as development, redevelopment, or incentive agreements – are the focus of this handbook because they are the embodiment of all the different aspects of economic development deal-making process.

Drafting a contract that specifies promised benefits and includes enforcement measures is not difficult to do. In fact, the idea is quite simple: if developers and companies seek financial assistance from the public sector in order to start-up or expand their operations, they must be prepared to: (a) invest in the community through job creation and capital investment; (b) treat local governments as they would any other contracting party; and (c) expect consequences for breaching their agreement. Contract law will govern how an agreement is drafted and how

courts will interpret it.

Contract law is, however, state law, and state legislation plays a critical role in drafting and enforcing good contracts. In our federal system, states possess more regulatory powers than municipalities and counties. As such, courts tend to defer to states and their legislatures when enforcing incentive contracts. If the legislature expresses a clear intent to promote specific goals through their economic development programs, even judges who are hostile to these goals will find themselves constrained to a degree to respect that intent. Having state statutes that embody the aforementioned principles allows for the imposition of conditions that could not be attained in contract negotiations but must be accepted as a matter of law. Moreover legislation is uniform throughout the state and establishes identifiable standards that reduce destructive inter-municipal competition.

The strongest contracts, therefore, are those whose key provisions are reinforced by similar and strong legislation. In the following pages we offer model language that can be adopted in individual development agreements and contracts local governments sign with subsidized businesses as well as in state statutes and municipal ordinances.

Moreover, in each state, special rules will govern the terms of individual contracts. While we choose to focus on some of the most important and generally valid principles, the handbook is not intended to be a substitute for the advice of local legal counsel.

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# SECTION ONE:

## VALUING PUBLIC COSTS AND BENEFITS

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Before any subsidy changes hands, local officials should have a solid understanding of the value of the expected public benefits and the real public costs of the incentives offered. Unfortunately, whether due to a perceived lack of technical precision or pressure to approve deals quickly, many officials do not thoroughly evaluate the costs and benefits of their subsidy programs. For example, a survey of local economic development practitioners showed only 24 percent possessed quantitative techniques for analyzing deals.<sup>8</sup>

Even when quantitative measures are developed, they often fail to capture the true costs and benefits due to bad accounting practices. Most local governments tally benefits on the revenue side of the ledger, including property taxes, paybacks and profit sharing. On the expense side, however, costs typically include only direct cash outlays. They exclude the opportunity costs tied to below-market interest rates, deferred paybacks, loan guarantees, and in-kind expenses.

They exclude tax expenditures, which are the most important and yet most misunderstood type of subsidy. If accounting practices do not recognize these different kinds of expenditures or fail

to acknowledge how incentives are often backed by promises to be paid by future revenues, accounts can not be considered to be in balance.<sup>9</sup>

Indeed, one of the reasons why incentives are so attractive to local governments is that they are often made off budget. Although more than half of all states now require “tax expenditure budgets” (that are intended to record the opportunity costs of any uncollected tax revenues in addition to any appropriated expenditures), their quality and exhaustiveness is uneven. Local governments that wish to better manage their finances in this area are urged to follow the advice listed below.

### **Estimate how much the public benefits are “worth” relative to the amount of the subsidy**

Most municipalities and many states do not have the expertise to conduct comprehensive cost-benefit analyses of incentive deals to determine whether the local benefits justify the loss of tax revenues. Cost-benefit analysis allows the analyst to compare the present value of anticipated public costs (e.g., cash expenses, foregone revenues and additional expenditures on services, such as schools and infrastructure) to the present value of expected benefits (e.g., tax

revenues and fees, new jobs, revenues generated by salaries of new employees and multiplier effects) *ex ante*.

This form of analysis can determine if the costs of subsidies are likely to outweigh the revenues generated over a particular time period, thus alerting public officials to the fact that a deal may provide too little payback for the expected expenses incurred. Cost-benefit spreadsheet programs can help the public sector determine the “tipping point” (less subsidy, more public benefits) at which the deal makes financial sense.

Commercially-available software programs, such as IMPLAN and Regional Economic Models Incorporated (REMI), or ones developed by universities, such as the University of Illinois at Chicago, allow government officials to evaluate both the employment and revenue impacts of potential incentive deals.<sup>10</sup> Missouri and Indianapolis use cost-benefit programs developed by private consultants to analyze each potential project. Many cost-benefit analyses are really only evaluating the *fiscal* impacts on the local government, i.e., the public expenditure and revenue effects of a subsidy, instead of the benefits and costs related to the induced and indirect employment ostensibly spurred by the corporate relocation or expansion. In Indianapolis, for example, if the fiscal impact analysis shows that it will take more than four years for a particular project to offer a positive revenue return to the city, it is not considered a project that is eligible for incentives.

Both fiscal impact analysis and cost-benefit analysis provide a ballpark estimate of how much each subsidized job or dollar of new revenue will cost. Armed with this

information, local governments can cap the amount of incentives available. The U.S. Small Business Administration and the U.S. Department of Housing and Urban Development have subsidy limits of \$35,000 per created or retained job.<sup>11</sup> A handful of states have followed their lead. Illinois’ Department of Commerce and Economic Opportunity caps incentives at \$10,000 per job created or retained through its Community Development Assistance Program. Minnesota, Pennsylvania, New Jersey and West Virginia also cap subsidies at \$15,000 to \$35,000 per job created.

While analytical tools are helpful, it is important to understand the assumptions underlying the models in order to feel confident of their predictive power. There are two areas where the spreadsheet models could stand to be improved. First, prospective public benefits like physical improvements and environmental cleanup may be difficult to value because, in most instances and without the use of sophisticated modeling, they have no obvious market price. Second, many local costs of subsidies are often shifted to the state or federal governments, and these intergovernmental transfers are not captured by cost-benefit analysis conducted only at the local scale. For example, the use of tax increment financing (TIF) by local governments may trigger additional transfers of aid from the state to equalize school funding. A more comprehensive analysis would be inclusive of costs borne by all levels of government.

### **Require corporate disclosure of relevant information**

Ideally, local governments would know how much bargaining leverage they have

with companies who request their assistance. What are other municipalities or states offering the company, and how important are these incentives to its investment decisions? Unfortunately, much of this “market” data is rarely disclosed. Even worse, many analysts suggest that, goaded by site selection consultants, companies frequently overstate the role of incentives in determining where companies choose to expand or relocate, and that many even decide on their project sites before governments make subsidy offers.<sup>12</sup> In other words, the financial gap companies seek to fill to make a project feasible may be much smaller than they would have the public sector believe. They can bluff and demand more than is really necessary because management has access to relevant information about the firm’s own cost structure and hurdle rates to which local governments are not privy. In practice, the government that is most optimistic about the value of economic development or has the most lax budget and statutory constraints will be the highest bidder.

Despite these hurdles, local governments can make some efforts to ensure that the incentive is necessary or, at a minimum, somewhat important to the company’s location decision. Disclosure requirements can allow the public sector to gain more knowledge about a business’ actual costs and financing needs and may force possible subsidy recipients to demonstrate their interest in a particular location. The city of Minneapolis’ 1998 living wage ordinance, for example, requires applicants for public contracts or financial assistance to provide the names of all programs to which they are applying and the total public cost of the assistance.

In Illinois, existing businesses seeking assistance must provide the state with the prospective plan for which 1,500 full-time jobs would be eliminated in the event that the business is not designated as a “High Impact Business” (a designation that allows it to access certain state tax exemptions). Proposals for new facilities must provide proof of an alternative non-Illinois site that would receive the proposed investment and job creation in the event that the business is not designated as a High Impact Business. This increased transparency may overcome some of the problems associated with bluffing, and, if staff can check on counter offers, may deter companies from playing multiple jurisdictions off each other in order to ratchet up the price of the subsidy.

Other incentive programs require that applicants disclose their development and operating pro forma and identify gaps that they are seeking to have filled by public assistance. Government personnel need to be financially literate enough to make sense of these spreadsheets, be familiar with current cost estimates, and identify costs that are being overstated.

While disclosure requirements may place a burden on the corporate subsidy-seeker to demonstrate that they are serious about relocating, these provisions are generally less effective (i.e., legally binding) than those we will discuss in the following chapters. For example, it is easy to falsify or exaggerate a firm’s cost structure for strategic effect. Development consultants regularly admit that firms draft separate pro forma for separate purposes (e.g., understating revenues for incentive and income tax purposes while overstating them for lenders).

Local governments should be aware that disclosure requirements are among the weaker forms of subsidy accountability and although they may be included in contracts, they offer few substantive protections. If they are going to be required, they must be used in tandem with impact analysis, performance standards, and enforceability mechanisms.

### Avoid reliance on “but for” provisions

Incentive programs often require the company to attest to the fact that it would not have considered the municipality as a potential location or would have eliminated a certain number of jobs *but for* the incentive. For example, the Michigan Economic Growth Act (MEGA) provides that:

*The tax credits authorized under the agreement address the competitive disadvantages of locating in Michigan instead of a site outside of the state; the project will not occur in Michigan without the tax credits offered by this agreement. If the company misrepresents itself by making this statement, the authority may revoke the company's eligibility for further credits.*<sup>13</sup>

Sometimes these “but for” clauses even come with teeth. In Illinois, for example, if a business receives the designation of “High Impact Business” in order to access certain state tax exemptions and it is later determined that the business would have made the investment and created or retained the requisite number of jobs *without* the benefits of the designation, the state department of economic development will revoke that designation.<sup>14</sup> It is also supposed to notify

the state department of revenue to begin proceedings to recover all wrongfully exempted state taxes with interest (i.e., clawbacks, a contractual provision we discuss in more detail in Section Four).

All of these types of “but for” provisions are intended to protect against the possibility that the firm does not really need the subsidy but is taking advantage of its superior bargaining position (the fact that firms are mobile but governments are not) to seek whatever assistance is available. The problem with these provisions is that they create a false sense of security. “But for” clauses are notoriously easy to elude and difficult to disprove – so difficult, in fact, that few states or cities actually enforce them. How, after all, can one demonstrate definitively that the incentive does or does not *matter* in a firm’s location decision? What constitutes proof that an expansion decision was made only because of the incentive? Research has consistently demonstrated that subsidies are rarely the deal-makers or deal-breakers; other factors tend to be much more important in the location decision-making calculus of a firm.<sup>15</sup>

“But for” provisions are very common in state statutes and redevelopment agreements despite the fact that they do not really guard against bluffing. It is critical to remember that they are no substitute for strong performance standards, oversight provisions, and enforcement mechanisms, topics to which we now turn.

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## SECTION TWO: SETTING PERFORMANCE STANDARDS

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What is an “ideal deal” from the perspective of the local government? That depends on what the local government hopes to achieve from its economic development programs. While the answer to this question may seem obvious (“good jobs,” “economic diversification,” “a stronger tax base”), knowing exactly why a particular community wants economic development can be difficult to intuit. Is it more important, for example, to bring in new jobs for an underemployed but skilled labor force or to redevelop a deteriorating section of the main street that has become an eyesore? Input from key stakeholders and community residents often provides a sense of which goals are a priority. Once these goals have been defined, they can then be translated into specific, legally binding performance standards.

### **Identify the authorizing statute**

The goals of economic development programs and the authority to give incentives are often contained in state statutes, which can be used to guide municipalities through the incentive process. And while the guidance might be very general, it is nonetheless important to refer to the statute in local agreements and mimic its language. For example:

*The MEGA Program was created by the Michigan Economic Growth Authority Act, Act No.24 of Public Acts of 1995. It gives Michigan municipalities the power to provide tax credits to businesses involved in manufacturing, mining, research, development, wholesale, trade and/or office operations, and enterprise for the purpose of . . .<sup>16</sup>*

Referencing the authorizing statute ensures that there is no ambiguity about the purpose of the contract and the authority to make it. It will also put the incentive recipient on notice of any statutory obligations that may not be contained in the contract itself.

It is important to remember that the authorizing statute typically sets a floor, not a ceiling, for the amount of control and the number of conditions a grantor may put on an incentive. This means city, regional, and state agencies have a certain amount of discretion to require behavior from assisted developers and companies above and beyond that required by statute or regulation.

## Articulate performance standards as specifically as possible

The public goals of the incentive must be stated explicitly so that it is possible to evaluate the extent to which the firms granted the inducements are complying with the conditions imposed. It is generally a mistake to be vague; “stimulating the economy,” “creating jobs,” and “increasing the tax base” are suitable as intent language in authorizing statutes. But they are not appropriate for development contracts because they are so open-ended that they impose no effective constraints on the granting authority nor do they give the courts much meaningful guidance in interpreting contractual conditions.

The terms of a contract must be clear in order to be enforceable. Ordinary words should be used in their ordinary contexts. Technical terms should be defined. If there is more than one reasonable definition, state which one is intended in the document itself. Contracts that rely on very loose parameters of fulfillment are considered “incomplete” and provide parties with opportunities to exploit existing gaps.

Some states have taken steps to limit such gaps. For example, Minnesota requires state agencies and municipalities to develop explicit benchmarks for awarding subsidies. These public purpose benchmarks include standards for job creation and for the wages of the new jobs. Moreover, job retention is only considered a legitimate criterion “*where job loss is imminent and demonstrable.*”<sup>17</sup> The law includes an exemption for business loans

and loan guarantees of \$75,000 or less to ensure that job creation and wage requirements do not harm start-up businesses, particularly those in low-income communities. The law requires each incentive-granting agency to submit their benchmarks to the Department of Employment and Economic Development and for the department to publish them annually.

If a term is ambiguous, its meaning may have to be interpreted by a judge. And courts cannot be counted on to find legally binding obligations that may seem obvious to the contracting parties at the time the contract is made but are not written in the contract itself. They often defer to the Parole Evidence Rule, which excludes any evidence of prior or contemporaneous agreements from consideration in a dispute over the interpretation of a contract.

This is especially true for mortgage agreements and other loan documents. Courts interpret loan contracts according to the principles and purposes of loan security. If the municipality signs a mortgage agreement with a firm for a low-interest loan, it must also specify the wider purpose of the incentive or else the court’s primary concern will be the company’s adherence to conventional loan terms (e.g., making payments on time, collateral security). For example, the state of West Virginia loaned over \$64 million to Anchor Hocking to help the company keep its plant open and provide jobs to its employees. Unfortunately it failed to state these purposes in the actual loan documents. The absence of a specific goal, coupled with a contractual provision allowing prepayment of the loan without penalty, led the court to conclude that the firm



satisfied its obligations by paying off the loan.<sup>18</sup>

Given these perils, the written contract should represent the complete understanding between the parties. In the following sections, we provide examples of the language used in contracts across the country to describe the different kinds of public benefits that local governments may pursue through their use of incentives.

### JOB CREATION AND RETENTION

Performance standards typically make incentives conditional on employment projections. An early study of nine grant and loan programs found that all required recipient firms to specify projected job creation.<sup>19</sup>

Local governments use two kinds of payment provisions for securing these benefits. The first sets a threshold job creation requirement as a condition for receiving public assistance. The second offers a specific amount of incentive on a per-job basis. An example of a threshold requirement is the Iowa New Jobs and Income Agreement, which provides that:

*The (subsidized) business must create at least 50 new full-time jobs at the project location within five years of the application approval and must maintain that level for five years after first meeting that obligation.*<sup>20</sup>

A business taking advantage of Michigan's Economic Growth Act (MEGA) program:

*(M)ust create 75 new jobs if it is expanding its facility within Michigan, 150 jobs if it is relocating to the state; and 25 jobs if the facility is relocating to a state enterprise zone.*<sup>21</sup>

The second kind of provision does not provide any funds to the company until the job has been created. "Back-loading" incentives based on the number of jobs is an attractive option for local governments. This kind of payment clause can potentially protect the jurisdiction's investment in case the company is not successful or falls behind in its hiring schedule.

The \$2.5 million incentive package negotiated between Bismarck, North Dakota and Coventry Healthcare contained a provision that gave Coventry incrementally larger payments as hiring progressed.<sup>22</sup> The city was thus allowed to withhold its largest payment until the final group of employees had been hired.

Another example of contract language that requires incentives to be calibrated to successive employment levels is from Vermont's Small Business Investment Tax Credit:

*A person may receive a credit against its income taxes in an amount equal to five to ten percent of its investments within the state of Vermont in excess of \$150,000 in plants or facilities and machinery and equipment in the applicable tax year according to the following:*

- 1) *A person employing fewer than 150 full-time employees may receive an income tax credit equal to ten percent of its investments in plants or facilities and machinery and equipment in the applicable tax year.*
- 2) *A person employing between 150 and 250 full-time employees may receive an income tax credit of six to nine percent of its investments in plants or*

*facilities and machinery and equipment in the applicable tax year based on the following proportional sliding scale:*

- (a) a nine percent tax credit for 150-174 full-time employees;*
  - (b) an eight percent tax credit for 175-199 full-time employees;*
  - (c) a seven percent tax credit for 200-224 full-time employees; and*
  - (d) a six percent tax credit for 225-250 full-time employees.*
- 3) *A person employing more than 250 full-time employees may receive an income tax credit equal to five percent of its investment in plants or facilities.*<sup>23</sup>

These types of payment clauses are common with corporate income tax credits. Standing alone, their inclusion in a contract is not an entirely foolproof means of ensuring accountability. Many of the “new” positions may have been created in the absence of public assistance; the fact that they are created *before* the public assistance changes hands begs the question of whether the incentives were truly necessary from an operating standpoint. Moreover, local officials may neglect to place effective monitoring and enforcement standards (e.g., clawbacks discussed later) in such contracts because they feel unduly protected by the presence of back-end payment schemes.

Regardless of which approach the local government takes, the contract should define the kinds of jobs that count toward job creation and retention goals. Simply requiring a certain number of “jobs” would leave a court the option of interpreting its meaning as either full-time and part-time

positions. Generally “full-time” implies that employees work a minimum of 35 hours per week (this is the case, for example, in order to qualify for protection under the Employee Retirement Income Security Act (ERISA) of 1974). Contracts in Iowa include a definition of a “Full-Time Equivalent Job” as the equivalent of employment of one person for eight hours per day for a five day, forty-hour workweek for fifty weeks per year.<sup>24</sup> The employment tax credit available to financial institutions in Delaware is only applicable for full-time employees who are eligible for health insurance benefits.<sup>25</sup> It is always best, however, not to rely on external sources for definitions. The best contracts will state the precise number of hours and perhaps necessary benefit levels for a position to count as a “job” under the terms of the contract.

Contracts can also prohibit the substitution of existing employees to meet job requirements. The Ohio Tax Credit statute excludes from the calculation of “new jobs” any employee who is hired to replace an employee who was already employed at the project location at the time the project was approved. It also excludes employees or employment positions that were transferred to the project location from another company operation located in Ohio.<sup>26</sup>

In 2002, the Kansas Court of Appeals ruled that “(a) taxpayer business which hires five new employees but dismisses ten existing employees has not added five employees.”<sup>27</sup> The court’s decision upheld the denial of a tax exemption by the Kansas Department of Revenue to a business that failed to increase its workforce with enough new employees to qualify for the exemption. This case illustrates the need for contracts

that require the hiring of a certain number of employees to also specify their minimum period of employment. Otherwise, an employer could attempt to hire employees and then terminate them after qualifying for the subsidy. This is also why, as we will discuss, it is critical to adopt a monitoring system that will allow local governments to oversee the manner in which the assisted company is adhering to the agreement.

## WAGES AND BENEFITS

The *number* of jobs may be less important than the *quality* of the jobs created and whether or not local residents can fill them. As such, local governments are slowly realizing that they must specify other performance standards that go beyond job creation and retention targets. A 2003 survey found that at least 43 states, 41 cities, and 5 counties – a total of 89 jurisdictions – now attach job quality standards to at least one development subsidy, up from just two in 1989.<sup>28</sup>

Many states now require contracts to specify a particular wage rate. Good Jobs First reports that wage standards are generally based on one of three types of formulas: poverty measures such as the federal poverty rate or state and federal minimum wages; static dollar amounts; or market rates such as the average wage of a state, region, county, and/or industry. Market-based wage standards are the most common type found in state incentive programs. The Maine Employment Tax Increment Financing (TIF) and Investment Tax Credit programs require that wages must exceed the average per capita income in the county (or “local area”) where the company is located.<sup>29</sup> The state’s Governor’s Training Initiative requires that employees be paid a wage equal to at least

85 percent of the average wage for that occupation in the given labor market, and that companies pay at least 50 percent of health insurance premiums.

Cities and counties are more likely to use poverty measures to set wage requirements. For example, Minneapolis, which imposes wage standards derived from either regional industry or occupational averages, also has a living wage law pegged to the poverty rate.

In most cases, market-based wage requirements are higher than those based on poverty standards. For market-based requirements, it is preferable to use a median wage measure rather than an average wage because averages can be skewed by a few employees earning very high or low wages. Specifying that the wage is for hourly non-management jobs also helps ensure that the wage level is not skewed by a few higher paying jobs. For example, the Iowa New Jobs and Income Agreement states that “*the business must pay a specified median wage for all new full-time hourly non-management jobs.*”

Temporary construction wages may also be subject to prevailing wage requirements if they are subsidized by public monies. The states of Pennsylvania, Ohio, West Virginia, and California require that specific grant-subsidized private construction projects comply with the state’s prevailing construction wage rates. For example, the Pennsylvania statute provides:

*If the projects for which Grant funds are to be used involves the construction, reconstruction, demolition, alteration and/or repair work other than maintenance work, done under contract, where the estimate cost of the total*

*Project is in excess of \$25,000, then the Grantee shall comply with the provisions of the Pennsylvania Prevailing Wage Act.<sup>30</sup>*

Contracts may also require that businesses provide other benefits to the new or retained employees. Indeed such provisions are becoming increasingly common, particularly at the local level. In 2003, 67 percent of the states with standards (43) and 80 percent out of cities and counties with standards (46) offered at least one incentive program that requires healthcare benefits be paid at the subsidized firm or encourages them by allowing benefits to count towards wage requirements. For example, the Maine Quality Centers program requires that firms create at least eight new full-time jobs and pay 50 percent of the costs of health care benefits. An Iowa statute requires the incentive recipient to pay 80 percent of the cost of a standard medical and dental insurance plan for all full-time employees working at the project. This statute also encourages the provision of child-care services for employees.<sup>31</sup>

Many cities allow employers to choose between providing benefits and paying higher wages. In 2003, 25 cities and two counties required companies to pay higher wages if such companies did not provide health benefits. The average amount allotted for benefits was \$1.50 per hour, ranging from \$.83 per hour in Duluth to \$2.34 per hour in San Diego. Oakland, Berkeley, Los Angeles, and Richmond, California and Burlington, Vermont all require employees to receive a certain number of days off for sick, vacation, or personal leave.

Unfortunately states and cities often lack the resources to effectively monitor benefits that are provided as part of subsidy deals. Programs may require companies to *offer* coverage to employees, but do not require that employees be enrolled.

### IN-STATE PREFERENCES

The question of whether incentive programs can require assisted firms to favor in-state suppliers and employees over out-of-state ones (i.e., “buy or hire local”) is legally complex. The Commerce Clause of the Constitution (Article I, § 8, cl. 3) gives Congress the power to regulate commerce to, among other things, prevent interstate competition at the expense of the national welfare. It has historically been interpreted to prevent states and municipalities from intentionally discriminating against out-of-state companies.

However, when the local government acts as a “market participant,” rather than as a “regulator of commerce”, an exception may be made. The Supreme Court has held that the use of grants and in-kind expenditures, as opposed to incentives offered as abatements or credits through the tax system, may trigger the market participant exemption in some cases. The rationale for the distinction is that taxation is a basic governmental activity representing a characteristic exercise of sovereign power, which can be distinguished from a local government’s voluntary participation in market transactions. When they are not in the business of taxation, local governments can operate more freely in the national market as buyers and sellers.<sup>32</sup>

For example, hiring requirements can sometimes mandate that the subsidized business hire workers that are residents of a particular geographic area (a city, state) or workers that have been “targeted” for some other socially relevant reason, e.g., individuals transitioning off of public assistance or out of prisons. The Ohio Tax Credit Agreement requires that businesses either display a “good faith effort” or make substantial progress toward hiring those most in need of employment. The Ohio statute requires that:

*“Within three years of the project’s initial operations, the company must show that a certain percentage (specified by the agency) of the new employees are either disadvantaged persons or minorities (as defined in the statute). The company must maintain this percentage throughout the term of the agreement.”*

Because it is often unclear whether a preference would fall within the market participant exception, that question is best left to a lawyer. In cases where it is clear that the exception does not apply – and in some uncertain cases – legislators and contract drafters often require a recipient’s best efforts to meet specified goals. While, in the eyes of the grantor, these terms may be less optimal than out-right requirements, they are still helpful towards achieving the desired results. For example, in Idaho, recipients of Community Development Block Grants must:

*to the greatest extent possible, provide opportunities for training and employment to lower-income persons residing within the unit of local government or the metropolitan area of non-metropolitan county in which a project is located. They must award*

*contracts for work in connection with such projects, to the greatest extent feasible, to eligible business concerns located in or owned in substantial part by persons residing in the same metropolitan area or non-metropolitan county as the project.*<sup>33</sup>

Similarly, Michigan’s MEGA Tax Credit Agreement requires a good faith effort on the part of the company:

*to employ, if qualified, Michigan residents at the facility. The company will also make a good faith effort to employ or contract with Michigan residents and firms to construct, rehabilitate, develop, or renovate the facility.*<sup>34</sup>

Subsidy recipients in Minneapolis, Los Angeles, and New Britain, Connecticut must meet guidelines for local hiring. Cities such as Chicago have required subsidized firms to make good faith efforts to hire workers from within city limits.

Unfortunately because these are non-mandatory hiring guidelines, they guarantee no results. In the end, incentive recipients retain the autonomy to hire whomever they please and can easily make the case that none of the targeted applicants were employable. And this may well be the case; employers generally have a better sense of who would be a good employee, and there are sometimes mismatches between employment opportunities and the skill levels of local applicants.

Given these issues, it is often preferable to include specific job marketing, solicitation, and training provisions in the incentive contract. These “first source” provisions generally avoid any Commerce Clause

concerns. They can range from a requirement that a subsidized firm advertise jobs through particular channels that have the greatest potential to reach targeted candidates, to a requirement to interview candidates referred from a specific source. For example, in Minneapolis, San Francisco, and Portland, Oregon subsidized firms are encouraged to sign job linkage agreements, committing them to hire new employees through a network of placement and training community agencies and to post job vacancies to the network's database.<sup>35</sup> Individual contracts can expressly require such linkages and periodic hiring reports, and state repercussions for failing to achieve express local hiring goals. Contracts can also require the firm to retain a specific level of new hires over the life span of the incentive.

And to the extent a contract calls for cooperation with an employment or training agency, the choice of agencies can be left to the grant recipient. The choice can, however, be limited to agencies pre-qualified by a state or local government that are capable of dealing with the employment needs of particular types of business. This allows the recipient some choice to use its expertise to avoid turnover and attrition while still achieving laudable social goals.

### ENVIRONMENTAL AND LABOR PROTECTION

Some subsidy contracts require the assisted firm to meet labor and environmental standards, which can be higher than those required by existing law or regulation. Others require the subsidized company to present a clean bill of health in so far as unlawful environmental or labor practices are

concerned. An Iowa statute attempts to protect local workers from employers with poor records with organized labor. It provides that:

*The employer must represent that it is not currently involved in a strike, lockout, or other labor dispute at any of its business sites in Iowa and that employees receiving training are not replacement workers who were hired as a result of a strike lockout or other labor dispute.*<sup>36</sup>

Similarly, the William S. Lee Quality Jobs and Business Expansion Act passed by the North Carolina Legislature provides that:

*A taxpayer is eligible for a credit allowed under this Article only if the taxpayer certifies that, at the time the taxpayer applies for the credit, the taxpayer has no pending administrative, civil, or criminal enforcement action based on alleged significant violations of any program implemented by an agency of the Department of Environment and Natural Resources, and has had no final determination of responsibility for any significant administrative, civil, or criminal violation of any program implemented by an agency of the Department of Environment and Natural Resources within the last five years.*<sup>37</sup>

This requirement applies to job, worker training, investment, and research and development tax credits.

Environmental provisions are often included to protect the value of the property and to protect the lender from liability. Pennsylvania loan agreements, for example, contain provisions requiring environmental compliance to protect the lender's interest in the property.

## THE CITY OF CHICAGO'S DEAL WITH FORD

The City of Chicago and the State of Illinois crafted an incentive package for the Ford Motor Company in 2000 that has some of the qualities of an ideal deal. Although the Ford plant has operated in Chicago since 1933, the company needed to make a critical decision in the late 1990s due to a change in product line: to retrofit its Chicago plant or to relocate. The city of Hapeville, Georgia (where Ford operated its Taurus/Sable assembly plant) made the decision more complicated by offering Ford an attractive incentive package.

Despite the offer from Hapeville, Ford chose not to leave Chicago. The City of Chicago and the State of Illinois negotiated a \$115 million incentive package with Ford, which includes both direct and tax expenditures but does not cover the cost of the new plant itself – a measure that ensures Ford has a financial stake in the deal. Ford agreed to develop and own an industrial park whose space is leased to its suppliers, and the City agreed to develop more than 900 acres land in the Lake Calumet area on the city's far South Side into an inter-modal freight transfer center.

Both of these developments converted brownfield properties into new productive uses. The new supplier park was expected to attract approximately 1,000 new jobs and save 2,500 unionized jobs at the Ford assembly plant. The Ford plant and supplier-park facility are expected to provide \$1.3 billion in tax revenue to the city and state over 10 years.

The deal has several caveats. Ford must create a minimum of 1 million square feet of building space. The company must also guarantee that it will maintain the existing union jobs at the main plant. Clawback provisions require Ford to create a minimum of 500 full-time jobs by the end of 2006 and to maintain these jobs through 2011. If these provisions are not met, Ford must pay back a percentage of the financing proportionate to the percentage of promised jobs the company failed to create, and it must repay the city for infrastructure and road improvements.

Sources: J. McCourt and G. LeRoy, 2003. "A Better Deal for Illinois" Chicago: Good Jobs Illinois; City of Chicago Department of Planning and Development Annual TIF Report (2001); J. Fitzgerald, 2002, "Retention Deficit Disorder" Boston: Center for an Urban Future.

The standard loan agreement in Ohio also requires annual environmental inspections, but like the Pennsylvania template, is primarily meant to guard against sudden depreciation of the asset.

### CAPITAL INVESTMENT AND PROHIBITIONS TO RELOCATE

In order for all of the above-mentioned benefits to materialize, the assisted firm must continue to invest in its facility and operate in place over a particular period of time. There are various measures to use to

control this, many of which may be best used in tandem. They include stating the amount of time the company must remain in place, employment levels, expected long term capital investment, and levels of additional square feet of occupancy. Long-term capital investment is subject to less cyclical variation than employment and more exacting than square footage requirements, and therefore may be a better benchmark for performance. But whatever combination of these measures one chooses to employ, it should include an explicit “stay-in-place” requirement.

A capital expenditure provision template from a municipality in Marion County, Indiana provides that:

*The City commits to providing a six-year real property tax abatement. . . as a result of the Applicants’ capital expenditure of not less than \$4,950,000 or of not less than \$2,831,400 on leased space associated with the redevelopment and/or rehabilitation activities.*<sup>38</sup>

What is critical here is the express tying of the abatement to a fixed level of investment.

Although optimal, it is highly unlikely that a business would promise to stay in one place in perpetuity – just to fulfill its obligations for a tax abatement. Still, local officials should expect a firm to remain in the locality for a reasonable amount of time, which is often tied to the length of the subsidy or abatement. For example, a Connecticut program prohibits the recipient “from relocating during the term the loan is outstanding or for ten years after receiving assistance, whichever is longer.”<sup>39</sup>

Minnesota law requires that the assisted company obtain the local government’s permission to move outside of the community if it moves within five years of receiving the subsidy. This permission can only be granted after a public hearing is held. In Ohio, assisted companies must maintain their operations at the project location for twice the number of years as the term of the tax credit.<sup>40</sup> Iowa has particularly stringent standards:

*So long as the Business is indebted to Iowa Department of Economic Development (IDED) or Community, the Business shall not, without prior written disclosure to the Community and IDED and prior written consent of IDED, directly or indirectly:*

- a) *assign, waive, or transfer any of business’ rights, powers, duties, or obligations under this loan agreement;*
- b) *sell, transfer, convey, assign, encumber, or otherwise dispose of any of the real property or other collateral securing the loan;*
- c) *place or permit any restrictions, covenants or any similar limitations on the real property and/or other collateral securing the loan;*
- d) *remove from the project site of the state all or any part of the collateral securing the loan;*
- e) *relocate its operations, physical facilities of jobs (including Created, Retained, and Community Base Jobs) assisted with the loan proceeds outside the community or abandon its operations of facilities or a substantial portion thereof with the community during the loan term.*<sup>41</sup>



States often treat in-state and out-of-state relocation differently. The State of Ohio reduces the penalties if the relocation is made within the state. Connecticut sets no penalty for in-state relocation, but requires that “*if the business relocates within state, it must offer employment to its employees from the original location if employment is available, or the authority may terminate guarantee of the loan.*”<sup>42</sup> The Michigan MEGA program allows in-state relocation only if the municipality condones the move. Some states, such as Pennsylvania and Iowa, prohibit in-state relocation altogether unless it is the result of an expansion that does not close or substantially reduce operations at the originally subsidized facility. Moreover, in Iowa a company is eligible for a grant only if it has not closed or reduced operations in one area of the state to relocate in another.<sup>43</sup>

### **Set a benefits period**

How much time should an assisted company be given to make good on its promises? “Benefit periods” are often set arbitrarily in contracts even though companies have a good sense of how long it will take them to complete specific projects. The company should provide some guidance about the expected project period, after which time the benefits (e.g., new employees hired, amount of capital invested) should have materialized. Without a benefit period, the company will have an indefinite amount of time in which to fulfill its promises.

When local governments use loan programs, they expect that the assisted company will not relocate until the loan and interest have been repaid. Some programs require the company to state that, at the time the contract is signed, it

*intends* to operate for the term of the loan or project period. This is problematic because the company will not be considered to be in violation of the contract if it ceases operations before the loan is repaid -- if it intended to operate the plant for the agreed-upon time period. It also means that the company can pay off the loan early and leave without penalty.<sup>44</sup> Therefore, if a municipality expects a facility to remain in the locality for some time beyond the loan term, it should specify those expectations in the contract and not treat the loan period as the benefit period.

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## SECTION THREE: DETERMINING BREACH OF CONTRACT THROUGH MONITORING AND DISCLOSURE

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If a company does not comply with the terms and conditions of the contract, it may be considered to have “breached” it. Although ceasing operations or relocating out of state may look like clear violation of an incentive agreement, determining when an assisted firm has breached its contract is not as simple as it may appear. Because a finding of breach can lead to the imposition of costly penalties and damages (discussed in the next section), it is important to clearly define what constitutes a breach in the agreement itself.

### **Define breach of contract**

A breach may be total or partial. Generally, a total breach is failure by one party to perform a significant obligation or obligations under the agreement. A total breach entitles the injured party to suspend performance of its side of the bargain and consider the contractual relationship dissolved. If the non-breaching party continues to carry out its contractual obligations despite the other party’s total breach, it may waive its right to seek redress for the total breach.

A partial breach is a failure by one party to perform a somewhat less significant obligation under the agreement. For example, an assisted company may create

the agreed-upon number of jobs but not provide employees filling the positions with some other promised benefit. Most often a partial breach does not terminate a contract; each party must continue to perform its duties and seek redress through negotiation, the courts, or through the provisions of the agreement that provide for such contingencies. Determining what constitutes a “total” and “partial” breach is often a nuanced legal question that requires consultation with an attorney. What is important here is that parties may anticipate breaches and provide solutions for them in the agreement, which can eliminate the need to resort to the courts should a breach occur.

If a party does not want a particular breach to terminate the entire contract, then a statement outlining the specific consequences for the specific violations must be included in the contract. For example the Indianapolis Economic Development Corporation Memorandum of Agreement (2002) provides:

*The City, by and through the Metropolitan Development Commission, reserves the right to terminate property tax abatement deductions for the project if it determines that the applicant has not made reasonable efforts to substantially comply with all of the*

*commitments and the applicant's failure to substantially comply with the commitments was not due to factors beyond its control.*

In a specific case, breach was further defined:

*As used in this agreement, "substantial compliance" shall mean the applicant's compliance with the following:*

- (i) making capital expenditures of not less than \$2,689,830 on the leased space; and*
- (ii) the creation of not less than 95 new permanent full-time positions with average hourly wage rates of \$12.65; and*
- (iii) the retention of 119 full-time positions with average hourly wage rates of \$13.54.*

If the company fails to comply with more than one of the substantial compliance categories, then repayment may be based on the highest level of non-compliance.

Defining breach in this manner provides the parties and, if necessary, ultimately a court with some meaningful guidance in enforcing the specific provisions of the contract.

When incentives resemble "normal" commercial instruments, such as mortgages, leases, or loans, defining breach is even more important. This is because the intentions of the government agency ("creating jobs") may be different from the standard obligations of the financial instruments, such as making regular loan payments.

In contract law, an immediate remedy is available for almost any breach, although in all but the most extreme cases, the party

found to be in breach must be given a reasonable time to "cure" the default. Minnesota companies receive a two-year grace period to fulfill their contractual obligations. The two-year period may be extended by one year, but only if the government agency holds a public hearing to review the circumstances. In Indianapolis, companies that have not met the outlined performance standards are put on probation for one year. If during the probation period the standards are still not met, the Indianapolis Economic Development Corporation has the right to cancel the incentive and require the company to repay the percentage of the incentive already received in proportion to the percent of their obligation they failed to achieve.

## **Define exceptions**

There are exigent business circumstances that may rightly excuse firms for failing to meet their contractual promises. Such exigencies can be accounted for in the contract. For example, in some agreements Ohio excuses a breach for failure to create or retain the number of jobs fixed in the agreement if that failure is caused by "market conditions." Under the agreement, the Director of Economic Development determines whether market conditions caused the failure. In making the determination, the Director must define market conditions in consultation with the Federal Reserve Bank of Cleveland by considering whether the following has occurred:

- a) Two consecutive quarters of decline in manufacturing employment in Ohio as a whole or, when relevant, by manufacturing sector. The Director must*

*rely on employment figures reported by the Ohio Bureau of Employment Services.*

- b) *A decline, as a whole or by a relevant sector, in twelve of the last thirty six months as detailed in the Federal Reserve's national industrial production index.*
- c) *A decline within the relevant section of the Standard and Poor's "Industrial Outlook."<sup>45</sup>*

### **Include a notification provision**

All contracts should include a notice provision no matter how insignificant it may seem. Notification requires that the company alert the municipality and wider community to any changes in its operations, such as the initiation of any lawsuits or bankruptcy proceedings, which might adversely impact the subsidized project. It also gives the economic development agency some time to rectify problems brought on by these changes – e.g., to find a new tenant for an abandoned facility, enlist the help of another developer to complete the project, or cushion layoffs with placement or retraining assistance.

For example, a notice provision used by the Florida Qualified Tax Industry Program provides that:

*A corporation must notify the state of any developments that impact the agreement. These may include commencement and full implementation of the project, project delays and cancellation of the project.*

The Iowa New Jobs and Income Program Contract goes a step further toward better monitoring:

*The business shall provide prompt advance notice to the community and the department*

*of any proposed change in the business ownership, structure or control which would materially affect the project.*

Clauses that require notice only in an event of a loan default or initiation of litigation should be avoided. There are a number of other adverse events that could forewarn a substantial breach, and notice of these needs to be expressly provided for in the contract.

### **Specify monitoring practices**

Monitoring is the key ingredient to ensuring compliance with incentive agreements. Unfortunately, many local governments are not vigilant once an agreement has been made, often due to a lack of resources. An investigative report of Ohio's enterprise zone program, for example, found that no major city there routinely visited subsidized companies to monitor their compliance with legislated performance standards.<sup>46</sup> One official in Kansas City noted that "*We don't want to be big brother, peering over their shoulders all the time. . . We have tried to avoid the whole notion of 'auditing'.*"<sup>47</sup> And even where attempts are made, subsidized firms are less than cooperative or timely.

The public sector needs to do more on this front. Without monitoring, the time and care that went into negotiating and drafting the agreement is worth little. With the decision to give an abatement must also come the commitment to monitor compliance once it has been made. And this commitment to monitor – including monitoring means and methodology – should be spelled out in detail in the agreement itself.

There are two common monitoring methods. The first requires that specified documents be open to inspection and audit by the granting authority. Indianapolis, for example, requires a notarized annual report from its subsidized companies. The city also conducts spot audits on about 5 percent of subsidized companies, in which a company has 24 hours to respond to a series of questions about the number of employees, wages, and capital investment it has generated since the incentive was awarded.

The second method is to impose an affirmative obligation on the part of the business to provide the necessary information. This relieves often under-resourced grantors from having to go out and actually gather the data. Still, caution is necessary. First, in the contract government officials need to be specific about the exact nature of the data desired. Second, they need to be aware that these requirements do not prevent a subsidy recipient from misrepresenting the facts. Businesses may provide their own interpretations of their employment and investment data. Requesting the raw data helps avoid this scenario.

Perhaps the best way to guard against such a possibility is to double check self-reported data from subsidized businesses against labor market statistics collected by the public sector, preferably the state's unemployment insurance records. Unemployment records, maintained by each state's employment office, reflect not only new hires but also every employee and their wages each quarter. Thus, they make for an ideal third-party-collected data set against which to verify retention and new hiring. Kansas City checks self-reported data against information derived

from the city's employee earnings tax. It is easy for state and local economic development agencies to request this data and work together with state employment agencies to track the employment practices of subsidized firms.

Legislation or contracts can also require companies to disclose deal-specific information to the general public. Minnesota's Subsidy Reform law requires every recipient of an incentive to file an annual report specifying the amount of the incentive, the public purpose to be served, the number and quality of jobs to be generated, and any other special treatment received. The law requires that each redevelopment agreement set measurable two-year goals and assess the corporation's progress. Failure to meet the goals may result in the repayment of the tax break with interest. The Minnesota Department of Employment and Economic Development (DEED) collects and publishes every disclosure report each June. The reports are readily available to the public from DEED, which also publishes a brief summary of the data. The disclosure form includes specific data on costs and benefits, including type of subsidy and its value, the number of jobs created, wages paid, and benefits provided, as well as other public purposes served by the deal.

Amendments made to the Minnesota law in 1999 are considered a model for transparency legislation and contain several improvements in the state's disclosure format, such as:

- More detailed wage disclosure (instead of one aggregated average hourly figure, companies must report the wage for each new job within wage ranges).

- Health care disclosure (the company must disclose the sum of wages plus the hourly value of employer-paid health care, also in ranges, so that it will be obvious if the employer is providing health care and, if so, what its approximate value is).
- Reporting on all subsidies the company has received from multiple agencies for a project.
- Reporting on whether and from where the company was relocating and why the assisted project was not possible in the company's previous location.
- Provision of the name and address of the company's parent corporation, so that the state will know if multiple subsidiaries of the same corporation are receiving subsidies.
- Finally, the amended law sets forth penalties for companies that fail to report by March 1 of each year. If a company fails to report within 14 days after the granting agency sends a warning, the company must pay a fine of \$100 a day up to a maximum of \$1,000. All cities with a population of 2,500 or more and all state agencies must file their reports with the state by April 1, and they must file a report even if it is only to say they had no reportable deals for the year. The state must warn the agency, and if the agency fails to report by June 1, then the agency loses the right to enter into more deals until it complies.

The state must include in its final report a list of companies that are ineligible to receive new subsidies because they have failed to achieve a goal in the last

five years and have not paid back any of the original incentive.

Other states, including Illinois, North Carolina, North Dakota, Washington, Nebraska, and Maine have recently followed Minnesota's example.<sup>48</sup> Maine's disclosure law requires that corporations receiving \$10,000 or more in state assistance provide annual reports on total employment, job creation, and the wages and benefits of existing jobs and jobs created.<sup>49</sup> The Economic Development Incentives Commission, created by the new law, was charged with studying the impact and cost-effectiveness of corporate subsidies and tax breaks and recommending reforms that will increase accountability.

In addition to establishing breach, monitoring also allows third parties, such as community organizations and unions, to ensure that both the firm and the public sector are complying with the terms of the contract. Four states, Illinois, Ohio, North Carolina, and Minnesota, now post relevant information on particular deals on the internet. Connecticut requires that assisted companies make incentive reports available to employee representatives if they request them.<sup>50</sup> Reporting requirements become especially important when a company is deciding to relocate, downsize or engage in any other form of restructuring because employee representatives can use the report in their own contract negotiations or publicize the company's other obligations. Employees can also assist municipalities in monitoring the firm's behavior and applying additional pressure to adhere to the contract.

The public interest in information, however, faces a countervailing business

interest in corporate confidentiality. Many contracts have confidentiality clauses to protect “proprietary business information.” Public dealmakers should closely scrutinize blanket clauses that leave the public in the dark.

Companies have legitimate interests in trade secrets, such as customer lists or profit-loss statements, which in the hands of a competitor could harm a business.<sup>51</sup> However, few subsidy applications, except perhaps business loans, require such information. In other words, the kinds of data required for compliance monitoring in development agreements (e.g., employment levels, local capital expenditures and the like) is not likely to constitute proprietary business information. The onus should be on the company to demonstrate how disclosure of the kind of data called for could disadvantage it with its competitors in order for it to be subject to confidentiality clauses.

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## SECTION THREE: PENALTIES FOR BREACH

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Contractual mechanisms must impose penalties on businesses that fail to live up to the promises made in exchange for incentives. Specifying performance and disclosure requirements only solves part of the problem; ensuring compliance requires agreeing to penalties for noncompliance. A breach of contract should trigger a host of remedies and damages, many of which should be specifically laid out in the contract itself. Penalties are particularly important when they are not specified in the enabling state statute or local ordinance. Without guidance from contract language or statute, courts have the authority to decide what the damages should be.

### **Opt for “back-loaded” incentives whenever possible**

Extensive penalty language is less important when municipalities and states structure incentives so that they pay out only when the company meets specified performance benchmarks. The benchmarks can be laid out incrementally over time, releasing a specified amount of the incentive at each stage. Doing so generally results in less need to recapture funds because of nonperformance further down the road. By placing the burden on companies to prove that they have qualified for the incentives, public officials

are freed from the responsibility of enforcing accountability provisions – a painful and litigious process. Local governments find these kinds of incentives to be easy to use. They are more politically palatable because the taxpayers are already enjoying the benefits from the project and are perceived to be “sharing” some of the increased tax revenues.<sup>52</sup>

Tax increment financing (TIF) deals are often structured in this “pay-as-you-go” manner. Such an arrangement means that a developer is reimbursed for the money spent on eligible TIF costs (e.g., demolition, parcel assembly, infrastructure development) by the municipality on an annual basis as tax increment revenues become available. These kinds of TIF agreements have built in performance and enforcement controls. The redevelopment agreement can be written so that in the event that a developer fails to make the needed investments, the municipality can withhold future payments.

Each TIF redevelopment agreement negotiated by the City of Chicago contains as “Issuance of a Certificate of Completion” section. It specifies that:

*the City has the right to terminate the Redevelopment Agreement, cease disbursement of City funds, and seek reimbursement from the development of*



*City funds if the project is not completed per the Redevelopment Agreement.*

In agreements that include the issuance of public notes or bonds, a provision is included allowing the City the right to seek reimbursement “*provided that the City is entitled to rely on an opinion of counsel that such reimbursement will not jeopardize tax-exempt status, if any, of the Bonds.*”

A provision in some of the City of Chicago’s redevelopment agreements states that if the developer fails to complete the project, the municipality has:

*the right (but not the obligation) to complete those TIF-funded improvements that are public improvements and to pay for the costs of TIF-funded improvements (including interest costs) out of City funds or other City monies. In the event that the aggregate cost of completing the TIF-funded improvements exceeds that amount of City funds available, the Developer shall reimburse the City for all reasonable costs and expenses incurred by the City in completing such TIF-funded improvements in excess of the available City funds....<sup>53</sup>*

Similarly, the Michigan Economic Development Training Grant uses an award schedule that only provides grant funds to the company as it meets certain program milestones. The state assumes less of a risk for training workers by holding more of the funds until the program is completed.

The use of this kind of structure, however, is not possible in all cases. Performance-based incentives are less popular with businesses, many of whom prefer to receive lump sum payments to cover construction and other start-up costs.

When a company has cash flow issues and needs funding up-front, they may not be willing to wait around until a government agency can evaluate performance measures. However, if project costs are incurred and paid out over a longer period of time, a back-loaded structure will be more appropriate.

## **Include non-performance provisions**

If public funds must change hands up front, nonperformance provisions must be written into the contract. And even in the pay-as-you go context, one should carefully consider scenarios where a default could occur after a benchmark has been met. For example, if a payment is tied to a specific level of employment being reached, what happens if, after the payment, the company discharges most of these new employees? Non-performance (or, more aptly here, undoing performance) provisions also make sense in this and many other pay-as-you-go scenario.

Non-performance provisions generally fall into five categories:

- **Rescission:** canceling a subsidy agreement if job and revenue projections are not met;
- **Clawback:** recovery of all or part of subsidy *costs* if performance goals are not met;
- **Recalibration:** adjustment of subsidy to reflect changing business conditions;
- **Penalty:** additional charges (e.g., the interest accrued on the public’s investment) for non-performance or relocation; and

- **Debarment and suspension:** prohibiting the non-compliant company from receiving incentives in the future.

Non-performance provisions should always: (a) state when the mechanism is triggered (i.e. the event that signals the breach); and (b) describe the penalty that will be exacted after a specified grace period.

## RESCISSION

While it is a rare non-performance provision, rescission terminates the incentive agreement in the event of non-performance. Unfortunately, if rescission is the only remedy specified, companies can breach the agreement mid-stream in a way that leaves the granting agency little value for its money. For example, rescission could allow a business to walk away from a development mid-stream, leaving nothing but a partially constructed project of little financial value. Thus, in addition to rescission, it is always necessary to include other remedies. The following is an example of a rescission provision from the Idaho Community Development Block Grant Program:

*The department shall have the right to terminate this contract in whole or in part, at any time before the date of completion, whenever it is determined the grantee has failed to comply with the conditions of the contract. The department shall promptly notify the grantee in writing of the determination and the reasons for the termination and the effective date.*

## CLAWBACKS

A “clawback” clause allows a grantor to take back previously conferred money or

benefits upon a specified breach by the grant recipient. Clawbacks can be tied to almost anything, including the number of employees, magnitude of capital investment, years in residence, or square footage of space developed. Once the grant recipient fails to meet a benchmark in the contract, the clawback clause kicks in, entitling the grantor to repayment of the benefits conferred or other appropriate remedies. For example, in its deal with Roll-Kraft, Inc., the city of Mentor, Ohio included the following clawback clause in its property tax abatement agreement:

*If Roll-Kraft materially fails to fulfill its obligations under this agreement, for reasons other than downturns of economic or business cycles, or if the City of Mentor determines that the certification as to delinquent taxes required by this agreement is fraudulent, the City of Mentor shall give at least 60 days written notice thereof to Roll-Kraft. Roll-Kraft shall have the opportunity to cure such default within such period, but if such default is not cured within such 60 day period, the City may terminate or modify the exemption from taxation granted under this agreement and may require the repayment of the amount of taxes that would have been payable had the property not been exempted from taxation under this agreement.<sup>54</sup>*

The City of Roanoke, Virginia ties the recapture to real estate:

*In the event the company fails to increase the square feet of occupancy by 20,000 square feet, the company shall repay to the [agency] the amount of five dollars per square foot for each square foot of increase less than 20,000 square feet.<sup>55</sup>*

Iowa ties the recapture to job creation:

*If the company fails to create and maintain the agreed number of jobs, it must repay a certain portion of the incentives it received depending on how well it has complied with the job creation goals. The business is not liable for any amount if it meets more than 90% of its job creation obligations. If the business has met less than 50% of its obligations, it must repay the same percentage in benefits as it fails to create in jobs. If the business created more than 50 % but less than 75% of its requirement, the business must pay one half of the percentage in benefits as it failed to create in jobs. If the business creates more than 75 % but less than 90%, it must pay one quarter of the percentage it failed to create in jobs.<sup>56</sup>*

The statutory guidelines for the Ohio Tax Credit Program tie recapture to the amount of time the company remains in the state:

*The maximum amount the authority can recapture depends on the amount of time the company remained at the project site: (1) If the company maintained operations at the location for one and one-half times the number of years of the term of the tax credit, up to 25% of the total allowed credits may be refunded; (2) If it maintained operations for the term of the tax credit, the amount required to be refunded cannot exceed 50% of the allowed credits; (3) If the company relocates operations within the term of the tax credit, the authority may require the company to refund up to 100% of the allowed credits.<sup>57</sup>*

While these examples are illustrative, it should be noted that clawbacks can be tied to any conceivable contractual

requirement. What is critical is that each clawback remedy be tied to specific types or category of breaches **and that the magnitude of the clawback has a reasonable connection to the magnitude of the breach.** Courts are very reluctant to impose a remedy – even if contractually agreed to – that amounts to a huge windfall for one party and a huge penalty for the other.

## RECALIBRATIONS

Recalibration provisions allow local governments to adjust the incentive to reflect changing business conditions. With such modifications, the agreement does not need to be completely terminated if certain aspects of the relationship change. A contract may provide explicit provisions for making the recalibration request. In Texas, a business may request a modification if:

*it is required to reduce or eliminate [its] work force because of 1) reductions in overall employment within an industry; 2) a substantial change in the skills required to continue the employer's business exists because of technological changes; or 3) other reasonable factors, as determined by the executive director.<sup>58</sup>*

Unfortunately, when governments and firms agree to penalties that can be easily modified to fit contingencies, the penalties do not provide the same incentive to fulfill the contractual obligations. Still, recalibration clauses have their uses. They are most common in low-interest loan programs. Local governments have been able to raise the rate of their loans if the assisted company is not meeting the contractual obligations of the loan. A Pennsylvania program levies a penalty of two points over the prime rate if a

## THE INTEL DEAL

The 1994 incentive agreement signed by the Intel Corporation and Washington County, Oregon and City of Hillsboro contained remedies for recovering public funds in the event that the company failed to comply with the provisions of the agreement for hiring and making service fee payments to the local governments.

The following provisions are excerpted from the agreement:

*4.1.3.1. If, in any Hiring Year that such requirements apply, Intel fails to meet the job creation, retention and compensation requirements of Paragraphs 2.2.1 through 2.2.4, Intel shall pay an amount equal to 100% of the net property tax savings of the tax year containing the end of such Hiring Year.*

*4.1.4. Intel may file an action in Washington County Circuit Court or Federal District Court for Oregon to contest this determination. Payment of the amount in dispute shall be a*

*precondition to contesting the notice of non-compliance. County shall place the amount in dispute into a trust and agency account pending final resolution, with interest accruing to Intel at the rate earned if Intel prevails.*

*If in any tax year, Intel fails to pay the community service fee required under paragraph 2.4, County may collect late payment penalty and interest on the delinquent CSF payment equal to the same penalty and interest as is charged by the County on all delinquent personal property accounts. In addition to any other remedy, failure to pay CSF by March 1 shall be basis for a finding of breach and non-compliance, and shall require payment to the County of 100% of the net property tax savings for that tax year.*

*Intel shall have the burden of documenting compliance with this Agreement. Intel shall provide to the County such documentation or information as County requires to verify compliance with the Agreement.*

company is found to be out of compliance. An agency inspector can waive the penalty if the cause of the violation is reasonable, such as a general economic downturn.<sup>59</sup>

### DEBARMENT AND SUSPENSION

Debarment provisions prohibit a company from ever doing further business with the public agency in the event of a breach. Suspension provisions are a similar bar but for a limited term. The federal government has long used the threat of debarment to

enforce its fair labor, health, and safety standards, and states have included similar provisions in their public works contracts.<sup>60</sup> State incentive programs may bar noncompliant firms from receiving any future subsidies from a particular program or from receiving any form of future assistance from the same state. Such penalties, however, are less common at the local level. In these matters, the courts tend to defer to the states so that the right to debar should be explicitly authorized by statute.<sup>61</sup> In Minnesota, for example,

companies that fail to pay their clawbacks are prohibited from obtaining any new subsidies in the state for five years from the date the breach was discovered.<sup>62</sup>

### **Ask for attorneys' fees, costs, and interest**

Even if a governmental unit, citizen's group, or private party wins a case against a breaching corporation, it will not be made whole if it has to pay attorney's fees and court costs out of its recovery. A contract provision requiring payment of fees and costs is a good hedge against this risk. In the case of grants, municipalities can also request interest on funds used by the subsidized firm that might have otherwise been invested by the local government in an interest-bearing account. Because the validity of an attorneys' fees clause varies from state to state, it would be wise to check state law before including such a provision.

### **Familiarize yourself with other forms of damages and relief**

There are a number of different kinds of damages or relief available to local governments; they can be available as a general matter of contract law, by agreement of the parties, and according to specific legislation. Unless the state enabling legislation provides that a remedy is to be exclusive, or the parties agree in the contract itself that this is the case, the grantor may be in a position to ask for specific performance or expectation, reliance, or restitution damages.

#### **SPECIFIC PERFORMANCE**

In some circumstances, a local government may ask a court to make the assisted

business keep its promise. This kind of relief is referred to as "specific performance" and may take the form of a court order requiring some action, such as compliance with a minimum wage agreement or an injunction forbidding the company from closing its plant. This remedy is available only when "the remedy at law is inadequate," i.e., when monetary damages will not fully compensate the granting authority. This could be the case when either (a) the value of the product or performance promised is so unique that money is no substitute or (b) monetary damages would be difficult or impossible to estimate.<sup>63</sup> A court will not order specific performance if that performance is impossible or unreasonably burdensome.

In general, courts are very reluctant to compel specific performance of any type, let alone ordering the continued operations of a production facility. City and state officials can anticipate this preference when drafting contracts by specifying monetary damages, the threat of which may compel the desired behavior.

#### **EXPECTATION DAMAGES**

These damages are intended to place the injured party in the position it would have been in had the other party kept its promise. When local governments provide incentives to private firms for new jobs, they *expect* that those jobs will materialize and that individuals holding the positions will purchase goods and services within the jurisdiction. If a municipality has conducted cost-benefit analysis before the incentive changed hands, it would have an estimate of the value of the anticipated public benefits that could be awarded to the slighted jurisdiction.<sup>64</sup> The government agency may also find itself in a position to

recover lost taxes and other public benefits that it expected. If the assisted firm has committed to keeping emissions to a specified minimum level and does not, it might be sued for the reasonable cost of reducing pollution to that level.

Courts, however, are reluctant to award damages that are too speculative. Therefore, the more comprehensive and detailed the cost-benefit analysis, the better chance a local government has of recovering expectation damages. Moreover, courts will only award this kind of damages if they are “foreseeable” in that at the time of the agreement, the parties likely foresaw that the damages would occur in event of a breach. Conducting the cost-benefit analysis up front and making the expected benefits part of the agreement helps resolve this foreseeability issue in favor of the grantor.

### RELIANCE DAMAGES

These damages are not intended to reflect the benefit expected but instead the extent to which the injured party suffered losses while acting in reasonable reliance on a promise that was broken. In other words, the goal of reliance damages is to put a party in the position it would have been had the promise never been made. This means that costs incurred *before* the agreement was reached are not recoverable. These damages tend to be lower in amount than expectation damages because a rational granting agency will only offer an incentive package if the expected benefits outweigh the potential costs.<sup>65</sup>

Reliance damages are easier to recover than expectation damages because they are, generally, less vague. In theory, if accurate records are kept of expenditures

reliance damages are easier to quantify than expectation damages. In addition to the value of the inducement, municipalities can ask for the interest that would have accrued on the incentive if it had not been disbursed, the costs associated with an ancillary investment in infrastructure for the project, and the legal and administrative costs incurred for the project. Though more difficult to measure, the social costs that accrue to the municipality because of business relocation (e.g., retraining employees, taking a loss on property transferred to the municipality) may also be requested, though because of their less concrete nature, they are less likely to be awarded by a court.

### RESTITUTION AND LIQUIDATED DAMAGES

“Clawback” clauses can embody the principles of restitution damages and liquidated damages. Restitution damages reflect the benefit the local government conferred upon the non-performing business minus the portion of the benefits the business conferred on the government. The point is to prevent unjust enrichment, i.e., one party benefiting at the other's expense. In most cases, the amount is equal to the economic development expenditure (i.e., the property taxes abated or market value of a land write-down) less the value of whatever lasting investment the business made.

Liquidated damages are damages agreed upon in the event of a specified breach. Generally, such contractual provisions are enforceable if three criteria are met: (a) the injury due to breach is uncertain or difficult to quantify; (b) the value of the damages reasonably approximates the probable loss; and (c) the damages are not designed to deter or punish a breach. If the value of an

inducement to the local government is \$30 million, but the contract provision provides for damages of \$60 million, it will not be enforced even if the parties intended to be bound. However, if enabling legislation governing the inducement allows or requires a penalty so denominated, it may override normal contract law.<sup>66</sup> Whether such a statutory provision is valid will depend on applicable state law, which varies from state to state.

The key point here is that clearly designed and drafted clawback clauses can help avoid litigation. When a subsidized business is faced with clear penalties for its failure to comply with the requirements of an incentive package, it should make financial sense for it to comply within the terms negotiated.

### **Include a waiver provision**

All contracts should contain a waiver provision to protect the public sector from losing its rights under the contract if it delays enforcement. Economic development agencies often hold off enforcing incentive contracts, attempting other non-legal means to get the non-performing business to honor its promises. It is also possible that a new administration may wish to enforce conditions where its predecessor did not.<sup>67</sup> Without a waiver clause, these delays could be interpreted as a waiver of the breach by the granting agency. A waiver clause could read: *“No failure to insist on the prompt performance by the company of its obligations under the agreement shall be construed as a waiver by the department of its rights under the contract.”*

### **Seek support from community organizations**

Grassroots campaigns and negative press can complement measures that local governments take to enforce contracts. Community groups have organized an increasing number of petition drives and referenda to place subsidies and performance measures on local ballots. Their power lies in their ability to raise community awareness of the deal terms, which may shame companies into better behavior. For example, after local organizations complained publicly of a deal gone bad, ABB Instrumentation announced that it would give back \$1.1 million to the Monroe County (New York) Industrial Development Authority when it failed to create the agreed-upon number of jobs.

Coalitions of community groups have been involved in similar kinds of efforts to obtain what are called Community Benefits Agreements (CBA) from assisted developers and businesses.<sup>68</sup> A CBA is a legally enforceable contract signed by community organizations and developers. In it the developer agrees to provide certain benefits and the community organizations promise support for the project that will aid in the developer’s dealings with those government agencies responsible for permitting, zoning, and financing the new development. It is typically negotiated before the actual incentive agreement, but can be incorporated into it if all parties agree.

In May of 2001, a coalition of labor and community-based organizations – the Figueroa Corridor Coalition for Economic Justice – negotiated a landmark CBA for the Los Angeles Sports and Entertainment

District development, a massive mixed-use project located next to the Staples Center sports arena. Among other things, the CBA required the developer to:

- Provide an assessment of community park and recreation needs, and a commit \$1 million toward meeting those needs;
- Increase the proportion of affordable housing in the residential unit mix and provide seed money for additional affordable units;
- Provide parking for the adjacent residential area;
- Assure that 70% of the jobs created in the project would pay the City's living wage; and
- Agree to consultation with the coalition on selection of tenants.

Formally requiring some sort of public participation in the process from the start allows such groups to gain a sense of ownership over the deal and can lead to a complementary CBA.

In some places, taxpayers have demanded that subsidies be subject to the community approval. Wisconsin requires a voter referenda if a portion of the electorate seeks to challenge the subsidy:

*The governing body may issue bonds under this section without submitting the proposition to the electors of the municipality for approval unless within 30 days from the date of publication or notice of adoption of the initial resolution for such bonds, a petition, signed by not less than 5% of the registered electors of the municipality is filed with the clerk of*

*the municipality requesting a referendum upon the question of the issuance of the bonds. If such a petition is filed, the bonds shall not be issued until approved by a majority of the electors of the municipality voting thereon at a general or special election.<sup>69</sup>*

Moreover, legislation can provide for a private right of enforcement by third parties to the contract. This would allow private citizens, unions, and community groups legal standing to sue a business that violates the law. Without such legislation, third parties often have no such right.



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# CONCLUSION

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Anecdotal evidence suggests that cities and states are becoming more assertive in their incentive negotiations with business.

Approximately half of the major cities and states in the Midwest have successfully enforced at least one clawback clause in the last 5 years.<sup>70</sup> Indianapolis was the front runner, having found 30 companies to be out of compliance since 1993--the year in which it established job goals and wage standards for all business incentive programs. For example, Indianapolis signed a deal with United Airlines giving it about \$300 million in tax breaks for a new maintenance hub at the Indianapolis International Airport.<sup>71</sup> In return the airline made two promises: to invest \$800 million by the end of 2001 and to create at least 6,300 full-time jobs by the end of 2004. When United failed to meet its first promise, it agreed to pay \$31 million to Indiana government agencies in prorated clawback fines.<sup>72</sup>

Other cities have followed suit. For example, in September 2002 the Kansas City redevelopment agency sued Aquila Merchant Services Inc. to recapture tax incentives it had awarded the business.<sup>73</sup> The suit claimed that the company violated an agreement to employ at least 400 workers downtown, and in doing so activated a clawback designed to reimburse the incentives. Aquila quickly settled the

case by returning \$1.57 million in tax abatements to the agency.

Although using performance standards is certainly better than giving away subsidies for free, local governments still draft contracts too loosely and enforce them too weakly to substantially increase the return on the public's investment. Or economic development practitioners give up before they start. They figure that even when they write excellent contracts, there is no guarantee that businesses will stick to their promises.

Defeatism is no excuse for ignoring the public's investment in economic development. Nor is the fear that many practitioners have of developing a reputation for "aggressive" and "anti-business" behavior. Local officials are often concerned that these contractual mechanisms lower the value of the incentive for the company if the company perceives future tussles with the law, a lack of flexibility on the part of the public sector, and additional reporting requirements and compliance costs.

Research has revealed that such fears are likely overstated.<sup>74</sup> If firms are aware of accountability provisions from the start of negotiations, formalizing the *quid pro quo* in a contract can actually clarify the

expectations of both parties, reducing the uncertainty and potential for arbitrary behavior that plagues incentives. If accountability mechanisms are clear and reasonable, firms may voluntarily repay the incentive if they renege on their promises, obviating the need for any formal legal enforcement.

Moreover, if more municipalities and states adopt these kinds of contractual provisions as normal practice, individual governments cannot claim that accountability mechanisms hamper their ability to compete for business relative to those that do not regulate incentives.

This handbook has stressed the importance of contractual provisions in protecting public interests. The following box displays selected model legislative language drafted by Good Jobs First that can be adopted for use in specific contracts and municipal ordinances. It brings together several of the main areas of emphasis in this handbook: performance standards, monitoring provisions, and enforcement mechanisms.

Our hope is that by including these kinds of legal provisions, practitioners can both perform better in negotiations with companies seeking subsidies and also monitor and enforce these agreements after the incentives have changed hands. Without such protections, the fiscal health of every municipality and state is made more vulnerable.

# MODEL DEAL LEGISLATION: THE ECONOMIC DEVELOPMENT AND FISCAL ACCOUNTABILITY ACT

Good Jobs First has drafted model legislation, several sections of which are excerpted here:

## SEC. 7 SUBSIDY LIMIT AND JOB QUALITY STANDARDS

- a. A granting body shall not grant award a development subsidy if the cost per job is greater than \$35,000.00. Such cost shall be determined by dividing the amount of the subsidy by the number of full-time jobs required under the application approved by the granting body.
- b. A granting body shall not grant a subsidy to an applicant unless the wages paid to employees at the project site are equal to or exceed 85% of the average wage as established under paragraphs (12) and (13) of section 5, provided, however, that for small businesses, the average wage must equal or exceed 75% of the wages established thereunder. The computation of wages under this section shall only apply to a recipient corporation that provides the health care coverage as approved in its application by the granting body.

## SEC. 8 RECAPTURE

- a. A recipient corporation shall fulfill its job creation, wage, health care and other benefit requirements for the project site within two years of the date of subsidy. Such recipient shall maintain its wage and benefit goals as long as the subsidy is in effect, or five years, whichever is longer.
- b. The corporate parent of a recipient corporation must maintain at least 90% of its employment in the State as long as the development subsidy is in effect, or not less than five years, whichever is longer.
- c. If the requirements under paragraphs (a) or (b) are not fulfilled, the granting body shall recapture the development subsidy from the recipient corporation as follows:

Upon a failure by the recipient corporation to create the required number of jobs or to pay the required wages or benefits, the amount recaptured shall be based on the pro rata amount by which the unfulfilled jobs, wages or benefits bear to the total amount of the development subsidy. Upon a failure of the corporate parent to maintain 90% of its

employment in the State, the rate of recapture shall equal twice the percentage by which such employment is less than 90%.

- d. The granting body shall provide notice to the recipient corporation of its intent to recapture the development subsidy and state the reasons and amount to be recaptured. The recipient corporation shall remit to the governing body such amount within 60 calendar days of the date of such notice.
- e. If a recipient corporation defaults on a development subsidy in three consecutive calendar years, the granting body shall declare the subsidy null and void, and shall so notify the Department of Development and the recipient corporation. The recipient corporation shall pay back to the granting body all remaining value of the development subsidy it has not previously repaid within 180 calendar days of the date of the notice of such default.

## SEC. 9 PRIVATE ENFORCEMENT ACTION

If a granting body fails to enforce any provision of this Act, any individual who paid personal income taxes to the State in the calendar year prior to the year in dispute, or any organization representing such taxpayers, shall be entitled to bring a civil action in state court to compel enforcement under this statute. The court shall award reasonable attorney's fees and costs to such prevailing taxpayer or organization.

## SEC. 10 PUBLIC RECORD DISCLOSURE

All records required to be prepared or maintained under this Act, including but not limited to applications, progress reports, recapture notices and any other records or proceedings relating thereto, shall be subject to disclosure under the State's Open Records Act.

## SEC. 11 SEPARABILITY

If any provision of this Act is determined to be unenforceable in a court of law, such determination shall not affect the validity or enforceability of any other provision of the Act.

## SOURCE:

[http://www.goodjobsfirst.org/  
accountable\\_development/model\\_legislation.cfm](http://www.goodjobsfirst.org/accountable_development/model_legislation.cfm)

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30. Pennsylvania Grant Agreement Template; See also Pennsylvania Prevailing Wage Act (43 Pennsylvania Statute § 165-1 et seq.)
31. Iowa Code 2001 section 15.329 -2.(c)
32. This distinction was recently tested in the case *Daimler-Chrysler Corp., et al. v. Cuno, et al.*, 386 F. 3d 738. The Sixth Circuit found that Ohio's investment tax credit, which Ohio granted to DaimlerChrysler to construct a new assembly plant, violated the Commerce Clause because the credit favored in-state economic activity at the expense of out-of-state activity. The fact that the credit reduced DaimlerChrysler's pre-existing income tax liability was in many ways the catalyst for the court accepting the case. On May 15, 2006, the Supreme Court issued its opinion, holding that Ohio taxpayers did not have standing.
33. Idaho Community Development Block Grant guidelines <http://adm.idaho.gov/adminrules/rules/idapa09/0201.pdf>
34. Michigan Economic Growth Act Tax Credit Agreement, Public Act 24, 1995
35. Molina, F. *Making Connections: A Study of Employment Linkage Programs*. Washington, DC: Center for Community Change, 1998; G. Hernandez and T. Wertheim, *First in Line: An Evaluation of San Francisco's First Source Hiring Program*, San Francisco: Urban Institute, August 2004 ([www.picsf.org/documents/documents.htm](http://www.picsf.org/documents/documents.htm))
36. Iowa Jobs Training Program (260F) <http://www.legis.state.ia.us/lsadocs/TopicPres/2005/PPMDF001.PDF>
37. North Carolina Session Law 1999-360 Senate Bill 1115 § 105-129.4 b(3)
38. Indiana Economic Development Corporation (IEDC) Memorandum of Agreement
39. Connecticut Development Authority, Participating Loan Program and Direct Loan Inducements, Master Guarantee Agreement; See also Connecticut Public Act No. 93:218
40. Ohio Corporate Franchise and State Income Tax Credits ( §122.17)
41. Iowa Community Economic Betterment Program Agreement, Iowa Code 261:22.13
42. Connecticut Development Authority, Participating Loan Program and Direct Loan Inducements, Master Guarantee Agreement; See also Connecticut Public Act No. 93:218
43. New Jobs and Income Act Investment Credit; Iowa Code 15.333(1)
44. *West Virginia v. Anchor Hocking*, No. 87-C-759-1 (N.D.W.V , filed June 3, 1988)
45. Ohio Enterprise Zone Request for Waiver of Relocation Restrictions
46. Roe, S. "Tax breaks and broken promises." *Toledo Blade* December 8, 1996: A7
47. Weber, R. "Do better contracts make better economic development incentives?" *Journal of the American Planning Association* 68, 2002: 43–55

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48. For a catalogue of best practices in subsidy disclosure, see [http://www.goodjobsfirst.org/pdf/disclosure\\_chart.pdf](http://www.goodjobsfirst.org/pdf/disclosure_chart.pdf)
49. Now incorporated into Chapter 761 of the Maine Public Laws *An Act to Encourage Accountability and Return on Investment for Maine Taxpayers from Economic Development Initiatives*. The text can be found at [www.janus.state.me.us/legis](http://www.janus.state.me.us/legis).
50. Connecticut Development Authority, Participating Loan Program and Direct Loan Inducements, Master Guarantee Agreement; See also Connecticut Public Act No. 93:218
51. *Black's Law Dictionary*, West Publishing, 1990
52. Interview with John B. Sternlicht, Policy and Legislation Director for Virginia Economic Development Partnership, 1998
53. City of Chicago, Department of Planning and Development TIF Redevelopment Agreement Application, 2002
54. City of Mentor Redevelopment Agreement
55. City of Roanoke Fifth District Employment and Training Consortium Agreement
56. New Jobs and Income Act Investment Credit, Iowa Code 15.333(1)
57. Ohio Revised Code § 122.17(K)
58. The Texas Smart Jobs Fund Program, Tex. Gov't Code Ann. Sec. 481.151
59. Pennsylvania Industrial Development Authority, Statement of Policy, Sections 303.61 to 303.65
60. *Merlino Construction Co. v. City of Seattle*, 741 P.2d 34 (Wash. Sup. 1987)
61. But see *Callanan Industries., Inc. v. White*, 118 A.D.2d 167 (1986), absent statutory authorization, the Department of Transportation did not have authority to debar contractor.
62. Minnesota Public Assistance to Business; Wage and Job Requirements (Minn. Statute, Chapter 224, Sec. 58, 116J.991
63. See *United Steelworkers of America v. United States Steel*, 631 F.2d 1280 (6th Cir. 1980). The union at the U.S. Steel plant presented a novel theory based on property law, rather than contract law, to prevent the company from closing its Youngstown, Ohio plant. The union argued that the longstanding relationship between the corporation and the people of Mahoning County created a property right in the steel industry on the part of the Youngstown community, and a corresponding obligation on the part of U.S. Steel to operate the mills. Although the federal court of appeals (6th Circuit) was sympathetic to the notion that "certain vested rights have arisen out of this long relationship and institution," the court regretted, "the mechanism to reach this ideal settlement, to recognize this new property right, is not now in existence in the code of laws of our nation."

64. See *Drews Co. v. Ledwith–Wolfe Assoc.*, 371 S.E. 532 (S.C. 1988); Dan Dobbs, *Handbook on the Law of Remedies* § 3.3 (1973)
65. See *City of Yonkers v. Otis Elevators*. 844 F.2d. 42 (2nd. Cir., 1988). Here the City of Yonkers was only able to ask for reliance damages for the costs it incurred in condemning and razing the property it provided to the Otis Corporation. In other cases, it may be possible to seek lost opportunity damages where use of federal or state resources by a municipality for an incentive could have been used for other purposes. See also J. B. Russel, “Implied contracts and creating a corporate tort: One way state and local governments are starting to fight plant closings”, *West Virginia Law Review* 90, 1249.
66. Furton, M. “The use of penalty clauses in location incentive agreements”, 70 *Indiana Law Journal* 1009 (1995). Furton argues that the common law rule invalidating penalties should not be applied in the case of incentive contracts.
67. See *In re Hooper's Estate*, 359 F.2d 569 (3rd Cir. 1966), cert. denied, *Marine National Exchange Bank v. Government of Virgin Islands*, 385 U.S. 903 (1966). The government of the Virgin Islands sued a business which had wrongly been granted tax exemptions by a prior administration.
68. Gross, J. with G. LeRoy and M. Janis-Aparicio. *Community Benefits Agreements: Making Development Projects Accountable*. Washington, DC: Good Jobs First, 2005
69. Wisconsin Statutes Section 66.521
70. Weber, R. “Do better contracts make better economic development incentives?” *Journal of the American Planning Association* 68, 2002: 43–55
71. “United Airlines to Pay Indiana About \$32 Million,” *Wall Street Journal*, January 2, 2002
72. Government officials were seeking another \$100 million in penalties, which are held up in bankruptcy court as part of the airline’s Chapter 11 reorganization. C. O’Malley, “State pursues Boeing factory - Vacant United hub won’t be a selling point, but ready supply of workers could be” *Indianapolis Star*, May 23, 2003.
73. Abouhalkah, Y. T. “City starting -- rightfully so -- to ask for its money back” *The Kansas City Star* Sep. 12, 2002
74. Weber, R. “Do better contracts make better economic development incentives?” *Journal of the American Planning Association* 68, 2002: 43–55; Purinton, A. *The Policy Shift to Good Jobs*. Washington, DC: Good Jobs First, 2003