FAIR EXCHANGE: PROVIDING CITIZENS WITH EQUITY MANAGED BY A COMMUNITY TRUST, IN RETURN FOR GOVERNMENT SUBSIDIES OR TAX BREAKS TO BUSINESSES

Deborah Groban Olson†

INTRODUCTION 236
A. WHAT IS FAIR EXCHANGE? 236
B. COMMUNITIES SHOULD NOT BE SECOND-CLASS INVESTORS 246
C. WHAT HAS BEEN THE ROLE OF THE GOVERNMENT IN BALANCING THE COMPETING NEEDS OF HUMAN COMMUNITIES AND BUSINESS, AND HOW HAS GLOBALIZATION CHANGED THAT ROLE? 247
I. HISTORICAL PRECEDENTS OF GOVERNMENT INVESTMENT IN PRIVATE BUSINESSES - FOR THE REVENUE END OF FAIR EXCHANGE 248
A. QUESTIONS CONSIDERED 248
B. HOMESTEAD ACT OF 1862 248
1. *What was the purpose of the Homestead Act of 1862?* 249
2. *What benefits does the Homestead Act of 1862 present?* 250
3. *Did the Homestead Act have a lasting impact on the U.S. economy?* 250
4. *Relationship between the Homestead Act and Fair Exchange* 251

† Deborah Groban Olson, Attorney at Law, has specialized for 25 years in creating and advising employee owned companies, including employee stock ownership plans, and cooperatives, representing companies, trusts, unions, and employees. As Executive Director of the Capital Ownership Group (COG), an online think tank developing policy to broaden capital ownership globally that operates from the Ohio Employee Ownership Center at Kent State University, (www.capitalownership.org) she directs its Alfred P. Sloan Foundation supported Fair Exchange Project (see http://cog.kent.edu/grphome.html.). Olson is General Counsel to the American Ingenuity Alliance (AIA), bringing together inventors and unions to jointly improve bargaining leverage. She is a board member and past chair of the National Center for Employee Ownership (NCEO). Olson has a BA (1971) from the University of Wisconsin and a JD (Order of the Coif 1976) from the University of Wisconsin. *More information available at*: http://esoplaw.com.

C. THE TENNESSEE VALLEY AUTHORITY – A VERY FAIR EXCHANGE 251
  1. *What was the stated objective of the Tennessee Valley Authority?* 253
  2. *History of the Tennessee Valley Authority* 254
  3. *Structure and Organization of the Tennessee Valley Authority* 256
  4. *The Tennessee Valley Authority's public/private business model* 257
  5. *Is the Tennessee Valley Authority still relevant today?* 259
  6. *The Importance of Integrity in the New Deal Programs* 260
D. THE 1971 LOCKHEED LOAN GUARANTEE 260
E. CONRAIL AND GOVERNMENT INVESTMENT IN RAILROADS 261
  1. *Railroads and the U.S. Government before 1970* 261
  2. *Why was Conrail created?* 263
  3. *What benefit did the government and citizens get from the Conrail deal?* 266
  4. *The Conrail deal was not a Fair Exchange for the taxpayers* 266
  5. *USRA/Conrail structure incorporates stakeholder governance* 267
    a) United States Railway Association (USRA) 267
    b) Conrail Governance Structure 269
  6. *Conrail was a fair exchange for employees* 269
  7. *Lessons from Conrail for New Fair Exchange Programs* 270
F. THE 1979 CHRYSLER CORPORATION LOAN GUARANTEE ACT AND ESOP 271
  1. *Why did the government agree to bail out Chrysler?* 271
    a) Terms of the Chrysler Loan Guarantee including Upside for the U.S. Government in Exchange for Risk 272
  2. *The Chrysler Program was a Success for the Government, the Company and its Workers* 272
  3. *What did the employees do with their Chrysler ESOP stock?* 274
  4. *Daimler buyout of Chrysler – would the union members' 15% have mattered?* 276

5. *Relevance of the Chrysler Loan Guarantee and ESOP to the Fair Exchange concept* 277

G. LESSONS THE GOVERNMENT LEARNED FROM ITS BAILOUT EXPERIENCES IN THE 1970S AND 80S 278

H. THE SAVINGS AND LOAN BAILOUT – THE PRICE OF FAILING TO REQUIRE EITHER ACCOUNTABILITY OR THE USE OF FAIR EXCHANGE PRINCIPALS 278

1. *Corporate Welfare is the Opposite of Fair Exchange* 278

2. *What caused the Savings and Loan crisis?* 279

3. *Deregulation of the savings and loan industry enabled substantial fraud that mainly benefited well-connected people* 281

4. *Who benefited from the savings and loan crisis and what did it cost American taxpayers?* 284

5. *If a business is too important for the government to allow it to fail, then it is too big to be left free from organized responsibility to that government* 286

II. THE AIR TRANSPORTATION SAFETY AND SYSTEM STABILIZATION ACT OF 2001 286

1. *Why was Air Transportation Safety and System Stabilization Act created?* 286

2. *Did Congress follow the U.S. General Accounting Office's 1984 study guidelines?* 287

3. *Outcome of Grants from the Air Transportation Safety and System Stabilization Act, Loans and Loan Guarantees* 288

4. *The Air Transportation Stabilization Board only provided loan guarantees to companies that agreed to compensate the taxpayer risk-taking with an equity type of upside benefits* 289

5. *Fair Exchange requirements saved the taxpayers $8.4 billion of available credit* 290

III. CITIZEN SHAREHOLDERS: HISTORICAL PRECEDENTS OF CITIZEN INCOME FROM GOVERNMENT/QUASI-GOVERNMENT INVESTMENT IN PRIVATE BUSINESSES – FOR THE CASH DISTRIBUTION END OF FAIR EXCHANGE 291

A. ALASKA PERMANENT FUND (APF) SHARING OIL AND GAS REVENUE WITH ALL ALASKA CITIZENS 291

1. *History of APF* 291

2. *Legislative Mission of APF* ... 294
3. *Allocation of Funds* ... 294
4. *Inflation-Proofing to Make the APF Permanent* ... 296
5. *Dividend Formula* ... 296
6. *APF Structure* ... 297
7. *Economic Impact of APF* ... 298
8. *Social Impact* ... 300
9. *APF Lesson for Creating Fair Exchange Programs* ... 301

B. ALBERTA HERITAGE FUND ... 303
1. *Alberta Heritage Fund Structure* ... 304
2. *Alberta Heritage Fund History* ... 305
3. *Heritage Fund Results* ... 306

C. COMPARISON OF ALASKA AND ALBERTA FUND INTENTIONS AND OUTCOMES ... 307

D. LESSONS FROM APF AND HERITAGE FUND FOR FAIR EXCHANGE ... 310

E. CANADIAN LABOR SPONSORED INVESTMENT FUNDS (LSIFs) ... 311
1. *What are LSIFs?* ... 311
2. *How and Why LSIFs Were Created* ... 312
3. *Quebec Solidarity Fund (Solidarity FTQ) – the first LSIF model* ... 313
4. *Impact of LSIFs* ... 316
   a) Filling the Capital Gap ... 316
   b) Job Creation ... 317
   c) Return to Government on LSIF Tax Credit Investment ... 317
   d) Broader Social Return on LSIF Investment ... 318
   e) Creation of Regional Financial Networks ... 318
   f) LSIFs Throughout Canada ... 319
   g) Social Audit and Worker Education ... 320
5. *Financial Performance of LSIFs compared to Comparable Commercial Funds for Individual Investors* ... 320
   a) Impact on Individual Investors ... 321
   b) Methodology Problems Comparing LSIF Returns to Commercial Returns ... 323
   c) Financial Return Comparison Data ... 324
   d) Do LSIF Rules Negatively Affect Returns on Investment ... 326
6. *Devaluation of the Crocus Fund and its Implications* ... 328

7. *Difficulty in Comparing Performance of LSIFs (Alliance and Non-Alliance) to Comparable Commercial Funds* 329
8. *Lessons for Fair Exchange from LSIFs* 331

F. NEW YORK STATE INVESTMENT FUNDS 333

G. COMMUNITY LAND TRUSTS (CLT) 335
1. *What is a CLT?* 335
2. *Lessons from CLTs for Fair Exchange* 336

H. RELATIONSHIP OF PRECEDENTS TO FAIR EXCHANGE MODELS 336

IV. FAIR EXCHANGE MODELS 337

A. INTERNATIONAL TRADE RULES 337

B. FEDERAL LEGISLATION TO LEVEL THE PLAYING FIELD BETWEEN STATES AND COMMUNITIES 338

C. FEDERAL "SAFE HARBOR" MODEL FOR LOCAL LAWS 338

D. MODEL FOR INVESTMENT OF FEDERAL FUNDS IN BUSINESSES: THE FAIR EXCHANGE INVESTMENT AND TAXPAYER PROTECTION ACT (FAIR EXCHANGE ACT) OF 2005 DRAFT, ("FAIR EXCHANGE ACT") 340

E. STATE STATUTORY LANGUAGE EXAMPLE 345

F. FAIR EXCHANGE ADDS SELF-ENFORCEMENT FEATURE TO COMMUNITY BENEFIT AGREEMENTS 349

V. ISSUES CONFRONTING POTENTIAL FAIR EXCHANGE LEGISLATION 349

A. THE BENEFITS OF MANDATORY FEDERAL LEGISLATION 349

B. GETTING INITIAL LEGISLATION PASSED ARGUES FOR OPTIONAL AND LOCAL 350

C. FORM OF FAIR EXCHANGE 351

D. TYPES OF GOVERNMENT LARGESSE FOR WHICH TO REQUIRE FE 351

E. COMPOSITION OF THE COMMUNITY TRUST TO ADMINISTER THE FAIR EXCHANGE ASSETSA 351

F. WILL FAIR EXCHANGE KEEP PRIVATE BUSINESS FROM DOING BUSINESS WITH GOVERNMENT? AND IF SO, IS THAT BAD? 352

G. WHAT ABOUT COMPANIES THAT HAVE SECURITIES THE TRUST DOES NOT WANT TO HOLD? 353

H. DEFINING AND MEASURING "COMMUNITY BENEFIT" 353

I. COMMUNITY TRUST NETWORK 356
1. *Fiduciary Issues and Voting Clout* 356
2. *Community Trust Network Mutual Fund with Voting Agreements is a Solution* 356

VI. HOW GOVERNMENTS, INTELLECTUALS, COMMUNITY AND NON-PROFIT ORGANIZATIONS COULD USE FAIR EXCHANGE 358
A. RANGE OF ISSUES, VENUES, AND JURISDICTIONS IN WHICH FE MIGHT BE USED 360
1. *Voluntary and Local* 360
2. *FCC Licenses: Taxpayers should get part of the profits generated when private companies use public airwaves* 360
B. FEDERAL FINANCING OF PILOT FE PROJECTS 361
C. HOW FAIR EXCHANGE CAN HELP COMMUNITIES SURVIVE THE GLOBAL "RACE TO THE BOTTOM" AND IMPROVE GLOBAL CORPORATE RESPONSIBILITY .....a.. 362
CONCLUSION... 364
A. FAIR EXCHANGE IS ONLY ONE OF THESE STRATEGIES.. 365

INTRODUCTION

A. WHAT IS FAIR EXCHANGE?

Fair Exchange ("FE"), in this article, means when communities invest in businesses by giving them tax abatements, tax breaks, or assets at below market rates, and the citizens get equity to be managed by a community trust.

The resounding response to this concept has been "Yes, of course!" from business people, federal, state, and local legislators, union leaders, community organizers, foundation staff, law professors, and journalists. Treating government investors the same way one treats other business investors is an idea that holds increasing sway today, as businesses become more mobile while their attachment to any particular community becomes more tenuous and subject to market influence.

The devil in the Fair Exchange concept is in the details. Even though the overall concept of FE is simple and intuitive, its numerous details require an in-depth study. This article explores legal and economic precedents, proposes Fair Exchange models, discusses practical and legal issues involved in designing the models, considers potential applications across a wide range of issues, venues and jurisdictions; and discusses strategies for implementing workable FE proposals. This article aims to generate substantial and detailed discussion on how to actualize FE at the local, state, federal, and global level.

At present there are no existing FE models, although there exists substantial and successful precedents for many parts that constitute a good FE model. The following is a hypothetical to clarify the concept of a FE program; it is only one of many possible ways to organize an FE model.

Suppose Multinational Manufacturing & Marketing, Inc. ("MMM") seeks $18 million in tax abatements, low interest loans, and loan guarantees to build corporate headquarters and a manufacturing facility in Detroit. Suppose the City of Detroit, the State of Michigan, and the U.S. federal government provide $18 million in abatements, loans and loan guarantees to MMM, with $6 million from each. In return for the government aid, MMM agrees to provide jobs and infrastructure improvements to MMM's new facility in Detroit worth at least $18 million over the next six years. This is an unfair exchange overall; although the company's investment may provide jobs for some citizens, all citizens, as taxpayers, are paying for the aid to MMM. Thus, the entire citizenry deserve a return on its investment. Therefore, a possible solution is to include a provision in the loan and loan guarantee package where the community investors each receive MMM shares worth 10% (in this case $600,000 each) of their investment at the closing of the deal as compensation for undertaking the risks involved.

Suppose further that MMM decides to close its facilities and move its operation to Sri Lanka after three years, having provided only $3 million in jobs and improvements. What can be done to enforce MMM's agreement with the government investors and compensate the taxpayers for their combined loss in jobs and tax dollars? Currently some communities have clawback laws[1] that allow the governments to seek compensation from companies like MMM for withdrawing its investment after receiving subsidies. Clawbacks are used as a disincentive to prevent type of disinvestments MMM is making by moving away. FE allows the company the ability to move if it has to, but the community gets return on its equity in the company if it prospers when it relocates. Unlike clawbacks, which are generally enforced via litigation (if enforced at all), a development agreement with FE equity provisions creates an automatic ownership stake upon default because the stock warrants automatically mature, as described below.

By contrast, under an FE law or FE Community Benefit Agreement ("CBA"), taxpayers' investments would receive treatment similar to those afforded to business investors—securing their investments with reasonable collateral or equity. MMM, the governments, and three community trusts[2] would sign an agreement wherein MMM gives $6 million

[1] GREG LEROY, NO MORE CANDY STORE: STATE AND CITIES MAKING JOB SUBSIDIES ACCOUNTABLE 43-71 (Institute on Taxation and Economic Policy 1997); *see generally* Kenneth P. Thomas, *The Sources and Processes of Tax and Subsidy Competition,* (conference paper presented at University of Minnesota during the "Reining in the Competition for Investment" conference (February 2004)), *available at* www.hhh.umn.edu/img/assets/6158/thomas_paper.pdf.

[2] For instance, the Detroit Community Trust, the Michigan Community Trust and the U.S. Community Trust can undertake such duties.

in stock warrants (in addition to the initial $600,000 each received as a closing requirement) for its publicly traded common stock as collateral for the government benefits it receives. These warrants would have terms that only mature if MMM does not fulfill its $18 million worth of promises, using metrics agreed upon in the initial contract. In the current example, MMM receives $18 million in benefits and returned $3 million in value. A total of $15 million in MMM stock warrants would mature immediately, providing $5 million of publicly traded common stock to each of the three community trusts.

In such a hypothetical, a community trust can hold stock for dividends, cash or other securities. The community trust can allocate assets and income within the community trust to individual accounts for each citizen of the jurisdiction who pays taxes to the government supporting the business venture in question. These assets and income can then be reinvested in local companies, used to augment public services, or employed in some combination of these options. Although in our hypothetical, each community would prefer that the jobs not leave for Sri Lanka, MMM could at least compensate the local citizenry for its loss of employment by sharing in MMM's profit from cost savings gained in relocation.

Local citizens make decisions about how to best use the community trust income to protect the local economy; the community trusts (particularly in conjunction with thousands of other community trusts, public pension and social investors) vote their stock to make MMM a more socially responsible company.

Federal legislation that required states and communities to create and enforce FE laws in as a condition for receiving certain federal funds, would enable all communities to enforce FE laws without losing companies to other U.S. communities. FE requirements could thereby level the playing field for communities nationwide (worldwide if global bodies enacted them); enacting FE laws that increase the power of governments in their business dealings with companies. Broad use of FE programs would enable community trusts to pool their stock assets so that each holds a diversified portfolio of assets; yet create voting trusts so that each community could vote the original block of stock it added to the pool.

The purpose of this article is to focus a policy discussion on the concept that a government investment in any private business should be handled as a business investment by a location-bound investor in a non-location-bound business. Government investors need more sophisticated tools to make these transactions a fair value exchange for the citizens paying for them. This article opens the discussion by marshalling precedents, examining models and drawing lessons from these models, all to

provide a platform from which communities can begin to experiment with the policy to develop best FE practices.

FE is both a general concept and a specific strategy aimed at solving a major structural problem – the mobility of capital and the immobility of communities and labor. The general concept of FE encompasses a wide range of strategies and programs used by governments, labor, environmental and community organizations, and those seeking to bring business under civil society control. These programs aim to compensate communities for the legal and financial benefits they provide to corporations within their borders.

The specific FE strategies discussed herein are not offered as alternatives to existing FE programs, but as concrete policy proposals aimed to subject businesses to civil society control. For example, the former World Bank economist, Noreena Hertz, proposed that the government should: 1) create a World Social Organization to counterbalance the World Trade Organization ("WTO"), with powers to protect human, labor and environmental rights comparable to the WTO's powers to protect trade; 2) create campaigns for national reform to disenfranchise corporations and re-enfranchise the citizenry; 3) increase anti-trust enforcement and restrict cross-media ownership; 4) create global legal aid to ensure greater corporate transparency; and 5) establish a global taxing authority to tax pollution and energy consumption to protect the environment, to tax alcohol and tobacco to provide a global health fund, and to tax multinational corporations to fund the development and enforcement of global norms to protect human, labor and environmental rights.[3] Joseph Stiglitz, the Nobel prize winner and former World Bank Chief Economist, suggests that the World Bank should change its development assistance methods that undermine democracy, forgive debts in developing countries, and create lending mechanisms that address a society's overall needs for development, instead of merely focusing on economic and financial needs using, capital and natural resources.[4] David Korten suggests decommissioning the Bretton Woods system of international financial institutions and replacing them with equivalents run by and using United Nations ("U.N.") standards.[5] Current global governance is divided between the U.N. and the Bretton Woods organizations. The latter organizations, including the International Monetary Fund ("IMF"), the World Bank and the WTO, dictate economic policies with callous disre-

---

[3] NOREENA HERTZ, THE SILENT TAKEOVER: GLOBAL CAPITALIZATION AND THE DEATH OF DEMOCRACY 209-212 (Free Press 2001).

[4] STIGLITZ, JOSEPH, GLOBALIZATION AND ITS DISCONTENTS 241-247 (W. W. Norton 2003).

[5] KORTEN, DAVID, WHEN CORPORATIONS RULE THE WORLD 267-80 (2nd ed., Kumerian 2001).

gard for social and environmental consequences of its policies.[6] Meanwhile, the U.N. finds itself forced to confront these social and environmental consequences with little funding and no economic authority.[7]

The FE strategies discussed herein are not intended to undermine the role of government. This article was researched and developed during the years 2000 to 2005, when the legitimacy of "big government" came under attack in the U.S. The author developed FE strategies using the concept of ownership by community trust, with the goal of showing alternatives to direct governmental ownership and avoiding charges of FE being a "big government" proposal. The article presents successful examples of government ownership, including the Tennessee Valley Authorities, the Chrysler Loan Guarantee and the Air Transportation Safety and System Stabilization Act of 2001. Government ownership in FE programs does not involve long-term government management of businesses; instead, it encourages government or community trust bodies to act as business investors for public benefit. In addition, the Tennessee Valley Authority's program provides a successful example of a profit-yielding long-term entity using a mixed public-private model.

In addition to numerous proposals for changes at the global governance level, there has been significant local activity by labor and community organizations to get community benefit agreements from businesses in exchange for their support in the government approval process of development projects.[8] These examples show that FE can be accomplished without stock or other equity changing hands, if promises are quantified and enforceable.

There is a long history of government investment in private companies; examples include land grants, abatements, natural resource leases, loans, loan guarantees and bailouts.[9] The success of these ventures for communities and citizens of has ranged from of these deals as business proposition range from profitable business ventures to scandalous scams. This article will examine these examples and incorporate the lessons they provide for creating FE legislation. Following is a brief overview of these examples.

During its first 100 years, with little else to invest, the U.S. government used land grants to railroads, homesteaders and state governments to develop the western frontier of the U.S. (the "West"), after removing

---

[6] *See id.*

[7] *See id.*

[8] *See infra* section V (H) in this article.

[9] *See, e.g.*, 7 U.S.C.A. §301 (2004) (originally enacted as Morrill Land Grant Act of July 2, 1862, ch. 130, §1, 12 Stat. 503.); 16 U.S.C. §831 (2001) (originally enacted as Tennessee Valley Authority Act of 1933).

the Native Americans[10]. The government succeeded in its goal: the homesteaders helped to populate the West, creating towns and states in the process, and many poor European and American peasants became the yeoman farmers Thomas Jefferson extolled as the bedrock of democracy.[11] Colleges that were set upon state-grant lands from that era now represent some of our largest and most prestigious universities.[12] And according to at least one congressional committee, the government received in discounted transportation costs an amount equivalent with what it gave the railroads (at least according to one congressional document).[13]

The Tennessee Valley Authority ("TVA") resulted in a very good deal for the government. It has provided a wide range of much-needed public services for over 70 years, including flood control and cheap power.[14] Most importantly, the TVA brought businesses, jobs and electricity to a large and extremely poor large and impoverished portion of the country.[15] Beginning in the darkest hours of the Great Depression, it continues to provide power and development benefits today. It has also repaid the government's financial investment many times over.

In the 1979 Chrysler Loan Guarantee Act[16] ("CLGA") and the 2001 federal airline bailout[17], the government required corporate loan recipients to provide stock warrants in addition to repaying their loans. In the Chrysler case, Chrysler was saved, along with all the related jobs and economic activity.[18] Under the CLGA, Chrysler employees received approximately 15% of the company's stock, the loan was repaid in full to the government ahead of schedule, and the U.S. government made over $300 million when it sold its stock warrants. It is too early to tell whether the government will turn a profit on the airline stock warrants from the 2001 airline bailout, but undoubtedly, the social benefits of preserving jobs in the airline industry has amply justified government involvement. However, when the government began to require 10 – 30% in stock warrants for airlines to qualify for loans and loan guarantees, Northwest Air-

---

10 Kansas Nebraska Act of 1854, U.S. Stats. At Large, Vol. 10, p. 27710 Stat. 277.

11 Thomas Jefferson, *Notes on Virginia*, 1782. "Those who labor in the earth are the chosen people of god, if he ever had a chosen people, whose breasts he made the peculiar deposits for substantial and genuine virtue. It is the focus in which he keeps alive that sacred fire which otherwise might not escape from the earth."

12 For example, the Universities of Michigan and Wisconsin. Act of July 2, 1862 (Morrill Land Grant Act), ch. 130, 12 Stat. 503 (current version at 7 U.S.C. §301 (2000)).

13 National Railroad Museum website at http://www.nationalrrmuseum.org/.

14 *See infra* section II (C).

15 *See infra* section II(C).

16 Chrysler Loan Guarantee Act of 1979, 15 U.S.C. §§1861-1875, P.L. 96-185 (repealed 1983).

17 Air Transportation Safety and System Stabilization Act, 49 U.S.C. §40101 (2001).

18 *See infra* section I(F).

lines concluded that it did not need the funds enough to give up equity, and decided not to submit its application. Both of these government actions were examples of businesslike deals where the government received tangible benefits for risking its funds; they provide the basis for the income end of the FE models proposed below in this article.

By contrast, the savings and loan bailout of the late 1980s was a disastrous investment for the U.S. government and its taxpayers. The $157 billion bailout was financed by floating 30-year bonds that, with interest, may ultimately cost the taxpayers as much as $500 billion or more.[19] Considerable evidence shows that the savings and loan industry failed due in large part to misconduct by senior insiders or outsiders. Well-connected insiders received remarkable benefits at the taxpayers' expense. High-ranking government officials dismantled the federal strike forces seeking criminal prosecution in these cases. Although the low-income investors desperately needed protection from loss in the failed savings and loans, most of the bailout benefit went to a wealthy few. The savings and loan bailout stands as an example of what governments should *not* do when investing in private businesses.

The Conrail deal shows the shortsightedness that comes from legislators taking dogmatic positions about public-private partnerships or allegiance to special interests at the public's expense. The U.S. federal government created Conrail out of seven bankrupt railroad companies, and Congress ordered that Conrail was to become profitable and sold to the private sector by a certain deadline. Congress did not provide that the government might hold Conrail stock to reap long-term rewards from its investment, so that even though the government invested over $10 billion in Conrail, because it had to sell Conrail to the private sector at the arbitrary deadline, it sold its stock for $1.9 billion in 1987, having lost $8.3 billion on its investment. Ten years after the federal government sold Conrail, a private company bought Conrail for $10 billion. Had the government held the stock for 10 years it would at least have broken even on its investment, instead of losing $8.3 billion on the deal.

The Alaska Permanent Fund ("APF"), Alberta Heritage Savings and Trust Fund (the "Heritage Fund") and the Canadian Labor Sponsored Investment Funds ("LSIFs") provide very useful examples of structures and the complex issues involved in developing the distribution end of Fair Exchange legislation.

In the APF, a state uses royalties obtained from natural resource exploration to provide dividends to all of its citizens and to serve as a source of income for government services, while investing the fund principal with no other social investment objectives. The fund grows nicely,

---

[19] *See infra* section I(H).

but the citizens become addicted to the dividend income in ways that may undermine their capacity to act for the general good as citizens. The APF provides the author's model for how a Fair Exchange trust might provide individual citizens with dividends from government investments in companies.

The Heritage Fund serves as an example of a province using royalties obtained from natural resource exploration to lower taxes, make investments in economic development projects, support government owned businesses, and provide loans to other Canadian provinces at below market rates. Because the Heritage Fund has been controlled directly by the government, unlike the APF (which is managed as a trust fund independent of the government) the Heritage Fund's focus is muddled and its direction has shifted with political winds. This fund, although initially larger than the APF, has not grown at all

The Canadian Labor Sponsored Investment Funds (LSIFs) provide a model of citizen investment directed by government chartered, labor controlled investment funds. The LSIFs have produced a significant increase in available venture capital in Canada, enabling substantial economic development in provinces such as Quebec and Ontario that previously had little access to venture capital. The LSIFs considered not only financial factors, but also social and environmental audits to screen the companies in which they invest. The LSIFs inspired the author's initial model for workable FE community trusts.

An ideal FE legislation would contain a combination of the airline bailout investment requirements, the APF's quasi-independent trust providing individual dividends, and the well-focused local investment strategies of the LSIFs. The TVA also provides an excellent model. All the precedents herein offer useful guides in realizing a new FE policy. It may be quite difficult to accomplish all of this in one law that also addresses the economic reality facing a community. The examples herein provide excellent models of different aspects of FE. Each jurisdiction will need to fashion its FE laws to meet its needs. Communities will need to balance the various features of the examples with their economic reality to create something that works for them.

This article does not intend to describe a definitive model for FE. The examples herein are preliminary, and suggest that. Based on the experience in creating them, FE cannot be a one-size-fits-all piece of legislation. Each local FE law will need to be crafted to fit the circumstances, resources and competitive situation of the community.

This article is the culmination of the Capital Ownership Group ("COG")[20] Fair Exchange Project's initial research phase. It was followed by a policy conference[21]. The comments from that conference are incorporated in this article. Based on positive reactions to FE at the conference, COG is launching more research and a project implementation phase. The implementation phase includes: finding more local and state FE examples; interviewing their leaders; assisting communities to create model FE policies; publicizing the outcome of these efforts, gathering and disseminating best practices information, educating interested parties, creating a technical assistance capacity, developing collaborative networks of FE trusts, innovators and leaders; and developing a federal or global trade policy to raise the floor on all government investments in private companies. The author hopes this article is the first step of a potentially large-scale public policy undertaking.

Recent events show the urgent necessity for action in the FE area. As global competition heats up, and global businesses gain increasing power in comparison to governments the economies of developed country economies suffer enormous pressure from growing energy costs and lower wages in the developing world, and governments in both the developed and developing world need new economic strategies and tools to protect the interests of their citizens from the pressure of global businesses that undermine civil society.

In the past few years, the U.S. federally guaranteed pension system has been overrun with bankruptcies of steel companies, airlines and manufacturing firms with under-funded defined benefit pension plans.[22] Since few new companies provide defined benefit pension plans, the Pension Benefit Guarantee Corporation ("PBGC") is sorely stressed when these firms file for bankruptcy because PBGC only gets a fraction of the pension funds it is obligated to pay retirees[23]. Because of its dire situation, the PBGC has started seeking equity for the pension plan liabilities it accepts.[24]

---

[20] *See generally* The Capital Ownership Group, at http:///www.capitalownership.org. The Capital Ownership Group (COG) is a non-profit network of professionals, academics and activists on six continents, using broad ownership to abate the negative effects of globalization. COG operates an online conference center, think tank and library based at Kent State University including 20 working groups and participants from six continents.

[21] COG Fair Exchange Conference, October 5, 2005 at George Washington University Law School. Presentations, materials and video of that conference *available at* http://www.capitalownership.org/grphome.html.

[22] *Entrepreneurs Reap Benefits While PBGC Gets Saddled With The Costs*, BUSINESS WEEK, Feb. 14, 2005.

[23] *Id.*

[24] In re U.S. Airways, et al U.S. Bankruptcy Court E.D. Va., Alexandria Division, Case No.94-13819, Consent Motion for an Order Approving Settlement of Claims of Pension Benefit Guaranty Corporation Pursuant to Federal Rule of Bankruptcy Procedure 9019, In re U.S. Airways, No. 04-13819 (Bankr. E.D. Va. filed Aug. 26, 2005).

A FE settlement providing corporate equity in exchange for PBGC taking on company pension liabilities was approved by the U.S. Bankruptcy Court for the Eastern District of Virginia in the Chapter 11 reorganization of U.S. Airways, Inc. ("US Airways").[25] U.S. Airways owed PBGC nearly $2.5 billion dollars for terminating its pension plans and over $200 million in minimum contribution liability.[26] Rather than engage in costly litigation about the bankruptcy priority of these claims, PBGC settled with the airline by accepting $13.5 million in cash, a seven-year note for $10 million dollars and 70% of the Unsecured Creditors' Stock in U.S. Airways.[27]

Recently, the U.S. government allocated $51.8 billion as a down payment to rebuild large portions of Mississippi and Louisiana destroyed by Hurricane Katrina in September of 2005.[28] The total government investment on this post-Katrina rebuilding project will likely exceed $200 billion;[29] much of those funds will probably go to rebuild businesses. The day after the government's plan became public, the *Wall Street Journal* reported that many U.S. corporations are using the current popular support for large-scale government relief projects to push for a broad range of business reforms that have little to do with hurricane relief.[30] Among the reforms that lobbyists are seeking are: the removal of environmental regulatory barriers to oil and gas drilling in the Arctic National Wildlife Reserve, the removal of fuel taxes on airlines, and the aid to rebuild chicken and oyster farms.[31]

The government's Hurricane Katrina cash allocation begins in the final year of the $15 billion federal airline bailout made necessary by the events of the terrorist attacks on September 11, 2001.[32] Based on these and numerous other examples, it becomes clear that governments are called upon to invest in private businesses on a regular basis and are therefore in need of ongoing government policies for engaging in private business investments, rather than approaching each one ad hoc.

---

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] Brody Mullins, *Lobbyists Seek Leverage from Storm: Congress Hears from Big Airlines and Energy Companies to Small Chicken Farmers*, THE WALL STREET JOURNAL, Sept. 9, 2005, at A4.

[29] *See CNN Nightly News*, (CNN television broadcast, Sept. 10, 2005).

[30] Mullins, *supra* note 28.

[31] *Id.*

[32] H.R. 3645, "Emergency Supplemental Appropriations Act to Meet Immediate Needs Arising from the Consequences of Hurricane Katrina 2005", September 4, 2005. The final report of the ATSSSA board was dated June 3, 2004 for loan applications with a deadline of 2002 that were due to be repaid between 2007 and 2009. *The Financial Condition of the Airline Industry: Hearing Before the H. Subcomm. on Aviation,* 108th Cong. (2004) (testimony of Michael Kestenbaum, Executive Director of the Air Transportation Stabilization Board), *available at* http://www.house.gov/transportation/aviation/06-03-04/06-03-04memo.html.

The issue of states providing subsidies to businesses is the subject of a current case on U.S. Supreme Court docket[33]. In *Cuno v. Daimler Chrysler*[34] the Sixth Circuit ruled that the investment tax credit granted to DaimlerChrysler against Ohio's corporate income tax violates the Commerce Clause of the U.S. Constitution. While *Cuno* is still pending a Supreme Court judgment, bills have already been introduced in the Senate and House to short-circuit the appeals process, reverse *Cuno*, and affirmatively give state and local governments the authority to grant wide array of economic development-oriented tax incentives to businesses.[35] The legislation in question, the "Economic Development Act of 2005" (S. 1066/H.R. 2471), is sponsored by Ohio Senator George Voinovich and Ohio Representative Patrick Tiberi.[36]

B. COMMUNITIES SHOULD NOT BE SECOND-CLASS INVESTORS

Wal-Mart's story exemplifies the central contradiction in the current relationships between corporations, governments and citizens. With annual revenues of $256 billion, Wal-Mart is the world's largest retailer and one of its largest companies.[37] Wal-Mart has used more than $1 billion worth of economic development subsidies to develop distribution centers and stores in the U.S.; subsidies for individual distribution centers amounted to as much as $48 million (with an average of $7.4 million), while the largest subsidy for retail stores was $12 million (with an average of $2.8 million).[38] Although Wal-Mart presents itself as an entrepreneurial success story, it has made extensive use of tax breaks, free land, cash grants and other forms of public subsidies.[39] In addition to tax breaks it gets access to these local markets with the frequent consequence of displacing local businesses and the jobs they provide. "It is quite possible that a new Wal-Mart store will destroy as many (or more) jobs than it creates – and the Wal-Mart jobs may pay less, meaning they do less to stimulate the local economy."[40]

---

[33] DaimlerChrysler v. Cuno, *2005 U.S. LEXIS 5422*, cert. granted *2006 U.S. LEXIS 1096 (U.S., 2006)*.

[34] Cuno v. DaimlerChrysler, Inc., 383 F.3d 379, 2004 U.S. App. LEXIS 18550 (6th Cir.) (6th Cir. Ohio, 2004).

[35] S. 1066/H.R. 2471, "Economic Development Act of 2005".

[36] Michael Mazerov, *Should Congress Authorize State to Continue Giving Tax Breaks to Businesses*, Center on Budget and Policy Priorities, *available at* http://www.cbpp.org/2-18-05 sfp.htm (last visited Sept. 15, 2005).

[37] Phillip Mattera & Anna Purinton, *Shopping for Subsidies: How Wal-Mart Uses Taxpayer Money to Finance its Never-Ending Growth*, Press Release and Executive Summary, GOOD JOBS FIRST, at 7 (May 2004), *available at* http://www.goodjobsfirst.org/pdf/wmtstudy.pdf.

[38] *Id.* at 7.

[39] *Id.*

[40] *Id.* at 10.

The web of human relationships that form a neighborhood or community is essential to human existence. People seek to live in places with high quality of life, where they can be safe and secure. People want clean water, air, food and medicine, and they prefer to live in places where physical and social infrastructure such as libraries, schools, parks, community organizations and churches are long established. In addition to all that, people need steady employment. Thus most people are invariably tied to certain communities. We need stable employment near these communities to enable stability in the neighborhood. These human needs have not changed significantly over the centuries.

By contrast, business entities have none or few of those constraints of place. Before technology made global markets possible, businesses often had a closer connection to specific communities because they needed to be close to natural resources, skilled labor, markets or transportation hubs. In this age of computers and global electronic markets, however, businesses have been freed from their local ties. Unfortunately, our business laws and forms of government have not caught up with this seismic social shift. Yet, to function successfully, businesses still need government to enforce contracts, keep order, protect property, provide infrastructure and allocate or protect claims to use of natural resources.

C. WHAT HAS BEEN THE ROLE OF THE GOVERNMENT IN BALANCING THE COMPETING NEEDS OF HUMAN COMMUNITIES AND BUSINESS, AND HOW HAS GLOBALIZATION CHANGED THAT ROLE?

Humans have always adapted their means of living to the demands of the economic engines, often at great human expense – such as sweatshops, child labor, overcrowded, diseased and crime-infested slums. In democratic societies, when these conditions threaten general community welfare, social movements such as unions, progressive political movements rise to demand government intervention.

To provide jobs for communities, governments at all levels have created programs to entice businesses to locate to protect the economic well being of the community. Businesses quickly learn to use, manipulate or lobby to create these programs to meet their own competitive ends.[41] Now that election campaigns are so costly in the U.S., businesses have achieved unprecedented control over legislative bodies.[42]

---

[41] *See generally* LEROY, *supra* note 1; see generally Thomas, *supra* note 1.

[42] According to Common Cause, a U.S. public interest group that lobbies for accountable government and clean elections: "The way congressional campaigns are currently financed is corrupt. It is a system where individuals and groups can contribute significant sums of money to elected officials who have the power to make decisions affecting the interests of those donors. It is also a system where incumbents' financial advantage often results in noncompetitive elections, making them less responsive to the voters and more responsive to special-inter-

A key function of government has been to develop, allocate and regulate the use and restoration of natural resources, but our current policies have resulted in enormous subsidies and nearly no net benefit for the public. For example, Wal-Mart, a global corporation that causes companies in China to compete with each other to lower wages,[43] received $1 billion in subsidies intended to protect communities and jobs, even though the opening of Wal-Mart stores in many communities leads to the closing of local businesses run by local people.[44]

Clearly, governments need to alter their course of dealing with private businesses; the balance between communities, business and government has swung much too far in favor of businesses in recent years. Since we do not have global government, it is increasingly difficult for nations, states and local governments to regulate businesses. Now that an increasing number of businesses have become multi-national, they are no longer subject to the laws of a single jurisdiction. Upon granting benefits such as tax breaks, tax abatements and subsidies of all types, local governments have the legal power to require the same rights and benefits as other investors in business. Yet, due to competitive economic pressure, few communities exercise this power.

I. HISTORICAL PRECEDENTS OF GOVERNMENT INVESTMENT IN PRIVATE BUSINESSES - FOR THE REVENUE END OF FAIR EXCHANGE

A. Questions Considered

Any FE law would necessarily be a complex legal and economic structure, but legal precedents exist for most of the proposed FE features, although to date they have not combined in a single program. This article is based on a literature survey seeking precedents and guidance on the feasibility of FE; it is a conceptual and historical overview of prior government programs investing in business and an examination of the FE element these programs contained.

B. Homestead Act of 1862

For each precedent, this article examines the following aspects: 1) what the community investor's intended goals were; 2) whether the community investor's goals had been to broaden asset ownership; 3) how well the community investor succeeded at its announced goals; 4)

---

est contributors." Common Cause: Holding Power Accountable, *available at* http://www.commoncause.org/site/pp.asp?c=DKLNK1MQIwG&b=191979 (last visited April 14, 2005).

43 WILLIAM GREIDER, ONE WORLD READY OR NOT, THE MANIC LOGIC OF GLOBAL CAPITALISM, 341-345 (Simon & Schuster 1997).

44 Mattera & Purinton, *supra* note 37, at 10.

whether and how the community's investment structure or policies might inform future FE policies; 5) whether the community got fair value for its investment in financial terms; 6) other social or economic return on investment obtained by the government or quasi-government body from the investment; and 7) available information on other impacts of the investment program. The article also investigates the problem of quantifying non-monetary returns to communities and suggests a preliminary basis for measuring community benefits.

U.S. government policy on the relationship between government, business and citizens in the 18th, 19th and early 20th centuries serves as a good starting point for comparison to and consideration of government policy options toward businesses in the 21st century.

1. *What was the purpose of the Homestead Act of 1862?*

The central purposes of the Homestead Act of 1862 (the "Homestead Act") were to settle the western frontier of the U.S., to build communities and to develop the U.S. economy.[45] Other laws passed at the same time used government land to create agricultural colleges and induce railroad companies to build railroads in the frontier, such as the Morrill Land Grant Act 1862,[46] which provided for college land grants; and the Pacific Railroad Act of 1862,[47] which provided participating railroad companies with 5 square miles of public land for every mile of rail laid, and which was later amended to include 10 square miles for every mile of rail laid.[48]

The Kansas-Nebraska Act 1854 opened up more land to settlers as the government "legally" acquired extensive land from the Native Americans.

The Homestead Act provided that any citizen (or applicant for citizenship) who was a head of household, veteran or person over age 21, and who had not fought against the U.S. could claim 160 acres of public land and obtain title by building a home on the land and farming it for 5 years.[49] The Homestead Act[50]; the Morrill Act[51] and the Pacific Railroad

[45] Act of May 20, 1862 (Homestead Act), Pub. L. No. 37-64, § 392 (repealed 1976).

[46] Act of July 2, 1862 (Morrill Land Grant Act), ch. 130, 12 Stat. 503 (current version at 7 U.S.C. §301 (2000)).

[47] Act of July 1, 1862 (Pacific Railway Act), ch. 120, 12 Stat. 489.

[48] S. COMM. ON ENERGY & NATURAL RESOURCES, 108th Cong., BACKGROUND FOR THE RAILROAD RIGHT OF WAY CONVEYANCE VALIDATION ACT OF 2003, H.R. REP. NO.1658 (describing the land grant features of the Pacific Railroad Act of 1862, 12 Stat. 489 and its 1864 amendment, 13 Stat. 356).

[49] Act of May 20, 1862, Pub. L. No. 37-64, § 392 (repealed 1976).

[50] *Id.*

[51] 7 U.S.C. §301.

Act[52] were passed in quick succession, soon after the South seceded from the U.S.

2. *What benefits does the Homestead Act of 1862 present?*

Between 1862 and 1938, 3 million people applied and almost 1.5 million households were given title to 246 million acres of land.[53] This acreage is close to the combined area of Texas and California.[54] The U.S. Department of Interior (1998) lists that 287.5 million acres of the public domain were granted or sold to homesteaders under the Homestead Act.[55] This is approximately 20% of all existing public land in the U.S.[56]

3. *Did the Homestead Act have a lasting impact on the U.S. economy?*

How many people living today had ancestors who acquired property through the Homestead Act?[57] As a means of gauging the Act's long-term impact, the living descendants of each family that acquired property under the Homestead Act were calculated[58] based on three different sets of assumptions. The most aggressive showing that in the year 2000 there were 93 million living descendants of the Homesteaders, which (based on 2003 population of 293 million[59]) would make those descendents approximately 32% of the current U.S. population. The medium estimate was 46 million descendents, or 25% of the current adult population. The most conservative estimate in which the homestead property passed to only one descendent per generation was 20 million. "Taking the medium estimate of 46 million. . . would mean that a quarter of the adult population potentially has a legacy of property ownership and assets in their background that can be directly linked to. . . the homestead policy".[60]

Land ownership changed the lives of landless families in numerous ways, providing upward mobility and a more secure future for the homesteader and his descendents.[61]

---

52 Ch. 120, 12 Stat. 489.

53 Trina Williams, *The Homestead Act: A Major Asset-building Policy in American History – Working Paper 00-9* at 1, *in* INCLUSION IN ASSET BUILDING: RESEARCH AND POLICY SYMPOSIUM, St. Louis Washington University/Center for Social Development, at http://gwbweb.wustl.edu/csd/Publications/2000/wp00-9.pdf, accessed on July 8, 2004.

54 Williams, *supra* note 53, at 5-6.

55 Williams, *supra* note 53, at 6.

56 Williams, *supra* note 53, at 6.

57 Williams, *supra* note 53, at 6.

58 Williams, *supra* note 53, at 7-8 and Chart I.

59 U.S. Census press release dated 12/22/2004 estimating the U.S. population as of July 1, 2004.

60 Williams, *supra* note 53, at 8.

61 Williams, *supra* note 53, at 3.

> Just as gaining an education is the surest way to rise in society today, in colonial days the acquisition of property was the key to moving upward from a low to a higher stratum. The property holder could vote and hold office, but the man with no property was practically on the same level as the indentured servant or slave.[62]

"The Homestead Act is still responsible for the generation of $46.3 billion every year".[63] Although some drawbacks have been identified regarding the Homestead Act (poor land, lack of implementation help, selective administration regarding racial eligibility, etc.), it provided a voice and an opportunity for many small landholders. The Act was progressive, insofar as it broadened the base of asset ownership beyond the wealthy.[64]

4. *Relationship between the Homestead Act and Fair Exchange*

The Homestead Act demonstrates that building assets among common folks helps promote healthy growth. It provided a portion of the asset basis for 25-32% of the adults currently living in the U.S. As one of the country's first and most enduring economic policies, it embodied the Jeffersonian concept that American democracy is best protected when the majority of common people have a material stake in society; and that it is in the best interest of the country as a whole to enable broad stake holding. The relationship between stakeholdership and citizenship has not changed in 250 years. However, in the 21st century equity in companies is a primary type of stake, as land was in the 18th and 19th century. Therefore, an FE policy that broadens the country's or the world's ownership base should be a stabilizing factor during the tumult of the transition from the industrial to the knowledge economy.

C. THE TENNESSEE VALLEY AUTHORITY – A VERY FAIR EXCHANGE

The TVA[65] is a striking example of a successful public/private partnership, in which the government distributed to the public a very fair exchange for its investment.

---

[62] *See* Williams, *supra* note 53, at 3 (discussing Dick Everett).

[63] Todd Arrington, Historian at the Homestead National Monument of America, "Economics and the Homestead Act" (2005) " bases his calculation as follows: "All the states that had homesteading at some point in American history have a modern combined gross state product of $4.63 trillion. If we assume that just one percent of that modern total can be related to homesteading (via agriculture, manufacturing, retail sales, real estate, etc.), that means that the Homestead Act is still responsible for the generation of $46.3 billion *every year.e.* . Dollar figures taken from the website of the United States Census Bureau. 1998 figures are the most recent available."

[64] Williams, *supra* note 53, at 10.

[65] Tennessee Valley Authority Act of 1933, 16 U.S.C.§ 831 (2004).

Since its inception, the TVA has provided flood control, improved river navigation, served as a regional economic development agency and lender, developed and taught modern agricultural and environmental stewardship methods, provided recreational spaces and opportunities, created small business incubators, brought local communities into the information age, and improved business and workforce productivity.[66] During its heavy dam construction phase in the 1940s, the TVA employed over 28,000 workers.[67] The 2004 TVA Annual Report stated that over the past three years, TVA helped its development partners attract or retain 145,000 jobs and provided $57.4 million in loan commitments, which leveraged $832 million in additional investments. In 2004 alone, the TVA leveraged investments of $2.1 billion, working with its business partnerships.[68]

> The federal government's initial investment of $50 million[69] in the TVA and its subsequent appropriations paid off handsomely and fulfilled its objectives well. The TVA began repaying the U.S. Government for its appropriation investment in 1948 on a sliding scale.
> A return on the U.S. Government's initial appropriation investment in TVA power facilities, plus a repayment of the initial investment, is specified by law. The payment for 2000 was $54 million, and total cumulative repayments and return on investment by TVA to the U.S. Treasury exceed $3 billion.[70]

TVA is now entirely self-supporting on its power generation revenue which, as of 2004, was over $7 billion per year, serving a 41,000 square mile watershed.[71] It annually pays local governments $338 million in lieu of taxes.[72] TVA provides wholesale electricity, serving 8.5 million people through 158 local power distributors, including munici-

---

[66] *What Contribution Does the TVA Make to the Valley Economy?*, Tennessee Valley Authority Official Website FAQ, *available at* www.tva.govabouttva/keyfacts.htm (last visited Nov. 1, 2005).

[67] *A Short History of the TVA*, Tennessee Valley Authority Official Website, *available at* www.tva.govabouttva/history.htm (last visited Nov. 1, 2005).

[68] *Tennessee Valley Authority 2004 Annual Report* 12, Tennessee Valley Authority, Knoxville, T.N., *available at* http://www.tva.gov/finance/reports/pdf/fy2004ar.pdf.

[69] C. Herman Pritchett, *The Tennessee Valley Authority as a Government Corporation*, 16 SOCIAL FORCES, 120, 122 (October 1937).

[70] *Tennessee Valley Authority 2000 Annual Report*, at Management's Discussion and Analysis, Tennessee Valley Authority, Knoxville, T.N., *available at* http://www.tva.gov/finance/reports/pdf/fy2000ar.pdf.

[71] *How is TVA Funded?* Tennessee Valley Authority Official Website FAQ, *available at* www.tva.govabouttva/keyfacts.htm (last visited April 10, 2006).

[72] *Does TVA Pay Taxes?* Tennessee Valley Authority Official Website FAQ, *available at* www.tva.govabouttva/keyfacts.htm (last visited April 10, 2006).

palities, cooperatives, industries and eight federal government agencies.[73] TVA electricity costs less than most electricity produced around the nation.[74] Its waterways reduce transportation costs for Valley businesses by $400 million each year compared to other modes of shipping.[75]

TVA does all of the above while also providing flood control, improving river navigation, serving as a regional economic development agency and lender, developing and teaching modern agricultural and environmental stewardship methods, providing recreational spaces and opportunities, creating small business incubators, bringing local communities into the information age, and improving business and workforce productivity.[76]

1. *What was the stated objective of the Tennessee Valley Authority?*

The TVA was one of the most visionary of President Franklin Roosevelt's New Deal innovations developed to lift the nation out of the Great Depression. The Depression's devastating impact on the South and the ongoing dispute (described below) about how to deal with the government-owned dam project and nitrate plants at Muscle Shoals, Alabama, enabled Roosevelt to embark on a grand plan to create a regional planning agency on a scale never before attempted. After his 1932 election Roosevelt said "It is clear that the Muscle Shoals development is but a small part of the potential public usefulness of the entire Tennessee River. . . transcends mere power development. . . [and] leads logically to national planning for a complete river watershed involving many States and the future lives and welfare of millions."[77] He asked Congress to create "a corporation clothed with the power of government but possessed of the flexibility and initiative of a private enterprise."[78] On May 18, 1933, Congress passed the Tennessee Valley Authority Act. Its stated purpose was:

---

73 *How Is TVA Electricity Distributed?* Tennessee Valley Authority Official Website FAQ, *available at* www.tva.govabouttva/keyfacts.htm (last visited April 10, 2006).

74 *See How Do TVA Rates Compare With Those of Other Power Companies?* Tennessee Valley Authority Official Website FAQ, *available at* www.tva.govabouttva/keyfacts.htm (last visited April 10, 2006).

75 *See Navigation on the Tennessee River*, Tennessee Valley Authority Official Website FAQ, *available at* www.tva.govabouttva/keyfacts.htm (last visited April 10, 2006).

76 *What Contribution Does the TVA Make to the Valley Economy*, Tennessee Valley Authority Official Website FAQ, *available at* www.tvw.govabouttva/keyfacts.htm (last accessed April 10, 2006).

77 Thayer Watkins, *Regional Development Policies and Programs of the U.S.*, Economics Department, San Jose State University, *available at* www2.sjsu.edu/faculty/Watkins/usreg.htm.

78 *Id.*

> An Act to improve the navigability and to provide for the flood control of the Tennessee River; to provide reforestation and the proper use of marginal lands in the Tennessee Valley; to provide for the agricultural and industrial development of said valley; to provide for the national defense by the creation of a corporation for the operation of Government properties at and near Muscle Shoals in the State of Alabama, and for other purposes.[79]

2. *History of the Tennessee Valley Authority*

In 1926 Senator George Norris (R. Nebraska) introduced a bill directing the federal government to take over and expand the Wilson Dam project at Muscle Shoals, Alabama and to build more federal dams along the Tennessee River.[80] Norris's concern for farmers caused him to vehemently oppose President Warren G. Harding's attempt to privatize the federal project to build the Wilson Dam at Muscle Shoals.[81] In 1921, Henry Ford offered to lease the dam and two nitrate plants for $5 million through the next century. Norris believed this was not a good deal for the government or for the local farmers and workers. Norris described Ford's offer as the worst real estate deal "since Adam and Eve lost title to the Garden of Eden".[82] Although the project made no progress in the Coolidge administration and was later vetoed by Herbert Hoover, it was ready and waiting for Roosevelt, who got it enacted in 1933.

During its early days, owners and managers of power companies that served the Tennessee Valley criticized the TVA as being both unnecessary and creating unfair subsidized competition. Its best-known critic was Wendell Willkie.[83] Wilke helped create Commonwealth and Southern utility company ("C&S"). Along with the Tennessee Electric Power Company ("TEPCO")[84], Willkie and C&S waged a 5-year battle against the TVA, challenging TVA's constitutionality. In January of 1939[85] the U.S. Supreme Court ruled that the TVA had the right to build power plants in competition with private companies. Shortly thereafter, TVA bought C & S's facilities.

---

[79] 16 U.S.C. § 831.

[80] Jack Neely, *Clash of the Titans*, Tennessee Valley Authority Official Website, *available at* www.tva.gov/heritage/titans/index.htm.

[81] *Id.*

[82] *Id.*

[83] *The Indiana Farmer: TVA Heritage*, Tennessee Valley Authority Official Website, *available at* www.tva.gov/heritage/wilke/index.htm.

[84] Timothy P. Ezzell, *Jo Conn Guild*, *in* THE TENNESSEE ENCYCLOPEDIA OF HISTORY AND CULTURE, *available at* http://160.36.208.47/FMPro?-db=tnencyc&-fonnat=tdeatil.htm&-lay=web&entryid=G050.

[85] *See* Tenn. Elec. Power Co. v. TVA, 306 U.S. 118 (1939).

In its early years when it was supported by Congressional appropriations, the TVA was able to develop fertilizers for growing crops and trees, teach farmers how to improve crop yields, help to replant forests, control forest fires, and improve habitat for wildlife and fish.[86] The electricity generated by TVA dams powered electric lights and appliances, making lives easier and farmers more productive; in addition, electricity encouraged industrial development, creating jobs for the local communities.[87] During the 1940s, the TVA engaged in one of the largest hydropower construction programs to produce aluminum for bombs and planes.[88]

By the1950s, TVA had become the nation's largest supplier of electricity and had completed a 650-mile navigation channel the length of the Tennessee River. Still demand exceeded supply but the TVA couldn't get further federal appropriations to build coal-fired plants so it asked for the authority to issue bonds.

President John F. Kennedy enjoyed playing off President Dwight Eisenhower's remark that the TVA represented "creeping socialism". In a 1963 speech at the TVA, Kennedy said "The tremendous economic growth of this region, its private industry and its private income. . . make it clear to all that the TVA is a fitting answer to socialism – and it certainly isn't creeping."[89]

Legislation was enacted in 1959 for the TVA power system to become self-financing.

The 1960s were years of unprecedented economic growth in the Tennessee Valley. TVA began to build nuclear plants as a new source of economical power.[90] During the 1970s and 1980s the TVA had difficulty keeping its power costs competitive because it had overbuilt nuclear power facilities, and the oil embargo and increased fuel costs required it to cancel several planned nuclear facilities.[91] In the 1990s, the TVA halved its staff, reduced expenses and began to stabilize and then reduce its power rates again.[92] However, since the late 1990s, the TVA has developed a strong pollution control system and begun to invest in solar and wind energy.[93]

---

[86] *A Short History of the* TVA, *supra* note 67.

[87] *Id.*

[88] *Id.*

[89] *TVA on the New Frontier*, Tennessee Valley Authority Official Website, *available at* www.tvw.govabouttva/history.htm.

[90] *Id.*

[91] *Id.*

[92] *A Short History of the* TVA, *supra* note 67.

[93] *See* (Tennessee Valley Authority 2004 Annual Report), *supra* note 68.

3. *Structure and Organization of the Tennessee Valley Authority*

The TVA's Board of Directors (the "TVA Board") consists of three members, all U.S. citizens, appointed by the President of the United States with the advice and consent of the Senate. Each member is appointed for nine years. The U.S. President appoints the Chair. Being a member of the TVA Board is a full-time job compensated by the TVA at a rate comparable to a Level IV Executive Schedule civil servant (the chair is Level III). Directors may live in homes provided by the Government (may now be the TVA), and they must not have any financial or business interests in the power industry or adverse to the TVA.[94] Board members can be removed at any time by a concurrent resolution of the House of Representatives and the Senate.[95]

The TVA Board directs the corporation, including hiring, firing, contracting, buying and selling assets, etc. However, they are required to pay "prevailing wages" and must give "due regard. . . to those rates which have been secured through collective agreement by representatives of employers and employees."[96]

The TVA can sue and be sued in its own name, controls its corporate name, can adopt, amend or repeal its bylaws. However, it also has the power to exercise the right of eminent domain in the name of the U.S. Government. It has the power to acquire real estate for the construction of dams, reservoirs, transmission lines, power houses, navigation projects and other structures along the Tennessee River or its tributaries and may use eminent domain to condemn property that private owners refuse to sell it at a fair price. It may also convey or lease land in the name of the U.S. to any corporation or person for use as summer residences, pleasure resorts, or for any purposes to assist shipping or manufacturing, with approval from Congress. Numerous specific dams, plants and other facilities are named as either prohibited from being sold by the TVA or permitted to be sold.[97] TVA has authority to help in adjustment of population displaced by its projects, to provide rights of way and easements to local governments, and to create its own law enforcement agents to maintain order on its properties.[98] TVA has the authority not only to produce fertilizer, but to create major programs to experiment with new fertilizer projects and methods through agreements with farmers, farm organizations, agricultural colleges, demonstration farms (except when the nitrogen facilities are needed for military purposes) and to create labs and plants to develop nitrogen products for the military.

---

94 16 U.S.C. § 831a(e)-(f) (1933).
95 16 U.S.C. § 831, Section 4(f).
96 16 U.S.C. § 831b.
97 16 U.S.C. § 831c(k)(b)-(d).
98 16 U.S.C. § 831c(l) (1993), 16 U.S.C. § 831c-3(a) (1933).

TVA has the right to seek assistance from any other federal agency, and the President shall direct that such assistance be rendered, if in his opinion it suits the public interest. Yet the patents on inventions and discoveries created, even by government employees working on TVA projects, belong to the TVA.[99]

Competitive bidding is required for contracts over $25,000 except in emergencies or repair situations. The Comptroller General of the U.S. audits the TVA at least annually.[100] TVA has an independent Inspector General's Office appointed by Congress that continuously examines the programs, contracts, and financial reports of TVA to identify areas of needed improvement to insure a more successful TVA, and to prevent and correct fraud.[101]

4. *The Tennessee Valley Authority's public/private business model*

TVA is authorized to sell its power in excess of its own needs on the open market; however, it must give preference to States, counties, municipalities, cooperatives, and non-profit farmers or citizens organizations supplying their own members. It has the authority to build electrical transmission lines to rural communities not served at reasonable rates, make all necessary reasonable rules and regulations for equitable distribution of electric power, and experiment to promote wider and better use of electricity.[102] TVA projects are considered to be primarily for the benefit of the people of the area, and particularly for the domestic and rural consumers. Industrial uses get secondary priority and are undertaken to make the production of energy affordable for domestic and rural consumers. Entities to which TVA sells wholesale power must distribute it on a fair basis to retail customers not to exceed scheduled rates set by the TVA board.[103] TVA is authorized to make payments-in-lieu-of-taxes to States and municipalities in which its facilities are located and is otherwise exempt from local taxes.[104] Half these payments are based on business income in the state, county or municipality, while the other half is based on TVA's property asset value.[105]

From its inception until 1959, Congress provided the TVA authority to issue bonds for specific projects fully backed by the U.S. Treasury.[106] In 1959, Congress expanded TVA's bonding authority to permit it to

---

[99] Tennessee Valley Authority Act of 1933, 48 Stat.58-59, 16 U.S.C.§ 831, Section 5.
[100] *Id.* at Section 8.
[101] Website of the Office of the Inspector General of the TVA, http://oig.tva.gov/3/13/05.
[102] Tennessee Valley Authority Act of 1933, 48 Stat.58-59, 16 U.S.C.§ 831, Section 10.
[103] *Id.* at Section 11-12.
[104] 16 U.S.C. § 831, Section 13.
[105] *Id.*
[106] 16 U.S.C. § 831h(b).

issue bonds on TVA's credit as needed to support itself as a business independent of government subsidy.[107] These new TVA bonds were not guaranteed by the U.S. federal government, but are exempt from state or local taxes other than inheritance, estate or gift taxes.[108] However, TVA still has to provide the Treasury Secretary notice of bond issuance seeking approval as to timing and rate. If the Secretary does not approve these bonds, the TVA may issue them as interim bonds to the Secretary, which the Secretary is directed to purchase up to a limit of $150,000,000 outstanding at one time. If the TVA and Secretary do not reach agreement on purchase of interim bonds within 8 months after their issue, the TVA may proceed to sell them on the open market.[109]

Beginning in 1961, the U.S. federal government required the TVA to start repaying—from proceeds in excess of those needed to meet the TVA's ongoing obligations—the investment the government made to create and underwrite the TVA's development, at the rate of not less than $10 million for each of the first 5 fiscal years, $15 million for each of the next 5 years and $20 million for each year thereafter until a total of one billion dollars of the appropriation investment shall have been repaid.[110]

The repayment plan also provided for the TVA board to defer payments for up to 2 years due to inadequacy of funds occasioned by drought, emergency, poor business conditions or other matters outside the TVA's control.[111]

> During the first 25 years of TVA's existence, the U.S. Government made appropriation investments in TVA power facilities. In 1959 TVA received congressional approval to issue bonds to finance its growing power program. For the past four decades, TVA's power program has been required to be self-supporting. As a result, TVA funds its capital requirements through internal cash generation or through borrowings (subject to a congressionally mandated $30 billion limit).[112]

Theft of its property or fraud against TVA is treated as theft or fraud from the U.S. Government[113] and the Government has the authority to

---

[107] 16 U.S.C. § 831n-4.

[108] 16 U.S.C. § 831n-4(b)-4(d).

[109] Tennessee Valley Authority Act of 1933 Section 15d (c), 48 Stat.66-67 as amended by 73 Stat.280 (1959), 73 Stat.338 (1959), 80 Stat.364 (1966), 84 Stat. 915 (1970), 89 Stat.750 (1975), 90 Stat.376 (1976) and P.L. No 96-97 (Oct.31, 1979), 16 U.S.C. Sec. 831n-4.

[110] *Id.*

[111] *Id.*

[112] *TVA 2000 Annual Report*, *supra* note 70.

[113] Tennessee Valley Authority Act of 1933 Section 21, 48 Stat.68-69, 16 U.S.C. Sec. 831t.

take over any or all of TVA's facilities in case of war or national emergency.[114]

5. *Is the Tennessee Valley Authority still relevant today?*

By operating as a quasi-private company, with government investment and oversight, the TVA has provided a wide range of much-needed public services for over 70 years, and has repaid the public investment many times over. It is difficult to imagine using the TVA model in the current political atmosphere, which focuses on privatization of much more standard public services and New Deal programs, such as Social Security. Yet, if there is a global economic crisis caused by the rising economic hegemony of China[115] or the decreasing access to petroleum, a TVA type of solution in some fields, such as biomass fuel generation, may be desirable. The devastation of large parts of Mississippi, Louisiana and Texas by the 2005 hurricanes may make TVA-type solutions necessary. Senator Edward M. Kennedy of Massachusetts has proposed that Congress create a Gulf Coast Redevelopment Authority, modeled after the TVA, to oversee the reconstruction of the areas devastated by the hurricanes.[116]

It is crucial to understand and consider utilizing features of this well-crafted public/private venture. The TVA was a bold idea born of grave necessity. The Great Depression was a crisis in capitalism caused by, among other things, major changes in methods and locations of production and an insufficiently regulated Wall Street investment community. The early 21st century is a similar period of global economic change and dislocation. The U.S. continues to lose increasingly higher skilled jobs to lower wage countries and is increasingly indebted to these countries as well.[117] At some point in the near future, there may be a sufficient crisis in the U.S. economy to change the political atmosphere

[114] Tennessee Valley Authority Act of 1933 Section 20, 48 Stat.68 as amended by 96 Stat.49, 16 U.S.C. Sec. 831s

[115] *See* ODED SHENKAR, THE CHINESE CENTURY, THE RISING CHINESE ECONOMY AND ITS IMPACT ON THE WORLD ECONOMY, THE BALANCE OF POWER, AND YOUR JOB 170-76 (Wharton School Publishing 2005).

[116] WSVN.com, *Rebuilding Gulf Coast After Katrina Most Expensive U.S. Reconstruction Project to Date* (Sept. 23, 2005), *available at* http://www.wsvn.com/news/articles/national/mia7332 (last visited Oct. 30, 2005).

[117] Niall Ferguson, *Our Currency, Your Problem: Why Asian banks finance the U.S. way of life*, N. Y. TIMES MAGAZINE March 13, 2005, at 19-22 ("[B]etween 70 and 80 percent of the American economy's vast and continuing borrowing requirement is being met by foreign [mainly Asian] central banks. . . . The Bush Administration's tax cuts for the Republican base and a Global War on Terrorism is being financed with a multibillion-dollar overdraft facility at the People's Bank of China. . . [and] according to a growing number of eminent economists, this arrangement cannot last. . .. Sooner or later they [the Asian banks] have to get out – at which point the dollar could plunge relative to Asian currencies by as much as 1/3 to 2/5ths and U.S. interest rates would leap upward.")

away from the current laissez faire government attitude toward the marketplace, providing openings for strategies that utilize government investment as pro-actively as the TVA does.

6. *The Importance of Integrity in the New Deal Programs*

Integrity in the use of public funds in the private sector was a key feature of the New Deal programs, as Franklin D. Roosevelt demonstrated in the 1930s. F.D.R. presided over a huge expansion of federal spending, including a lot of discretionary spending by the Works Progress Administration. Yet the image of public relief, widely regarded as corrupt before the New Deal, actually improved markedly. . . . [T]he New Deal made almost a fetish out of policing its own programs against potential corruption. . . . F.D.R. created a powerful "division of progress investigation" to look into complaints of malfeasance in the WPA. The division proved so effective that a later Congressional investigation couldn't find a single serious irregularity it had missed."[118]

The political climate in the U.S. may be changing as the consequences of privatization and tax cuts begin to take their toll on public well-being. The combined social costs of tax cuts, the Iraq war and reconstruction of the massive hurricane damage may change the political climate regarding government spending to make New Deal type programs more appealing. Particularly when their New Dealers judicious use of public funds is compared with the corruption of the current proponents of less government and privatization, such as the S&L bailout and the Enron scandal, there may be a resurgence of interest in and relevance of the New Deal programs such as the TVA and the Works Progress Administration.

D. THE 1971 LOCKHEED LOAN GUARANTEE

The 1971 Federal Government loan assistance to Lockheed Corporation set an important precedent, showing the willingness of the government to provide financial assistance to a failing non-government corporation.[119] Congress passed the Emergency Loan Guarantee Act of 1971 (the "Emergency Act"), which served to protect 60,000 jobs and a potential GNP loss of $120 to 475 million, mostly in California, just as the economy was recovering from the 1969–70 recession.[120]

The government protected its investment in Lockheed in many ways. It appointed a board consisting of the Secretary of Treasury, Fed-

[118] Paul Krugman, *Not the New Deal*, N.Y. TIMES, September 16, 2005, at A27.

[119] Comptroller General of the United States, *Report to Congress: Guidelines for Rescuing Large Failing Firms and Municipalities*, GAO/GGD 84-34, March 29, 1984, at 10, *available at* http://archive.gao.gov/d5t1/123950.pdf.

[120] *Id.* at 11.

eral Reserve System Chair and the Securities and Exchange Commission Chair, and charged that board with obtaining sufficient collateral for the government investment.[121] In addition, the board had power to change management, approve asset sales, inspect the books and have an audit from the U.S. General Accountings Office.[122] The government also restricted the payment of dividends on Lockheed Corporation's common stock and limited the payment of other loans to a lender receiving a loan guarantee.[123] The government's loan guarantee of $250 million enabled Lockheed to obtain a new aid package of $750 million.[124] Lockheed retired the government loan guarantee early, as it was able to replace it with a revolving credit agreement for $100 million.[125]

The Act was worded to allow emergency loan guarantees to any major business[126] enterprise, although it was clearly intended to provide a $250 million loan guarantee to Lockheed.[127]

Thus, at its birth, the Congress understood that any government investment policy should cover a broad range of possible investment transactions between government and business. This article contends that such a policy is increasingly necessary in a global economy. The government's subsequent case-by-case actions (such as those naming Chrysler or the airline industry) have mistakenly avoided implementation of a clear general policy. A well-constructed federal policy on government investment in private businesses would create a model and a platform for similar policies at the state and local levels.

E. CONRAIL AND GOVERNMENT INVESTMENT IN RAILROADS

1. *Railroads and the U.S. Government before 1970*

The U.S. government has been deeply involved in the development, protection, regulation and deregulation of the railroad industry since the birth of the industry.[128] Railroads were crucial to the development of the American West, a necessity to connect a nation straddling a vast geographical expanse. The government's first large investment in the railroads was under the Pacific Railroad Act of 1862, when the government parceled out 131 million acres of land[129] to private businesses in ex-

---

[121] *Id.* at 12.

[122] Comptroller General of the United States, *supra*, note 119.

[123] *See id.*

[124] *See id.*

[125] *See id.*

[126] Emergency Loan Guarantee Act, P.L. 92–70, § 2, 85 Stat. 178 (Aug. 9, 1971)

[127] Comptroller General of the United States, *supra*, note 119 at 11.

[128] As evidenced by the numerous acts cited in this paper from the Pacific Railroad Act of 1862 through the Conrail reorganization.

[129] *Nation Building 1860-1900*, National Railroad Museum Website, *available at* www.nationalrrmuseum.org/collections-018-historical-outline-.html (last visited Oct. 31, 2005).

change for building railroads connecting the two coasts.[130] In exchange for these land grants, the federal government required the railroads to provide transport for government troops and property for half the normal rate.[131] A Congressional Committee in 1945 estimated that the U.S. federal government received $900 million in railroad transportation costs in exchange for parceling out $126 million worth of raw, undeveloped lands that required railroads to give them value.[132]

Railroads were the first national corporations and pioneered corporate business practices regarding treatment of customers, employees and state, local and federal governments. The rise of the railroad companies and their impact on America is a good analogy for the rise of multinational corporations and their impact on the global culture and economy. Railroad owners became fabulously rich. The size of railroad companies and their resources dwarfed the resources of those, such as farmers, workers and injured parties who dealt with them. Because of the potential profits it could generate, the potential monopoly it could exert over an area, and the wide variety of manipulation that could be employed, the railroads were at the center of most of the corruption of the late 19th and early 20th centuries. Names like Jay Gould, James Fisk, Cornelius 'Commodore' Vanderbilt, and Daniel Drew were synonymous with corruption and scandal.[133] "As business grew rapidly during the last half of the 19th century, government control fell hopelessly behind."[134]

In 1887, Congress created the Interstate Commerce Commission (ICC) to regulate the railroads, taking that responsibility from the states, which were not well equipped to regulate these national companies. Yet it took 30 years, numerous additional regulations and Supreme Court cases before the ICC could exert enough control over the railroads to curb their unfair rate practices that were most destructive of communities and farmers, and their most brutal labor practices.[135] Congress also passed various anti-trust laws to regulate the robber barons' corporate and financial manipulation practices.[136]

From 1900 to 1945, during the Golden Age of the Railroad, the U.S. federal government developed a reasonable means to regulate the excesses of the growing railroad industry; but this balance did not last long.[137] After World War II, other means of transportation and commu-

---

[130] 12 Stat. 489.

[131] *Nation Building 1860-1900*, *supra* note 129.

[132] *Id.*

[133] *Id.*

[134] *Id.*

[135] *Id.*

[136] *Id.*

[137] *The Golden Age 1900-1945*, National Railroad Museum Website, *available at* www.nationalrrmuseum.org/collections-018-historical-outline-.html (last visited Oct. 31, 2005).

nication provided increasingly stiffer competition with rail.[138] The government invested in building the interstate highway system and many airports. Auto, truck, barge and air transportation became major competition for rail. Still, the government retained an archaic regulatory scheme treating railroads as the monopolistic enterprises they had been during earlier years.[139] During the 1950s and 60s, although the railroad system was losing passengers and freight to auto, truck and air transport, the railroads were not permitted to drop routes or change their highly regulated rate structure. By the end of the 1960s several of the nation's largest railroads were facing bankruptcy, and many others followed during the 1970s.[140] The railroad industry needed major restructuring, including substantial government investment, regulation and deregulation, the government's creation of the National Railroad Passenger Corporation, which created Amtrak,[141] and the formation of Conrail from the remnants of seven bankrupt railroads in the Northeast and Midwest.[142]

2. *Why was Conrail created?*

Penn Central was the largest transportation company in the U.S. when it came into existence in 1968, out of the merger of the Pennsylvania and New York Central railroads.[143] Due to competition from the trucking industry, increased labor costs, regulation of rates which lagged cost increases, and inability to truly merge the two companies, Penn Central lost $5.2 million in 1968 and $56.3 million in 1969; furthermore, these losses continued to grow.[144] From 1969 to 1970, rail passenger services sustained a loss of as much as $375,000 per day, forcing Penn Central to seek emergency government assistance in May 1970.[145] Unable to get initial assistance, Penn Central filed for bankruptcy under Section 77 of the Bankruptcy Act, under which railroads were not permitted to go out of business. However, Penn Central's operating income could not cover its operating costs, costing more money to operate it than to shut it down. Thus in January 1974, Congress passed the Regional Rail

---

138 *Id.*

139 *Id.*

140 *Decline and Revitalization 1945 – 1995,* National Railroad Museum Website, *available at* www.nationalrrmuseum.org/collections-01 8-historical-outline-.html (last visited October 31, 2005).

141 *Id.*

142 Rudolph G. Penner, Congressional Budget Office, Economic Viability of Conrail xi (1986) [hereinafter Penner] http://www.cbo.gov/ftpdocs/50xx/doc5016/doc22c-Part02.pdf at 1 and http://www.cbo.gov/ftpdocs/50xx/doc5016/doc22c-Part04.pdf at 7.

143 Comptroller General of the United States, *supra* note 119 at 10.

144 *Id.*

145 *See* Comptroller General of the United States, *supra* note 119 at 10. (stating that two assistance plans initially discussed included a $200 million loan guarantee from the Department of Defense and a $750 million loan guarantee from the Department of Transportation).

Reorganization Act (the "3R Act").[146] The purpose of the 3R Act was to "identify a rail system that would provide adequate and efficient rail service in the Northeast and Midwest, and [to] reorganize the railroads in the region into an economically viable system that could provide that service."[147] The act also established the Consolidated Rail Corporation ("Conrail") as a for-profit freight railroad and the United States Railroad Association (USRA) as a government corporation to fund and oversee Conrail's operations.[148]

Additional legislation to nurse the railroad industry back to health under government investment and supervision and then turn it back to the private sector[149] followed, including the legislation described below.

USRA's final plan for the reorganization sought in the 3R Act[150] was created by Congress in Title VI of Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) (P. L. 94-210). It amended the 3R Act to conform its provisions to the final structural, operational and financial system designed for USRA by Conrail. The 4R Act initiated the first significant reduction in federal regulation of railroads since the enactment of the Interstate Commerce Act of 1887.[151] Because regulatory restrictions had contributed to the bankruptcy of Conrail's predecessors, Congress began regulatory reform in the 4R Act to prevent additional railroad bankruptcies and to improve the opportunities for all railroads, including Conrail, to survive as private companies.[152]

---

146 87 Stat. 985.

147 PENNER, *supra* note 142

148 *See* 87 Stat. 985; PENNER, supra note 142, at 4-5. The Regional Rail Reorganization Act states that its intent is to address these problems:

- The rail service providers in the Midwest and Northeast region of the U.S. were insolvent and preparing to enter bankruptcy.
- Rail services were threatened with cessation or significant curtailment because trustees were unable to formulate acceptable plans for reorganization. The rail service operates across properties that were acquired for public use but have deteriorated and require extensive rehabilitation and modernization.
- Public convenience and necessity require that adequate and efficient rail service in the region and throughout the Nation meets the needs of commerce, national defense, environment and passengers, U.S. mail, shippers, States and their political subdivisions and consumers.
- Continuation and improvement of essential rail service in this region is also necessary to preserve and maintain adequate national rail services and an efficient national rail transportation system.

Rail service and rail transportation offer economic and environmental advantages with respect to land use, air pollution, noise levels, energy efficiency and conservation, resource allocation, safety, and cost per ton-mile of movement to such extent that the preservation and maintenance of adequate and efficient rail service is in the national interest. The Federal Government cannot meet these needs without substantial action.

149 PENNER, *supra* note 142, at 2-7.

150 87 Stat. 985.

151 PENNER, *supra* note 142, at 5.

152 *Id.* at 5.

In April of 1976 Conrail began operations in 16 states with 99,000 employees and a 17,000-mile route system.[153] Because Conrail's railroads needed substantial repairs from years of neglect, the U.S. government financed these renovations by purchasing debentures and preferred stock in Conrail, and subsidized its operating losses during this period of rebuilding.[154]

The regulatory reforms in the 4R Act proved insufficient, however. The U.S. government continued to invest in Conrail and, by 1985, had committed as much as $10.2 billion in 1985 dollars.[155] Lower traffic and higher operating cost than projected meant the financial health of the railroad industry did not improve.[156] Conrail was doing worse than expected (as was the industry). Congress enacted two laws - the Staggers Rail Act of 1980[157] ("Staggers Act") and Northeast Rail Service Act of 1981[158] ("NERSA") to address these problems.

The Staggers Act significantly reduced the government's regulation of pricing and marketing activities for all railroads.[159] It enabled railroads to restructure rates and services to improve profits and, if losses could not be avoided, to abandon unprofitable routes and services.[160] Conrail's success in 1980 stemmed from this newfound ability to emphasize profitable services and drop unprofitable ones.[161]

The Northeast Rail Service Act of 1981 (NERSA)[162] required Conrail to demonstrate, by 1983, that it could be profitable.[163] In 1983, USRA reported that Conrail met the NERSA profitability tests.[164] The government was thus required to initiate the return of Conrail to the private sector as a single entity by selling the government's Conrail common stock.[165]

The government's sale of its Conrail stock had to follow certain procedures under NERSA:[166] the sale had to ensure continued rail service, promote competitive bidding for the stock, and maximize the return to the federal government on its investment.[167] The details of the sale

---

153 *Id.*

154 *Id.*

155 *Id.* at 2, Table 1.

156 *Id.* at 4.

157 Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895 (1980).

158 Northeast Rail Service Act of 1981, 45 U.S.C. §§ 1101—1116 (2000).

159 PENNER, *supra* note 142, at 5.

160 *Id.*

161 PENNER, *supra* note 142, at 7.

162 45 U.S.C. §§ 1101-1116.

163 PENNER, *supra* note 142, at 7.

164 *Id.*

165 PENNER, *supra* note 142, at 7.

166 45 U.S.C. §§ 1101-1116.

167 PENNER, *supra* note 142, at 8.

were left to the discretion of the U.S. Department of Transportation (the "DOT"), which began soliciting proposals for purchase in 1983.[168] In 1985, the DOT announced its intention to privately sell the government's Conrail stock to the Norfolk Southern Corporation, based on the belief that Conrail's long-term viability would be more secure as a subsidiary of a larger, more experienced railroad.[169] However, the relevant Congressional subcommittee raised concerns about this private deal and requested a study from the Congressional Budget Office on the viability of Conrail and the options for its sale.[170] The study described the Norfolk deal and alternate proposals by two groups of investment bankers that would keep Conrail independent. The chief contention between the two groups was the likelihood of Conrail's long-term viability as an independent operator.[171]

3. *What benefit did the government and citizens get from the Conrail deal?*

By 1981 Conrail began a financial turnaround and no longer required government investment. It began to profit.

On March 26, 1987, the government sold its ownership interest in Conrail through what, at the time, was the largest initial public stock offering in nation's history. This transaction, with added cash payments from Conrail to the U.S. Treasury, produced about $1.9 billion for the taxpayers and returned the Northeast-Midwest rail freight system to the private sector as a for-profit corporation, as Congress had envisioned when it created Conrail.[172]

In 1985, Conrail restored, retroactive to July 1984, industry-level wages that were reduced for three years in wage negotiations mandated by NERSA. DOT then selected Norfolk Southern Corporation as the preferred purchaser of the government's interest in Conrail.

4. *The Conrail deal was not a Fair Exchange for the taxpayers*

The U.S. government invested $10.2 billion in Conrail, and sold it for $1.9 billion in 1987. Thus the government lost $8.3 billion on the Conrail deal. In 1997, Norfolk Southern Corporation and CSX Corporation acquired Conrail for $10 billion.[173] Had the government retained its

---

[168] *Id.*

[169] *Id.*

[170] *Id.* at Preface.

[171] *Id.*t att9.

[172] *A Brief History of Conrail,* Conrail Website, *available at* www.conrail.com/history.htm.

[173] CSX and Norfolk Southern press release, 3/19/98 (found at www.prnewswire.com/cgi-bin/storiesp1?ACCT=105&STORU=www/story/3-19-98) entitled "Conrail Acquisition to Take Millions of Truck miles Off Pennsylvania Highways State to Save More than $18.5

stock for the 10-year period, it would have been able to recoup its investment fully, selling at the price of $10 billion.[174]

Even though the government had a duty to save the rail system when it was imploding in the 1970s, the fair exchange question remains: why did the government require a complete sale of its stock as soon as the DOT determined Conrail to be viable? Unlike the later Chrysler deal, the government did not provide for any reward to the citizens or the government for the risk it took with the taxpayers' money. Clearly, Conrail was a government success in that it revitalized the rail system at a critical moment, but the government did not recoup its investment. One reason for this failure to recoup is that the legislation creating Conrail required the government to sell its interest into private hands at a very early-set date. The law stopped the government from acting as a prudent investor would, to obtain a reasonable return for its risk.

5. *USRA/Conrail structure incorporates stakeholder governance*

The 3R Act of 1973[175] provided for two new entities: a non-profit association known as the United States Railway Association (USRA)[176] and a for-profit corporation known as Conrail.[177] The governance structure of these entities provides useful insights for those seeking to create Fair Exchange Commonweal Agencies or Community Trusts (described later in this article) that include the interests of multiple stakeholders. Their form and structure are outlined below.

a) United States Railway Association (USRA)

The USRA was a non-profit government corporation, directed by a Board of Directors.[178] The government members of the Board were the Association's incorporators and served as acting Board of Directors for a period of not more than 45 days after the date of its incorporation. Association employees were not government employees. The Association existed until dissolved by Act of Congress. The Board of Directors consisted of 11 individuals, described in Section 201 of the 3R Act– as follows:

Million in Road Maintenance Costs" states "CSX and Norfolk Southern submitted their application to acquire Conrail to the U.S. Surface Transportation Board (STB) last June The board is expected to issue its final decision on the $10 billion transaction in July."

[174] This is a math equation, the supporting data for which is set out in the previous three sentences.

[175] Regional Rail Reorganization Act of 1973, Pub. L. No. 93-236, §§201-215, 87 Stat. 985 (1974) ("3R Act").

[176] *Id.* at 87 Stat. 988-1004.

[177] *Id.* at 87 Stat. 985, 1004-1009.

[178] *Id.* at 87 Stat. 985, 988.

> The Chairman was appointed by the U.S. President with advice and consent of the Senate; the Secretary, the Chairman of the Interstate Commerce Commission and the Secretary of the Treasury, or their duly authorized representatives, were the three government members of the board; seven non-government members were appointed by the U.S. President with advice and consent of the Senate, from a list of qualified individuals, most of whom must be independent from any connection with railroad interests.[179]

The USRA Board's primary duties were to study the regional rail transportation problem and solve that problem by establishing Conrail as a self-sustaining, efficient rail system, providing service to as many current locations as possible in a safe and environmentally friendly way, and do so with financial assistance "at the lowest possible cost to the general taxpayer"[180] and allocating routes between Conrail and other companies to ensure efficiency, service and promote competition.[181] USRA had authority to make loans to Conrail and other railroads to accomplish the ends of its Final Plan.[182]

All rail properties transferred to Conrail by other rail companies or trustees were to be paid for in stock and securities of Conrail. Conrail was to sell its rail properties for compensation. Much of its property would come from the bankruptcy judges placing assets of railroads that could not otherwise be reorganized into Conrail.

---

[179] USRA Section 201(d) provided diverse board representation as follows:
One from list of qualified individuals recommended by National League of Cities and Conference of Mayors;
Two to be selected from lists of qualified individuals recommended by shippers and organizations representing significant shipping interests including small shippers; and,
One from list of qualified individuals recommended by financial institutions, the financial community, and recognized financial leaders.
The lists of qualified individuals were required to include not less than three individuals. Also, except for members appointed under paragraphs (1) and (3) (A), (B), (E) and (F), no board member could have any employment or other direct financial relationship with any railroad. Those appointed under (2), (C) and (D) could be employed or have direct financial relationship with any railroad. The non-governmental members had staggered terms of office of 2, 4 or 6 years and the chair's term was 6 years. The President of the Association was to be chosen (from amongst recommendations made by the Secretary of Transportation) and serve at the pleasure of the Board.

[180] Pub. L. No. 93-236, 101(b)(6), 202 and 206.

[181] Pub. L. No. 93-236, 202 and 206.

[182] Pub. L. No. 93-236, 210.

b) Conrail Governance Structure

Conrail was a for-profit corporation designed under Title III of the 3R Act and established by the USRA Executive Committee.[183] These USRA incorporators served as the corporate Board of Directors until Conrail distributed its stock to the estates of the railroads from which it would receive rail properties.[184] The Board of Directors consisted of 15 individuals selected in accordance with Conrail articles of incorporation and bylaws provided that, so long as USRA or the Federal Government held or guaranteed 50% or more of Conrail's outstanding indebtedness (as determined by the Secretary of the Treasury), three members of the Board shall be the Secretary of Transportation, the USRA Chairman and the USRA President; in addition, five members of the board shall be individuals appointed by the U.S. President with the advice and consent of the Senate.[185]

Conrail common stock was issued to the estates of bankrupt railroads in exchange for railroad properties, which the bankruptcy judges were instructed to transfer to Conrail, if they could not be used to successfully reorganize relevant railroad companies.[186] Conrail was permitted to repurchase said stock in order to establish an employee stock ownership plan.[187]

6. *Conrail was a fair exchange for employees*

Section 102(5) of the 3R Act, passed in 1974, includes provisions requiring the creation of an Employee Stock Ownership Plan (ESOP).[188] The final system plan required Conrail to explain how ESOP plans could be practically used to meet the corporation's capitalization requirements including potential cost savings, improved labor relations, and improved service.[189] Section 301(e) also contemplated repurchasing some of the stock sold to the public by the ESOP, or even total employee ownership.[190]

In 1982, Congress proposed an amendment to the 3R Act (section 1142, Title IV: Transfer of Freight Service) that required the Secretary of Transportation (after July 1, 1982 and before December 31, 1983) to sell the common stock of the Corporation held by the federal government, if the Association determined that Conrail would be profitable. Because

183 Pub. L. No. 93-236, 301(a) and (c).
184 Pub. L. No. 93-236, 301(c)-(d).
185 Pub. L. 93-236, 301(d).
186 Pub. L. No. 93-236, 301(e).
187 Pub. L. 93-236, 301(e).
188 William Jones, *Rail Act to Spur Worker Owners*, WASH. POST, Jan. 2, 1974.
189 Under Section 206(e)(3) of the 3R Act.
190 *See* Pub. L. No. 93-236, 301(e).

employee sacrifices were the key in making Conrail profitable, the Secretary was required to first offer the stock to the employees in the amount of wages, or wage increases, foregone by them. If the Secretary or his agent first offered the stock at one price and then lowered the price to attract additional purchasers, the Secretary was required first to offer the reduced price stock to the employees.

In October of 1986, the Conrail employees agreed to a wage package at 12% below the industry standard and obtain an employee stock ownership plan (ESOP) containing 15% (4.4 million shares) of the outstanding Conrail stock.[191] When Conrail stock was first made available for sale to the public, the employees received shares (based on a union agreement) valued at $24 per share, equivalent to the wage sacrifice they made over the previous three years.[192] Some employees sold their shares for cash on the market immediately. Those employees who held their shares until the CSX purchase of Conrail received $100 per share for their stock.[193] For example, employee John Fink, who began his railroad career in 1963 with the New York Central, received 237 shares of Conrail stock at $24 per share.[194] As of April 2005, the proceeds in his IRA from the sale of those shares were worth over $100,000.00.[195] There was no organized use of the shareholder vote by employees.[196]

7. *Lessons from Conrail for New Fair Exchange Programs*

The taxpayers unnecessarily lost at least $8.3 billion through the federal government's handling of its Conrail investment; this loss could have easily been avoided, had Congress not required a sale to the private sector as soon as the company reached profitability. Employees who held onto the stock they received got a fair return on the sweat equity comprised of their wage concessions.

The Conrail governance structure provides a model of a multi-stakeholder governance process. Whether this structure would have served the country well in the long run as, for example, the TVA has, is a question open to debate; government's prematurely forced sale of its Conrail stocks made it impossible to answer the question with any certainty.

---

[191] Richard Gillespie, *Conrail Sale Gives ESOP as Much as $300 Million*, PENSIONS AND INVESTMENT AGE, Oct. 13, 1986.

[192] Author's telephone Interview with John Fink, Executive Assistant to the President, United Transportation Union International (Apr. 6, 2005).

[193] *Id.*

[194] *Id.*

[195] *Id.*

[196] *Id.*

F. THE 1979 CHRYSLER CORPORATION LOAN GUARANTEE ACT AND ESOP

The summary version of the Chrysler Loan Guarantee of 1979 ("Chrysler Guarantee")[197] is this:

The Arab oil embargo caught Chrysler Corporation sitting on a mountain of debt as well as a huge inventory of gas-guzzlers. President Jimmy Carter agreed in 1979, to provide Chrysler with up to $1.5 billion in loan guarantees, as long as Chrysler won $2 billion in concessions from banks, suppliers and unions. New CEO Lee Iacocca cut costs to the bone, eliminating 53,000 jobs. The company also cornered the booming minivan market. In 1983, the company paid off its loans seven years early, at a profit of $350 million to the government.[198] Chrysler invented the minivan in 1983-84 and had no minivan competitors for several years thereafter[199].

1. *Why did the government agree to bail out Chrysler?*

Chrysler set sales records in 1972-73, but gasoline shortages, political uncertainty, high interest rates, severe inflation and weakening consumer confidence drove Chrysler into a financial crisis in the mid-70s. American consumer demand soared for smaller, more fuel-efficient cars. Japanese manufacturers were the first to respond, making great inroads into the U.S. market. The combined domestic market share of the total U.S. car market fell while the market share for imports rose to 23.4 percent.[200]

The major reasons advanced for passing the Chrysler Guarantee were that Chrysler was the 17th largest company in the country (the 10th in 1978) and the 3rd largest automaker in the U.S. There had never been a bankruptcy of this size in the U.S. Chrysler employed 134,000 workers concentrated in the Detroit area, which already had a high rate of unemployment.[201] There was concern about the effect of a Chrysler bankruptcy on the manufacturing sector, and Chrysler was the sole producer of the M-1 tank.[202] The UAW estimate of lost jobs if Chrysler failed was

---

[197] *See* Chrysler Corporation Loan Guarantee Act of 1979, Pub. L. 96-185, Stat. 1324 (1979).

[198] *America's Biggest Bailouts*, BUSINESS WEEK ONLINE, *available at* http://www.businessweek.com/magazine/content/01_40/b3751710.htm.

[199] Email from Robert Jensen to author, dated 9/19/05, correcting earlier manuscript of this article.

[200] *The Troubled Years*, National Automobile Bankers Association/Vehicle Information Services (2001), *available at* www.AutoWorld.com.

[201] Comptroller General of the United States, *supra* note 119 at 15-16.

[202] *Id.*

500,000 including employees, dealers, and suppliers. The General Accounting Office later estimated the potential job loss at 700,000.[203]

a) Terms of the Chrysler Loan Guarantee including Upside for the U.S. Government in Exchange for Risk

The Chrysler Guarantee,[204] signed in January 1980, provided for up to $1.5 billion in loan guarantees.[205] The five-person board administering the loan guarantee program included: as voting members, the Secretary of Treasury as Chair, the Federal Reserve Chair, and the U.S. Comptroller General as voting members; with the Secretaries of Labor and Transportation as non-voting members.[206]

In the Chrysler Guarantee, most of the beneficiaries of the government assistance were required to make significant concessions. The government's aid was to be matched by concessions from U.S. and foreign banks, governments, creditors, stockholders, suppliers, dealers, and union and non-union employees.[207] The Loan Guarantee Board had a very active oversight role, adjusting the amounts of these concessions between parties, approving any assets sales over $5 million, any contract of over $10 million, and approving any financing and operating plans.[208] Chrysler was thus reorganized into a much more efficient firm without going through bankruptcy.[209]

Under the terms of the Chrysler Guarantee Agreement, Chrysler issued to the government warrants for 14.4 million shares of Chrysler stock at $13 per share. In 1983, after the guaranteed loan was fully repaid—seven years before the loan was originally due – the government sold these warrants for $311 million.[210]

2. *The Chrysler Program was a Success for the Government, the Company and its Workers*

Chrysler ultimately used $1.2 billion of the $1.5 billion guarantee authority. There were very complex negotiations between the Loan Guarantee Board, U.S. senators, Chrysler management, and the International Union United Automobile, Aerospace and Agricultural Implement

[203] Author's telephone interview with Robert Jensen, author of CHRYSLER CONTRACT TALKS 1979-1983, a summary of the negotiators of negotiations between the UAW, Chrysler and the government during the period of the loan guarantee negotiations and implementation, and one-time Administrative Assistant to Marc Stepp, UAW Vice President and Director of the UAW Chrysler Department, at the time of the Chrysler contract negotiations (Dec. 19, 2004). .

[204] *See* Chrysler Loan Guarantee Act of 1979.

[205] Chrysler Corporation Loan Guarantee Act of 1979 §4(b).

[206] Comptroller General of the United States, *supra* note 119, at 16.

[207] *See id.*; *see also* Chrysler Corporation Loan Guarantee Act of 1979.

[208] Comptroller General of the United States, *supra* note 119, at 16.

[209] *See id.* at 17.

[210] *See id.* at 16.

Workers of America ("UAW"). The UAW had made significant concessions to Chrysler before it sought the loan guarantee. The union reopened its contract three times in 13 months during the negotiations approving additional requests for concessions.[211] The total concessions given by the UAW during the period 1979-81 amounted to $1.1 billion.[212] Management also made significant concessions.[213] In exchange for these concessions, the employees received "$100,000,000 of common stock of the Corporation"[214] (approximately 15% of Chrysler's common stock)[215] through an employee stock ownership plan ("ESOP")[216] to be allocated equally among the plan's participants.[217]

The Comptroller General of the United States, upon comparing the government bailouts of Lockheed and Chrysler, the bankruptcy of Penn Central and the creation of Conrail, concluded that the Chrysler Guarantee was "the most sophisticated in terms of how commercial lending principles were embodied in. . a [its]. . a structure."[218] He further concluded that in each of these experiences the government had learned from the previous one; had better results by using more commercial lending principles; and that similar future programs will benefit from that experience and "will result in an even more financially rigorous program if the circumstances warrant".[219]

The value of the Chrysler stock warrants to the government and of the stock given to the Chrysler ESOP in 1979 increased. The value of the stock warrants when they were issued was $3.00 per share. These warrants issued to the government allowed it to purchase Chrysler stock at $13.00 per share exercisable in 1990.[220] Chrysler redeemed the warrants in 1983 when their market price was $30.00 per share.[221] When the company rebounded, the government profited financially, and the employees, through the ESOP, then owned 15% of the publicly traded Chrysler Corporation.[222]

---

211 Author's telephone interview with Douglas Fraser, President of the International United Auto Workers Union (Nov. 21, 2004).

212 *See* Jensen, *supra* note 203.

213 Public Law 96-185, 96th Congress, 93 Stat.1324, 15 U.S.C. 1861 et seq. 93 Stat 1329, Sec. 6(a)(2) required at least $125,000,000 in concessions from Chrysler employees not represented by a union.

214 Public Law 96-185, 96th Congress, 93 Stat.1324, Sec. 4(a)(4), 15 U.S.C. 1861 et seq.

215 *See* interview with Douglas Fraser, *supra* note 211; *see also* interview with Robert Jensen, *supra* note 203.

216 Chrysler Corporation Loan Guarantee Act of 1979 §7.

217 Chrysler Corporation Loan Guarantee Act of 1979 §7 (c)(3)(C).

218 Comptroller General of the United States, *supra note* 119, at 17.

219 Comptroller General of the United States, *supra* note 119, at 18.

220 *Id.* at 16.

221 *See* Interview with Douglas Fraser, *supra* note 211; *see also* Comptroller General of the United States, *supra* note 119, at 16.

222 *Id.*

3. *What did the employees do with their Chrysler ESOP stock?*

Ownership of 15% of a publicly traded company can be controlling ownership.[223] However, this was not a major focus of the UAW at the time of the Chrysler Loan Guarantee or thereafter. Although Senators Russell Long and Gaylord Nelson suggested stock and included it in the loan guarantee legislation,[224] the UAW leaders were "in survival mode."[225] The UAW was consumed with their members' concerns about the huge concession package they took, and the unions had not requested stock.[226] The UAW was interested in how it might vote the stock; the union leaders report that their lawyers, after researching the issue, found that it would be extremely expensive (in terms of millions of dollars) to organize the proxy votes of the union members.[227] Doug Fraser said, "We had no ESOP expert. . . . We didn't focus on this. . . . We didn't think the stock would be worth anything. We were looking at how we could exercise control over the stock as an organization".[228]

The ESOP required in the Chrysler Loan Guarantee Act was a standard type of ESOP[229] that would have required, in a publicly traded company, pass-through voting on all issues for the participants to direct the vote of the Trustee on allocated shares.[230] The UAW was not familiar enough with ESOPs (which were only made tax deductible by Congress in 1974[231]) to know that they might have been able to obtain more influence over the voting of this stock had they insisted on having a major voice in choosing the ESOP trustee; neither Fraser nor Jensen knew who the trustee was.[232] Since their members were focused on the concession package, it is unlikely that they would have used any bargaining leverage to get a voice in selecting the trustee if it would have cost their members any further concessions.

Corey Rosen, one of the Senate staff who drafted the Chrysler Loan Guarantee Act, reported that no one from the Union ever discussed the Act with him and that he had only one discussion with a Chrysler staff

---

[223] The SEC requires individuals as they acquire large blocs or 5, 10 and 20% of publicly traded stock to disclose it. *See* Securities Act of 1934, Securities Exchange Act of 1934 SS, 17 U.S.C. 78m, 78p (2004).

[224] *See* interview with Douglas Fraser, *supra* note 211; *see also* interview with Robert Jensen, *supra* note 203.

[225] *Id.*

[226] *Id.*

[227] *Id.*

[228] Interview with Douglas Fraser, *supra* note 211.

[229] *See* Chrysler Loan Guarantee Act of 1979; 15 U.S.C. 1861; 93 Stat. 1330; Internal Revenue Code, 29 U.S.C. 4975(e)(7) (1980).

[230] Internal Revenue Code, 29 U.S.C. 4975(e)(7) (1980).

[231] Employee Retirement Income Security Act of 1974, 29 U.S.C. 1001 (1974).

[232] *See* interview with Douglas Fraser, *supra* note 211; *see also* interview with Robert Jensen, *supra* note 203.

person. Neither labor nor management was very interested in the required ESOP when it was placed in the law. Rosen says he would have told the Union to ask for more stock had they asked him at the time bill was drafted. He believes they would have been able to negotiate for more stock or voice in appointment of the trustee.[233] However, the Union was focused on huge concessions demanded from them and had little faith that the stock would ever be valuable.

UAW President Douglas Fraser was given a seat on the Chrysler Board of Directors, but the seat was given to him personally, and was not made an institutional seat for the holder of the UAW presidency.[234] He used that position to raise issues of concern to the union members and as a person knowledgeable about the industry, but not as one who controlled a voting bloc.[235] But in the 1982 negotiations, the union pushed for and won a major workplace participation program to enable workers to have a greater voice in quality matters.[236] This joint program continues up to the present.[237]

In 1984-85, each individual UAW member's Chrysler ESOP account was worth approximately $8,000.[238] Marc Stepp, UAW Vice President in charge of Chrysler, wanted the members to keep their stock and build their personal savings.[239] The UAW members expressed, through their local presidents at their National Council meeting, a strong desire to get money back on the concessions they had made.[240] Chrysler happily agreed with the UAW to buy back the shares of any UAW member who wanted to cash out of the ESOP.[241] They were happy not to have such a large bloc of their stock in the hands of the workers.[242] The agreement was that the UAW members would automatically receive the cash unless they made an affirmative decision to keep the stock.[243] According to Douglas Fraser, most of the union members took the cash and most of the managers retained their stock.[244] The lowest value of the stock during the issuance of the loan guarantee was approximately $3.00 per share.[245] The stock value was $30 in 1983 when the government exercised its

---

233 Author's telephone interview of Corey Rosen by author on March 1, 2005.

234 *See* interview with Douglas Fraser, *supra* note 211.

235 *Id.*

236 *See* interview with Douglas Fraser, *supra* note 211; *see also* interview with Robert Jensen, *supra* note 203.

237 Interview with Robert Jensen, *supra* note 203.

238 *Id.*

239 *Id.*

240 *Id.*

241 *Id.*

242 *Id.*

243 *Id.*

244 *Id.*

245 *Id.*

warrants; the price later went up to $50 per share, split and rose to $50 again and split again.[246]

4. *Daimler buyout of Chrysler – would the union members' 15% have mattered?*

In 1995, Kirk Kerkorian, who owned 10% of the Chrysler Corporation stock, began an effort to purchase the majority of the stock and take Chrysler private.[247] He was working with former Chrysler President, Lee Iacocca.[248] Mr. Kerkorian planned a leveraged buyout including employee ownership.[249] He had complained for months about a low stock price ($40 per share) and feeble dividends, when Chrysler was "a money machine throwing off $1 billion in excess cash per quarter".[250] Management at Chrysler were not happy about the takeover plan and began looking for a white knight to keep Kerkorian from taking over Chrysler and using its cash to pay off his acquisition debt.[251] The white knight materialized in the form of the German automaker, Daimler Benz.[252] Shortly thereafter, Daimler Benz and Chrysler merged to form the Daimler-Chrysler Company. After a short time it became clear that Daimler had taken over Chrysler, and that it was not a partnership of equals.[253] In September 1998, German management of DaimlerChrysler replaced a large number of U.S. Chrysler managers, many more left, and Chrysler was again in major financial trouble.[254] "When Kerkorian agreed to the Daimler deal, Chrysler had close to $10 billion in cash."[255] Daimler-Chrysler's profits in 2000 fell 40 percent from the year before; losing $528 million in the last quarter compared to $1.2 billion profit the year before.[256]

Had the employees kept their 15% ownership of Chrysler, would Daimler have been able to take over Chrysler? Might the union, with some sway over 15% of the company's stock, have been able to negotiate a deal to keep Chrysler locally owned, maintaining jobs in the U.S. and cash in Chrysler? Or could they have prevented the Kerkorian takeover without a partner? We will never know the answer. At the time of the Daimler takeover, UAW President Steven Yokich favored the

---

246 *Id.*

247 BILL VLASIC & BRADLEY A. STERTZ, TAKEN FOR A RIDE: HOW DAIMLER-BENZ DROVE OFF WITH CHRYSLER 8 (Harper Business 2001).

248 *Id.*

249 *Id.*

250 *Id.* at 3.

251 *Id.* at 51.

252 *Id.* at 100-05.

253 *Id.* at 376.

254 *Id.*at 370-73.

255 *Id.* at 366.

256 *Id.* at 364-65.

Daimler merger as a means to save Chrysler UAW jobs. He saw Daimler as a much needed deep pocket with auto making experience. He saw that as the best protection for the US Chrysler workers. The union leadership was not fond of Kerkorian.[257] At the time of the merger there was no single shareholder with a 15% stake. Had the union members retained their shares, they might have had a strong or even a determining voice in defeating the Kerkorian takeover effort, or changing the direction the merger/takeover took. We will never know.

In 2005 it is the Chrysler part of the business that is supporting the ailing Daimler part.[258] How might that have strengthened the hand of the Chrysler workers if they were still major stockholders at DaimlerChrysler?

5. *Relevance of the Chrysler Loan Guarantee and ESOP to the Fair Exchange concept*

The Chrysler Guarantee saved a large U.S. company from bankruptcy; the company recovered and paid back the government early and in full. In addition the government made a profit. The workers acquired a large bloc of stock. Their sale of that stock helped to replace some of the wages they had given up as concessions. Had the workers not sold their stock, they might have played a major role in the decisions that led Daimler Benz to takeover Chrysler. Chrysler, a major U.S. employer and once an important pillar of the U.S. economy, is now only a division of a German multi-national corporation, which can, at any time, decide to dump the Chrysler workforce or assets. Although Chrysler was troubled when taken over by Daimler in 1995, Kerkorian said that if Chrysler had joined his leveraged buyout in 1995 instead of selling out to Daimler three years later, "We would have owned it clean as a whistle, with no debt. . . . The union guys and the management, they'd have twenty percent. It would have been a real little jewel".[259]

---

[257] Mr. Yokich passed away before these interviews took place.

[258] DaimlerChrysler 2004 Results Annual Press Conference & Conference Call by Bodo Uebber, Chief Financial Officer (Stuttgart, Germany, Feb. 10, 2005), *available at* http://www.daimlerchrysler.com/Projects/c2c/channel/documents/621909_uebber_50210.pdf; *but cf.* DaimlerChrysler Q2 and First Half 2005 Results Conference Call by Bodo Uebber, Chief Financial Officer (July 28, 2005), *available at* http://www.daimlerchrysler.com/Projects/c2c/channel/documents/706732_dcx_q2_2005_uebber.pdf (suggesting that the recent poor accounting of the Daimler division may be largely a function of a one-time expense and temporary automotive industry economic conditions).

[259] Vlasic, B. & Stertz, B., *Taken for a Ride: How Daimler-Benz Drove Off with Chrysler*, Harper Business (2001) at 348.

G. LESSONS THE GOVERNMENT LEARNED FROM ITS BAILOUT EXPERIENCES IN THE 1970S AND 80S

The U.S. General Accounting Office (GAO) Report to Congress *"Guidelines far Rescuing Large Failing Firms and Municipalities"*[260] (the "1984 GAO Study") recommended a set of guidelines for U.S. government loan and loan guarantee programs based on the bailout experiences at Chrysler, Lockheed, Penn Central/ Conrail and New York City.[261] The report concluded that there should be a general policy governing these intervention situations - that, when it is determined that government intervention is in the national interest, Congress should:

a) clearly describe the specific national interest served and congressional intent for the program including specific goals and objectives, and avoid conflicting intentions;
b) use commercial lending principles to structure the transaction to protect the national interest;
c) get risk compensation in the form of loan fees or more likely equity or warrants and loan priority over private lenders;
d) get concessions from suppliers, unions management, etc.; and
e) create a control board including the Secretary of Treasury, Secretary of Office of Management & Budget and Chair of Federal Reserve Board that would have some control over management.[262]

H. THE SAVINGS AND LOAN BAILOUT – THE PRICE OF FAILING TO REQUIRE EITHER ACCOUNTABILITY OR THE USE OF FAIR EXCHANGE PRINCIPALS

1. *Corporate Welfare is the Opposite of Fair Exchange*

The folks who created the S&L crisis, developed its bailout (and many of whom benefited directly from it) the Reagan and Bush administrations, ran on platforms of keeping government from interfering with business. They also sought to limit government expenditures on entitlements for the poor. Their deregulation of the S&Ls, and the bailout required to clean up from the deregulation mess, was to transfer billions of public dollars to a small number of wealthy S&L investors. Under their leadership, government has given the most to businesses without proper oversight or protection of the public interest whereas, the TVA, for example, was created by the New Dealers, who believed in government regulation of business. Yet, based on substantial planning and a concern that the government must protect the public interest when it invests tax-

---

[260] Comptroller General of the United States, *supra* note 119, at 17-18.
[261] *Id.*
[262] *Id.*

payers' money, the TVA they created continues to serve multiple public purposes of economic development for a region, cheap power, and job creation. It made money for the region and the government, and became self-sustaining. This S&L bailout section is included to provide those interested in Fair Exchange with a fact source to use when confronted with arguments of those who claim to want to keep government out of business. Many who preach that position did not hesitate to bail out S&L investors without providing protection for the public interests or purse.

2. *What caused the Savings and Loan crisis?*

The S&L industry began in the late 1800s for the sole purpose of providing home mortgages.[263] Government regulation of the industry became necessary when nearly two thousand of S&L institutions failed during the Great Depression, forcing the federal government to provide deposit insurance to quell fears of further S&L failures.[264]

BETWEEN 1966-1979, S&Ls experienced difficulties with increasingly rising market interest rates.[265] Interest rate ceilings prevented S&Ls from paying competitive interest rates on deposits, so that consumers replaced substantial amounts of S&L deposits with securities offering higher rates of return.[266] Concurrently, money market funds began competing with S&Ls for savings, which were additionally prohibited from seeking higher-return investments other than accepting deposits and granting home mortgage loans.[267]

By 1981, two-thirds of the nation's S&Ls were losing money and many were broke.[268] Instead of forcibly closing the insolvent S&Ls and reducing potential losses for the Federal Deposit Insurance Corporation (FDIC), the government allowed these institutions to continue operating at a loss.[269] During this delay, various S&Ls invested in questionable business operations in an attempt to regain solvency,[270] using the more expansive powers Congress bestowed upon them during the 1980-82 period, powers granted in the hopes that the S&Ls would enter new areas of

---

263 Mark Zepezauer & Arthur Naiman, *The S&L Bailout: $32 billion every year for 30 years*, in TAKE THE RICH OFF WELFARE (1996), *available at* http://www.thirdworldtraveler.com/Corporate_Welfare/S&L_Bailout.html.

264 *Id.*

265 *Id.*

266 *Id.*

267 Federal Deposit Insurance Corporation (FDIC), *The S&L Crisis: A Chrono-Bibliography*, 1, FDIC Website, *available at* www.fdic.gov/bank/historical/s&l (last updated Dec. 20, 2002).

268 *Id.*

269 During the 1986-89 period, losses were compounded as insolvent institutions were allowed to remain open and grow, allowing ever increasing losses to accumulate. *See* FDIC, *supra* note 367, at 4.

270 *See* Zepezauer & Naiman, *supra* note 263.

business and thus return to profitability.[271] "For the first time, the government approve[d] measures intended to increase S&L profits as opposed to promoting housing and home-ownership."[272]

ACCORDING TO THE FDIC, FROM 1982-1985 there were reductions in the Federal Home Loan Bank Board's regulatory and supervisory staff. In 1983, a starting S&L examiner was paid $14,000 a year. The average examiner had only two years on the job. S& L industry growth increased by 56% between 1982 and 1985, during this period of supervisory and examination retraction. Forty Texas S&Ls tripled in size between 1982 and 1986, many of them growing by 100% each year; California S&Ls followed a similar pattern.[273]

The St. Germain Depository Institutions Act of 1982 ("GARN") was enacted in December of 1982. This Reagan Administration initiative completed the process of expanding federally chartered S&Ls' powers, enabling them to diversify their activities to increase profits.[274] Major provisions included: elimination of deposit interest rate ceilings; elimination of the previous statutory limit on loan to value ratio; expansion of the asset powers of federal S&Ls by permitting up to 40% of assets in commercial mortgages, up to 30% of assets in consumer loans, up to 10% of assets in commercial loans and up to 10% of assets in commercial leases."[275]

The de-regulation of the S&L industry did not stop many of the S&L institutions from failing, however; from1989 to 1996, the Federal Savings and Loan Insurance Corporation ("FSLIC") closed or otherwise resolved 296 thrift institutions with total assets of $125 billion.[276] Between the creation of the Resolution Trust Corporation ("RTC") in 1989

---

[271] FDIC, *supra* note 267, at 2 ("MARCH, 1980 —Depository Institutions Deregulation and Monetary Control Act (DIDMCA) [was] enacted. Th[is] law is a Carter Administration initiative aimed at eliminating many of the distinctions among different types of depository institutions and ultimately removing interest rate ceiling on deposit accounts. Authority for federal S&Ls to make ADC (acquisition, development, construction) loans is expanded. Deposit insurance limit raised to $100,000 from $40,000. This last provision is added without debate. NOVEMBER, 1980—Federal Home Loan Bank Board reduces net worth requirement for insured S&Ls from 5 to 4 percent of total deposits. Bank Board also removes limits on the amounts of brokered deposits an S&L can hold. AUGUST, 1981—Tax Reform Act of 1981 enacted. Provides powerful tax incentives for real-estate investment by individuals. This legislation helps create a "boom" in real estate and contributes to over-building. SEPTEMBER, 1981—Federal Home Loan Bank Board permits troubled S&Ls to issue "income capital certificates" that are purchased by FSLIC and included as capital. Rather than showing that an institution is insolvent, the certificates make it appear solvent.").

[272] *Id.*

[273] FDIC, *supra* note 267, at 2.

[274] *Id.*

[275] *Id.*

[276] Timothy Curry & Lynn Shibut, *The Cost of the Savings and Loan Crisis: Truth and Consequences,* FDIC BANKING REVIEW (Dec. 2000), *available at* www.fdic.gov.bank/analytical/banking/2000dec/brv13n2_2.pdf.

and that agency's resolution in 1995, an additional 747 thrifts with total assets of $394 billion had to be rescued by last-minute efforts from government agencies.[277] The combined closings by both agencies of 1,043 institutions holding $519 billion in assets contributed to a massive restructuring of the S&L industry.[278]

The government's decision in the early 1980s—to turn the S&Ls loose in the marketplace to compete with banks—was the point at which a well constructed policy including fair exchange could have changed the course of S&L history to the advantage of the public. When interest rate fluctuation began to make the S&Ls financially untenable, the government had at least three options: 1) to close them down; 2) to use government funds to recapitalize the industry in exchange for fair exchange equity and lifting of S&L interest rate rules; or 3) to change the S&L regulations to enable them to make up for the losses and become profitable again. The government chose the third option, but also removed both regulations and oversight. The outcome, as noted below, was an enormously expensive fiasco paid for, not primarily by the private S&L investors, but by the taxpayers. So the taxpayers ended up with the risk of option 3 without any potential upside for the risk.

3. *Deregulation of the savings and loan industry enabled substantial fraud that mainly benefited well-connected people*

These changes in the early 1980s ended the requirement that S&Ls lend money only in their own communities, allowed them to offer 100% financing (i.e., no down payments), and permitted S&L owners to lend money to themselves.[279] These changes invited fraud; and sure enough, the GAO reported that "fraud played a significant role" in the S&L failures and that the RTC "suspects that fraud or criminal activity on the part of directors, officers, or senior managers contributed to the failure of 40 percent of the thrifts it has investigated".[280] Several of the biggest scandals of the S&L fiasco involved high-level government officials using

---

[277] *Id.*

[278] *Id.*

[279] FDIC, *supra* note 267, at 5.

[280] Savings and Loan Crisis: Federal Response to Fraud in Financial Institutions, Hearing Before the U.S. Senate Comm. on Banking, Housing, and Urban Affairs, GAO/T-GGD-90-61, at 2 (1990) (statement of Richard L. Fogel, Assistant Comptroller General, U.S. General Accounting Office), available at http://archive.gao.gov/d38t12/141927.pdf; see also FDIC, supra, note 367 (noting the following government measures that eased restrictions on thrifts: in January 1982, the Federal Home Loan Bank Board reduced the net worth requirement for insured S&Ls and allowed net worth to be calculated by more liberal accounting standards; in April 1982, the Bank Board eliminated the minimum stock holder restriction on S&Ls, allowing for single-owner S&Ls, and also eased the means of purchasing S&Ls by allowing buyers to use real estate, rather than cash, as collateral).

the S&L funds for their personal advantage. These are some examples. "J. William Oidenburg bought State Savings of Salt Lake City for $10.5 million, then had it pay him $55 million for a piece of land he'd bought for $874,000. With the help of. . . Herman K. Beebe, who served a year for bank fraud, Don Dixon bought Vernon Savings and Loan (one of the nation's healthiest) and then set up a series of corporations for it to loan money to. Four years later, he left Vernon $1.3 billion in debt. Beebe also had money in Silverado Savings, an S&L partly owned by President George H. W. Bush's son Neil. Silverado told a prospective borrower he couldn't have $10 million; instead, he should borrow $15 million and buy $5 million in Silverado stock. Although federal examiners knew Silverado was leaking cash as early as 1985, it wasn't closed down until December 1988, a month after Bush was elected president. Because Silverado kept leaking cash for those three years, it ended up costing taxpayers more than a billion dollars."[281]

There are many stories about criminal activities connected with this crisis.[282] Numerous S&L bankruptcies followed.[283]

---

281 *See* Zepezauer & Naiman, *supra* note 263.

282 Additional S&L crime stories can be found in these sources: STEPHEN PIZZO, MARY FRICKER AND PAUL MUOLO, INSIDE JOB: THE LOOTING OF AMERICA'S SAVINGS AND LOANS. (McGraw- Hill 1989); *David* Scheim *Trust of Hustle: The Bush Record* found at www.campaignwatch.org/morel/htm 3/14/05; *LA Times*, 7/31/1990, p. 1;*Wall Street Journal*, 8/9/1988, p. A1; *Austin American- Statesman*, 5/17/92, p. G1; *Washington Post*, 7/4/1992, p. A1; *Washington Post*, 12/28/1989, p. A21; *San Diego Union-Tribune*, 1/1/1990, p. B8; and Jonathan Kwitny, "How Bush's Pals Broke the Banks," *The Village Voice*, 10/20/1992, p. 27. Black, William, The Incidence and Cost of Fraud and Insider Abuse, Washington, DC: National Commission on Financial Institution Reform, Recovery and Enforcement, Staff Report No. 13, 1993; CALAVITA, KITTY, PONTELL, HENRY N., AND TILLMAN, ROBERT H. *Big Money Game: Fraud and Politics in the Savings and Loan Crisis,* (University of California Press 1997); ETTLESON, SHERRY AND THOMAS HILLIARD, *Crime and Punishment in the S&L Industry: The Bush Administration's Anemic War on S&L Fraud,* (Public Citizen's Congress Watch 1990); FAILED THRIFTS: INTERNAL CONTROL WEAKNESSES CREATE AN ENVIRONMENT CONDUCIVE TO FRAUD, INSIDER ABUSE, AND RELATED UNSAFE PRACTICES, (U.S. General Accounting Office 1989 T-AFMD-90-4); GUP, BENTON, BANK FRAUD: EXPOSING THE HIDDEN THREAT TO FINANCIAL INSTITUTIONS, (Bankers Publishing Co. 1990); MAYER, MARTIN, THE GREATEST-EVER BANK ROBBERY: THE COLLAPSE OF THE SAVINGS AND LOAN INDUSTRY, (Charles Scribner's Sons 1990); O'SHEA, JAMES, *The Daisy Chain: How Borrowed Billions Sank a Texas S&L,* (Pocket Books 1991); PILZER, PAUL Z. AND ROBERT DEITZ, *Other People's Money: The Inside Story of the S&L Mess,* (Simon and Schuster 1989); The U.S Government's War Against Fraud, Abuse, and Misconduct in Financial Institutions: Winning Some Battles but Losing the War: Twenty-Ninth Report, Washington, DC: U.S. House of Representatives. Committee on Government Operations, Committee Report 101-982, 1990;Whiteford, Taylor & Preston, Issues Regarding the Role of Fraud and Other Criminal Misconduct in Causing Failures in the Thrift Industry, Washington, DC: National Commission on Financial Institution Reform, Recovery and Enforcement, Staff Report No. 14, 1993;Why S&L Crooks Have Failed to Pay Millions of Dollars in Court-Ordered Restitution: Nineteen Case Studies, Washington, DC: U.S. House of Representatives. Committee on Banking, Finance and Urban Affairs, Committee Print 102-11, 1992.; "William Black Tackles the Savings and Loan Debacle," *in* UNSUNG HEROES: FEDERAL EXECUCRATS MAKING A DIFFERENCE, 22-63 Norma M. Riccucci, Washing-

IN 1987, losses at Texas S&Ls comprised more than one-half of all S&L losses nationwide, and of the 20 largest losses, 14 were in Texas. In January 1987, GAO declared the FSLIC fund insolvent by at least $3.8 billion.[284]

IN APRIL 1987, before Edwin Gray ended his term as Chairman of the Federal Home Loan Bank Board, he was summoned to the office of Senator Dennis DeConcini, where four other Senators (John McCain, Alan Cranston, John Glenn, and Donald Riegle) questioned Gray about the appropriateness of Federal Home Loan Bank Board investigations into Charles Keating's Lincoln Savings and Loan.[285] All five senators who received campaign contributions from Keating would become known as the "Keating Five."[286] The subsequent failure of the Lincoln Savings and Loan cost the taxpayers an estimated $2 billion.[287]

IN NOVEMBER 1988, George Bush was elected President and the S&L problem was not part of election debate. In February 1989, President Bush unveiled the S&L bailout plan. In August of that year, Financial Institutions Reform Recovery and Enforcement Act ("FIRREA")[288] abolished the Federal Home Loan Bank Board and FSLIC and turned S&L regulation over to the newly created Office of Thrift Supervision ("OTS").[289] The deposit insurance function shifted to the FDIC.[290] A new entity, the RTC, was created to resolve the insolvent S&Ls.[291]

Other major provisions of FIRREA included: $50 billion of new borrowing authority, with most financed from general revenues and the industry; meaningful net worth requirements and regulation by the OTS and FDIC; and allocation of funds to the Justice Department to help finance prosecution of S&L crimes. Additional bank crime legislation the next year (i.e., the Crime Control Act of 1990) mandated a study by the National Commission on Financial Institution Reform, Recovery and Enforcement to uncover the causes of the S&L crisis, and come up with recommendations to prevent future debacles.[292]

---

ton, DC, Georgetown University Press, 1995. Wilmsen, STEVEN K., *Silverado: Neil Bush and the Savings and Loan Scandal,* (National Press Books 1991).

283 FDIC, *supra* note 267, at 3-4.

284 *Id.* at 4.

285 *See id.*

286 *See id.*

287 *Id.*

288 Financial Institutions Reform Recovery and Enforcement Act (FIRREA), 12 U.S.C. 1181, PL 101-73,108 Stat 183 (8/9/1989).

289 *Id.*

290 *Id.*

291 FDIC, *supra* note 267, at 5.

292 *Id.*

4. *Who benefited from the savings and loan crisis and what did it cost American taxpayers?*

In 1989, Congress appropriated $157 billion to bail out the S&Ls, but even that was far from enough.[293] In 1990, the GAO estimated "that losses from thrift failures could be as much as $500 billion in the next 40 years."[294] To make up the difference, the RTC sold off the assets of failed S&Ls, often in deals that seem much more beneficial to the buyers than to the U.S. taxpayers.[295]

> "For example, Robert Bass, one of the richest men in America, bought American Savings and Loan for $350 million, then received $2 billion in government subsidies to help him resurrect it. During one week in 1988, the government promised $8 billion in assistance to nine S&L purchasers; one of them put $20 million down, and the other eight paid nothing."[296]

As of August 1990, the GAO estimated that the cost, including interest, could be as much as $500 billion, stating, "the taxpayers will have to pay for most of it."[297]

Curry, writing in 2000 after they claimed the S&L cleanup was complete, stated that due to the 1,043 thrift closures in the 1986-95 period, the insurance resources of FSLIC were overwhelmed, causing taxpayers to pay approximately $124 billion to cover the depositors insurance and $29 billion from the thrift industry for a total of $153 billion[298]. However, these figures only count the interest payments on the bonds floated for the bailout to the extent that their rate exceeds the normal U.S. Treasury rate; they do not include the amount of government debt that would not have been incurred without the S&L bailout.[299]

Many sources reported that political connections helped protect S&L misconduct,[300] particularly in Florida and Texas.[301] But the bailout funds came from taxpayers and went to the people who buy the bonds, many of whom are the same ones who caused the problems.[302] So, ulti-

---

[293] STEPHEN PIZZO, MARY FRICKER & PAUL MUOLO, INSIDE JOB, THE LOOTING OF AMERICA'S SAVINGS AND LOANS 59 (McGraw-Hill 1989).

[294] *See* savings and Loan Crisis, *supra* note 280.

[295] Zepezauer & Naiman, *supra* note 263.

[296] *Id.*

[297] *See* savings and Loan Crisis, *supra* note 280.

[298] Curry & Shibut, *supra* note 276.

[299] *Id.* at 31.

[300] Jonathan Kwitny, *How Bush's Pals Broke the Banks*, THE VILLAGE VOICE, Oct. 20, 1992, at 24.

[301] David Scheim, *Trust of Hustle: The Bush Record, available at* www.campaignwatch.org/hustle.htm (last visited Mar. 14, 2005).

[302] Zepezauer & Naiman, *supra* note 263.

mately, the S&L bailout amounted to a massive transfer of wealth from ordinary people to predominantly wealthy S&L investors.[303]

In its August 1990 report "Savings and Loan Crisis: Federal Response to Fraud in Financial Institutions," Richard Fogel of the GAO stated that of the annual appropriation in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)[304] of $75 million (for each of 1990 1991,1992) to enhance the Department of Justice's efforts against financial fraud, $65 million went to fraud prosecutions and $10 million to civil proceedings.[305] Fogel described the large number of investigations, prosecutions, indictments and convictions obtained by the FBI and US Attorneys, stressing the importance of the Dallas Bank Fraud Task Force, 27 other special task forces and the Special Counsel for Financial Institution Fraud.[306] Fogel sought more funds for the special task forces and Special Counsel[307] and access for the Special Counsel to more timely and centralized data to effectively oversee the government's effort to pursue financial institution fraud.[308] David Scheim reported that

> "In December 1989, the Bush Administration dismantled all 14 of the regional strike forces and folded them into the Justice Department.[1] Attorney General Richard Thornburgh took this step despite widespread protests from Congress and law enforcement officials that it would cripple federal efforts against organized crime.[2] Indeed, during their two decades of operation, the independent strike forces had made enormous progress against organized crime, and had played key roles in convictions of Mafia bosses in major U.S. cities throughout the country.[3] . . . Such strike forces nationwide prosecuted Mob figures involved in S&L fraud.[6] Strike Force efforts helped convict, among others, Mario Renda, who, working with the Mob, brokered deposits into 130 S&Ls nationwide, all of which failed."[309]

---

303 *Id.*

304 Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), 12 U.S.C. 1181, PL 101-73,108 Stat 183 (8/9/1989)

305 *See* savings and Loan Crisis, *supra* note 280 at 11.

306 *Id.* at 1-8.

307 *Id.* at 1, 14.

308 *Id.* at 1, 11-13.

309 David Scheim *Trust of Hustle: The Bush Record* found at www.campaignwatch.org/morel/htm 3/14/05; Scheim cites the following publications for these facts: *Washington Post*, 12/28/1989, p. A21; *San Diego Union-Tribune*, 1/1/1990, p. B8; *San Diego Union-Tribune*, 1/1/1990, p. B8; *Wall Street Journal*, 8/9/1988, p. A1; and Pizzo, *Inside Job*, p. 112, 120-23, 303, 337.

5. *If a business is too important for the government to allow it to fail, then it is too big to be left free from organized responsibility to that government*

The S&L bailout provides a good example of a cyclical pattern in the relationship between government and business in the U.S. The pendulum seems to swing regularly from regulation to deregulation, from protection from the rich and powerful to protection for the rich and powerful. We saw that pattern with the railroads, from the land grants to the robber barons to the anti-trust laws to the implosion from regulation as rail ceased to be a monopoly, to the Conrail bailout and then sale to CSX. With the S&Ls it was creation of S&Ls so the worker could get a home, loan through a period of intense regulation after the markets imploded during the depression. As the economy heated up and the Depression sank further into memory, the S&L financiers were able to sell the virtues of deregulation. Deregulation led to uncontrolled profit seeking, thievery and then collapse. One would think that after so many of these cycles, the pendulum should come to rest on the proposition that society requires some amount of market regulation to curb the greed of human nature and the ability of the rich to take unfair advantage of communities and working people, but that regulation must keep current with market trends, so as not to kill the regulated industry.

The Fair Exchange lesson of the S&Ls is that any business that needs government investment must treat the taxpayers as investors with the oversight, control and upside potential that any market investor would demand. And, where an industry was created to serve a specific public purpose, government oversight must also serve to protect that public purpose.

II. THE AIR TRANSPORTATION SAFETY AND SYSTEM STABILIZATION ACT OF 2001

1. *Why was Air Transportation Safety and System Stabilization Act created?*

Congress's primary concern in creating the Air Transportation Safety and System Stabilization Act[310] ("ATSSSA 2001" or "2001 Airline Bailout") was to preserve the U.S. airline industry that was devastated by the terrorist attacks in New York and Washington D.C. on September 11, 2001 (hereinafter "9/11"). The country and Congress were in shock and focused on these acts as the worst attack on civilians in U.S. history. Congress was not focused on making industrial investment policy. Several airlines lost planes, all lost revenue when the airports were

---

[310] 49 U.S.C. §40101.

closed for several days, and most suffered a loss of passengers for months after the 9/11 attacks.[311] Of the $15 billion appropriated for airline stabilization, $5 billion was granted to the airlines by the Department of Transportation, with no strings attached,[312] for "losses incurred as a direct result of the 4-day government shut-down of air traffic and incremental losses stemming from the terrorist attacks. . . . DOT distributed $4.6 billion in cash to 427 passenger and cargo air carriers."[313]

2. *Did Congress follow the U.S. General Accounting Office's 1984 study guidelines?*

Apparently, the drafters of the ATSSA 2001 paid attention to the guidelines outlined in the 1984 GAO Study of earlier bailouts, utilized current business practices to protect the taxpayers' interests as investors, and made efforts to prevent resort to government funds by those with other options.[314] The Air Transportation Stabilization Board ("ATSB") is similar to the boards created for Conrail and Chrysler. Its voting members are the designees of the Federal Reserve Chair, the Secretaries of Treasury and Transportation, with a designee of the Comptroller General of the United States serving as a non-voting member.[315]

The ATSB application[316] echoed many of the guidelines in the 1984 GAO Study. The application explicitly limited the salary and termination benefits of executives of any applicant. It required that there be no other available lending source financial information a commercial lender would require and a detailed business plan including an analysis demonstrating precisely how the airline intended to repay the debt. The application states "the Board will give greater preference to those applications that meet the greatest number of evaluation criteria" These included: "a demonstration of concessions by the air carrier's security holders, other creditors, or employees,"[317] "a description of all security (if any) for the loan"[318] including real estate and financial statements of guarantors[319]; and " a description of the Federal Government's ability to participate. . .

[311] Philip Mattera, "The Big Bailout: Questions about Federal Aid for the Airline Industry and the Takeover of Airport Security," Corporate Research E-Letter No. 16, September 2001, available at http://www.corp-research.org/sep01.htm.

[312] Press Release, Senators Fitzgerald and Corzine, Limit "Blank Check" Subsidy for Airlines (Sept. 21, 2001) (on file at http://corzine.senate.gov/press_office/record.cfm?id=186653).

[313] *The Financial Condition of the Airline Industry: Hearing Before the H. Subcomm. on Aviation,* 108th Cong. (2004), *available at* http://www.house.gov/transportation/aviation/06-03-04/06-03-04memo.html.

[314] Pub. L. No. 107-42.

[315] Pub. L. No. 107-42.

[316] Air Transportation Stabilization Board Application for Air Carrier Loan Guarantee, Formt# 001, OMB No. 0348-0059.

[317] *Id.* at 5.

[318] *Id.* at. 6.

[319] *Id.*

in the gains of the Borrower. . . through the use of such instruments as warrants, stock options, common or preferred stock, or other appropriate equity instruments. "The Board will give greater preference to. . . applications that demonstrate that the proposed instruments would ensure that the Federal Government will. . . participate in the gains of the air carrier and its security holders."[320]

Despite the 9/11 crisis atmosphere, in the Senate debate[321] on September 21, 2001, Senator Fitzgerald, a Republican from Illinois, and Senator Corzine, a Democrat from New Jersey: 1) insisted on equity participation for all loan guarantees; 2) specifically referred to Chrysler loan guarantee warrants; 3) asked that Treasury seek warrants as a condition of each loan guarantee; 4) mentioned that the U.S. government made a $350 million profit on Chrysler warrants; and 5) mentioned that FDIC wiped out the shareholders of Continental Bank in Chicago before they provided government assistance and came out of it with the FDIC owning 80% of Continental Bank.[322]

The criteria utilized in ATSSSA provide a precise and businesslike model for some of the requirements that a Fair Exchange law should contain. Its limitation to a single industry at a time when many of the industry's employees and many other businesses were deeply injured by the same event raises a logical question: why shouldn't this be a general policy covering all similar government investment situations?

3. *Outcome of Grants from the Air Transportation Safety and System Stabilization Act, Loans and Loan Guarantees*

In his report to the House Subcommittee on Aviation, ATSB Executive Director Michael Kestenbaum stated:

> The ATSB received sixteen loan guarantee applications prior to the June 28, 2002 application deadline established under the Board's regulations drafted by OMB. They included a range of large airlines, low-fare airlines, smaller airlines, charter and cargo carriers. The ATSB has approved seven applications, denied eight applications, and has one application pending. One of the approved applications was withdrawn prior to closing. The ATSB has issued six loan guarantees totaling $1.56 billion supporting loans totaling $1.74 billion. The carriers who have received ATSB guarantees are America West Airlines ($380 million for a $429 million loan), Ameri-

320 *Id.*

321 147 CONG. REC. S9590 (daily ed. Sept. 11, 2001).

322 *Id.*

> can Trans Air ($148.5 million for a $168 million loan), Aloha Airlines ($41 million for a $45 million loan), Frontier Airlines ($63 million for a $70 million loan), US Airways ($900 million for a $1.0 billion loan), and World Airways ($27 million for a $30 million loan). Evergreen Airlines received conditional approval for a loan guarantee but withdrew its application after obtaining a private loan. The loans range in maturity from five to seven years with final maturity dates between 2007 and 2009. The guarantees generally have represented about 90 percent of the total loan amounts, with roughly 10 percent of the risk assumed by private sources.[323]

4. *The Air Transportation Stabilization Board only provided loan guarantees to companies that agreed to compensate the taxpayer risk-taking with an equity type of upside benefits*

The statute also indicates that, to the extent feasible and practicable, the government should be compensated for the risk of extending loan guarantees.[324] The ATSB has strived to ensure that the government be compensated for the risk assumed in making the guarantees through fees and stock warrants.[325] To date, the six ATSB borrowers have paid approximately $145 million in guarantee fees to the federal government.[326] The ATSB also obtained stock warrants in the six air carriers to allow the government to participate in their financial success.[327] For those air carriers, the warrants represent between 10 and 33 percent of each company's equity.[328] Based on recent stock prices, the ATSB warrants currently have a "paper value" in excess of $100 million.[329] While they can be exercised and sold at the ATSB's discretion (ATSB is exploring different options for monetizing the warrants) the actual value realized will be a function of a number of factors such as the size of the position offered, liquidity of the underlying stock and markets, investor interest, and the

323 *The Financial Condition of the Airline Industry: Hearing Before the H. Subcomm. on Aviation,* 108th Cong. (2004) (testimony of Michael Kestenbaum, Executive Director of the Air Transportation Stabilization Board), *available at* http://www.house.gov/transportation/aviation/06-03-04/06-03-04memo.html.

324 *Id.* at 2.

325 *Id.*

326 *Id.*

327 *Id.* at 2.

328 *Id.*

329 *Id.*

timing and manner in which the warrants are monetized.[330] The warrants will have expired by 2012.[331]

Currently, all five of the outstanding ATSB guaranteed loans are performing.[332] Table 1 below demonstrates loan guarantee amounts, while Appendix A lists equity provided to the government in exchange.

TABLE 1. ATSB LOAN GUARANTEES[333]

Carrier	ATSB Loant$ (millions)	Total Loan (including private loans) $ (millions)
America West	380	429
American Trans Air	148.5	168
Aloha Airlines	41	45
Frontier Airlines	63	70
US Airways	900	1,000
World Airways	27	30

5. *Fair Exchange requirements saved the taxpayers $8.4 billion of available credit*

Airlines unwilling to provide stock warrants, such as Northwest Airlines, did not receive loan guarantees.[334] The Act provided ATSB $10 billion of loan guarantee authority during a specific time frame.[335] At the end of that period, the ATSB approved seven out of sixteen applications

---

330 *Id.*

331 *Id.*

332 *Id.* ("The current amount of outstanding guarantees is $1.19 billion. Frontier Airlines repaid its loan in full ahead of schedule in December of last year. However, there is always a risk of eventual defaults given the challenges the industry continues to face. The ATSB closely monitors the financial performance of all of its borrowers. The borrowers submit monthly financial reports to the ATSB, and the ATSB meets regularly with the borrowers to discuss the state of the business. . . . On occasion, the Board has granted amendments and waivers to loan terms for several of its borrowers. In these cases, the ATSB strives to ensure that taxpayer interests are protected or enhanced. For example, the ATSB negotiated a prepayment of $250 million from US Airways as part of an agreement to provide the company with flexibility to meet changing conditions in the airline industry.").

333 Statement by Brookly McLaughlin for Subcommittee on Aviation Hearing on the Financial Condition of the Airline Industry (Embargoed until June 3, 2004).

334 Micheline Maynard, *Airlines Shy Away from Loan Guarantees by U.S.*, N.Y. TIMES, Jan. 3, 2002, *available at* www.nytimes.com/2002/01/03/business/03AIR.html ("The nation's airlines, which pleaded for a federal bailout package to help them survive the impact of the Sept. 11 terrorist attacks, are shying away from applying for government loan guarantees after seeing;" the 33% stock option requirements placed on America West as a condition of its loan guarantee. Immediately after the announcement of the America West deal Northwest said it would not submit an application that it had been preparing.).

335 *The Financial Condition of the Airline Industry: Hearing Before the H. Subcomm. on Aviation, 108th Cong.*, *supra* note 313, at 1.

and issued $1.6 billion in loan guarantees.[336] Thus the airline industry was preserved, but the taxpayers did not spend public funds needed for other important public functions to subsidize any airline that did not have true need.

III. CITIZEN SHAREHOLDERS: HISTORICAL PRECEDENTS OF CITIZEN INCOME FROM GOVERNMENT/QUASI-GOVERNMENT INVESTMENT IN PRIVATE BUSINESSES –FOR THE CASH DISTRIBUTION END OF FAIR EXCHANGE

Section II above (the cash infusion section) gave examples in which private companies sought and received financial assistance or investment from the public sector. In some of those instances, the government received a return on equity. This section (the cash distribution section) provides examples in which the citizens receive income or equity return from the public or quasi-public investment.

A. ALASKA PERMANENT FUND (APF) SHARING OIL AND GAS REVENUE WITH ALL ALASKA CITIZENS

1. *History of APF*

The Alaskan economy had always been primarily based on natural resource extraction, whether gold, furs, fish or timber.[337] In 1955, the drafters of the Alaska state constitution understood the inherently precarious position of an extraction-based economy; thus provided in Article VIII, Sec.2 of the Alaska Constitution that the legislature would utilize, develop and conserve "all the natural resources belonging to the State. . . for the maximum benefit of its people."[338]

In 1967, discovery of large oil reserves on state-owned land in the Prudhoe Bay area of Alaska resulted in a windfall to the state. The Alaskan state government, which had a total budget of $124 million in 1969, before the oil revenues began to flow into the state coffers, received $3.7 billion in petroleum revenues during the 1981 fiscal year. Recognizing that its mineral reserves, although large, are finite, and that the resulting income will not continue in perpetuity, the state government took steps to assure that its current good fortune will bring long-range benefits.[339]

In 1969, at its initial auction of leasing rights at Prudhoe Bay, Alaska received a $900 million lease bonus from the oil companies. The

---

336 *Id.*

337 Joan Kasson, "The Early History of the Alaska Permanent Fund", *Trustee Papers*, 5, 13 Alaska Permanent Fund (1997). *available at* http://www.apfc.org/reportspublications/TP5-2.cfm.

338 *Id.*

339 Zobel v. Williams, 457 U.S. 55, 56-57 (1982).

State was only 10 years old and opted to spend those funds on basic infrastructure needs, such as schools, water, sewers, roads, airports, health, education and social services. But shortly after spending these funds a consensus developed in the State that too much of the $900 million had been spent too quickly and that the state needed to improve its ability to preserve the one-time oil profits.[340] In the 1970s, therefore, when development of the trans-Alaska oil pipeline began to turn North Slope oil into cash, Alaskans sought a way to retain long-term benefit from the oil revenue. Until the pipeline started eight years after the 1969 lease sale, there was no and Alaskans were concerned about when they would see something more than the $900 million lease bonuses.[341]

The outcome was a constitutional amendment approved via a general election in 1976:[342]

> At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.[343]

Subsequent legislation increased the minimum percentage from 25% to 50% for a small number of new leases, though the legislature repealed the change in 2003 and returned to the 25% standard.[344]

After the legislature established the APF, there was a major debate about whether the Fund should be managed as a savings trust for the future or as a development bank. As a development bank, it would have made loans to companies to help create and expand businesses and jobs in Alaska. The prevailing alternative was the creation of a public trust in which the primary purpose was protection of the principal, with only the interest available for appropriation by the legislature.

---

340 Email attachment of 8/1/05 to author, correcting facts on earlier article draft from Larry Persily, City of Anchorage Finance and Budget Coordinator and former Deputy Commissioner of Alaska Department of Revenue [hereinafter Persily].

341 *Id.*

342 *See* Alaska Permanent Fund Corporation, An Alaskan's Guide to the Permanent Fund 6 (10th ed. 2001) [hereinafter Alaskan's Guide].

343 *Id.*

344 Email attachment of 8/1/05 to author, correcting facts on earlier article draft from Larry Persily, City of Anchorage Finance and Budget Coordinator and former Deputy Commissioner of Alaska Department of Revenue. The Early History of the Alaska Permanent Fund, The Trustee Papers 5, Alaska Permanent Fund 1997 at 37.

In 1980 the Alaska legislature decided that the APF should adhere to the "prudent investor rule" and its trustees should invest in diversified trust quality investments.[345] The APF is managed separately from other state investments.[346]

In 1980,the Alaska legislature created the first APF dividend program. It provided that each Alaskan citizen over the age of 18 "would receive a portion of the APF's earnings annually" based on a formula providing one dividend unit for each year of residency since 1959. A single unit was valued at $50. So that a resident since 1959 would have received 21 units or $1,050, while a one-year resident would have received $50. The U.S. Supreme Court ruled this system unconstitutional as a violation of equal protection under the U.S. Constitution's 14th Amendment.[347] (The current allocation formula is in the 'Dividend Formula' section below.)

Separate from the legal battle over dividends, the legislature in 1981 made a special appropriation of $1.8 billion in surplus oil revenue to the APF, an additional $1.26 billion in 1986, and several hundred million dollars more in the following years.[348]

In 1982 the Legislature, at the request of the APF Trustees, enacted an "inflation proofing" program to protect the APF's purchasing power by moving some of each year's investment earnings into the protected principal, to cover the "loss" to inflation.[349] In 1983 the APF branched out from CDs and bonds and first invested in the stock market and a year later in real estate.[350] By 1987, the APF was larger than any other endowment or private foundation in the country. In 1989 its assets reached $10 billion. In 1990 it began to invest outside the U.S.[351] In 1998 the APF's earnings first exceeded the State's general oil royalty and tax revenue, as it earned revenue of $2.6 billion with assets of $25 billion. APF's investment earnings had started exceeding its constitutionally mandated 25% deposits years earlier, back in the early 1980s.[352]

---

[345] Kasson, *supra* note 337, at 10-11.

[346] *See id.* at 10-11; Persily, *supra* note 340. Email correcting facts on earlier article draft from Larry Persily, City of Anchorage Finance and Budget Coordinator and former Deputy Commissioner of, Alaska Department of Revenue, to author, (July 31, 2005) (on file with author).

[347] Zobel v. Williams, 457 U.S. 55 (1982).

[348] E-mail attachment of 8/1/05 to author, correcting facts on earlier article draft from Larry Persily, City of Anchorage Finance and Budget Coordinator and former Deputy Commissioner of Alaska Department of Revenue.

[349] ALASKAN'S GUIDE, supra note at 342; ALASKA STAT. 37.13.145 (2004); Persily, *supra* note.

[350] Persily, *supra* note 340.

[351] *See* ALASKAN'S GUIDE, *supra* note 342 at 16.

[352] *See* E-mail correcting initial draft of this article from Laura Achee, Alaska Permanent Fund Public Relations staff to author, (May 4, 2005) (on file with author) [hereinafter Achee]; Persily, *supra* note 340.

2. *Legislative Mission of APF*

The Permanent Fund legislation[353] transferred management of the assets, investments and earnings from the Alaska Department of Revenue to the Alaska Permanent Fund Corporation in April 1980. The Corporation's mission[354]is to:

1) . . . provide a means of conserving a portion of the State's revenues from mineral resources to benefit all generations of Alaskans;
2) . . . maintain safety of principal while maximizing total return; and
3) . . . be used as a saving device managed to allow the maximum use of disposable income from the Corporation for purposes designated by law.

The 1980 law directed the Trustees to use the Prudent Investor Rule, to diversify investments, to invest only in income producing assets, and only to invest in specific classes of assets permitted under AS 37.13.120.[355] The legislature gradually expanded the list of allowable investments, and then in 2005 eliminated the list entirely, directing that the Trustees only follow the Prudent Investor Rule.[356] The Rule means, among other things, that investments must be diversified and that any investment in Alaska must be held to the same investment criteria as any other investment. Though there is no statutory provision mandating investments in Alaska, the APFC runs an internship program to train Alaskans in finance, and they invest through brokers with Alaska offices.[357] The Trustees' investment strategy seeks to obtain a 5% real rate of return (over inflation).[358]

3. *Allocation of Funds*

Annually, at least 25% of the State's mineral royalties and lease bonuses must be placed in the APF.[359] The principal is invested but cannot be spent without a vote of the citizens.[360] The income[361] can be spent

---

[353] Alaska Stat. Sec. 37.13.010 (2004).

[354] Alaska Stat. Sec. 37.13.020 (2004).

[355] *The Early History of the Alaska Permanent Fund*, The Trustee Papers Vol. No. 5, Alaska Permanent Fund (1997) p. 62

[356] Persily, *supra* note 340.

[357] *See* ALASKAN'S GUIDE, *supra* note 342 at 24.

[358] *Id.* at 22; E-mail from Laura Achee to author, 06/04/05, Alaska Permanent Fund Public Relations staff, correcting initial draft of this article; and Email attachment of 8/1/05 to author, correcting facts on earlier article draft from Larry Persily, City of Anchorage Finance and Budget Coordinator and former Deputy Commissioner of Alaska Department of Revenue.

[359] Persily, *supra* note 340.

[360] ALASKAN'S GUIDE, *supra* note at 342.

[361] APF income is defined under ALASKA STAT. 37.13.140 (2004).

by the Legislature or reinvested. The required percentage of oil and gas royalties goes into the "Reserved Fund Balance". The Reserved Fund Balance holds all such required annual deposits plus additional appropriations made by the Legislature. It also includes all unrealized APF gains and losses.[362]

The "Unreserved Fund Balance", also known as the "Realized Earnings Account" (REA), is the portion of the APF that may be spent by the Legislature. The APF's Statutory Net Income is its Realized Earnings (consisting primarily of interest, dividends, rents from real estate or capital gains (losses) realized upon any asset sales) less the cost of managing the Fund assets.[363] The Statutory Net Income is available for appropriation by the Legislature, which, over the years, has chosen to spend the money for dividends for Alaskans and little else.[364] AS 37.13.145 mandates (among other things) the formulae for allocating dividends[365] to the Alaskan people and for inflation proofing[366] of the principal, which is merely moving the money from one column in the ledger (earnings) to another (principal) and really isn't spending the money at all.[367] After the Legislature provides these two mandatory items, the remainder stays in the unreserved portion of the APF and is invested along with the principal.[368]

In most years the APF produces more income than that required for dividends and inflation proofing. Any remaining income becomes part of the Earnings Reserve Account (ERA). The Legislature may appropriate funds in the ERA for any lawful purpose,[369] but has never chosen to appropriate any significant amount.[370] Some years the Legislature makes additional appropriations to the principal of the Reserved Fund after making the statutorily required appropriations.[371]

---

362 ALASKA STAT. 37.13.140 (2004); *see Fund Financial History & Projections as of February 25, 2005*, ALASKA PERMANENT FUND CORPORATION, FUND FINANCIAL HISTORY & PROJECTIONS AS OF FEBRUARY 28, 2005 4-5 (2005), http://www.apfc.org/iceimages/financials/2005_2_Fin.pdf.

363 Alaska Statutes 37.13.145; Alaska Permanent Fund 2005 Financial Statement pp.4-5 Fund Financial History & Projections as of February 25, 2005 (found at www.apfc.org/ice images/financials/2005 (3/23/05)

364 Persily, *supra* note 340.

365 ALASKA STAT. 43.23.025 (2004). The dividend is computed by adding the fund's net income for the previous five years. That number is multiplied by 21% and then divided by twice the number of eligible applicants.

366 ALASKA STAT. 37.13.145(c) (2004).

367 Persily, *supra* note 340.

368 Achee, *supra* note 352.

369 ALASKAN'S GUIDE, *supra* note at 342.

370 Persily, *supra* note 340.

371 *See* Fund Financial History, *supra* note 363; Achee, *supra* note 352.

4. *Inflation-Proofing to Make the APF Permanent*

The purpose of inflation proofing is to preserve the corpus of the APF against inflation and the inevitable exhaustion of oil resources and revenue.

In 1982 the Legislature enacted the inflation proofing formula currently in use, which is determined by multiplying the annual percentage change in the U.S. Consumer Price Index by the principal balance at the end of the fiscal year.[372] For example, if the CPI went up 3%, and the APF balance stood at $20 billion, the formula dictates that the legislature move $600 million from earnings to the APF's principal to cover the loss to inflation. Depending on the rate of inflation, and the APF's earnings, that transfer could represent a lot or a little of any year's earnings.[373] For 1991, 53% of the APF's income was needed for inflation proofing, while in 1987 high earnings and low inflation meant only 14% was needed for inflation proofing.

In 2001, at the request of the Board of Trustees, a proposed constitutional amendment offered complete and permanent inflation proofing for the entire APF rather than just the principal.[374] (The Legislature has consistently declined since then to place the constitutional amendment on the ballot for political rather than fiscal reasons.[375]) As of March 21, 2005 it was being reintroduced.[376]

The trustees' constitutional amendment proposal would cap annual payouts from the APF for any purpose at 5% of the APF's total market value, in order to make it a permanent resource. The trustees' long-term target is an 8% annual return, with an assumed annual inflation rate of 3% on average, leaving a real rate of return at 5%. Therefore, in the long term, to allow enough retained earnings to protect the entire APF against inflation and to protect the APF principal from any incursion, the trustees believe the annual payout should be limited to no more than 5% of a rolling five-year average of total market value.[377]

5. *Dividend Formula*

In 1982 the first $1,000 dividend check was distributed to Alaska residents. Every Alaskan who applies, resides in the State during the qualifying year and on the dividend application date, and was present in

---

[372] ALASKA STAT. 37.13.145(c) (2004); Persily, *supra* note 340.

[373] Persily, *supra* note 340.

[374] ALASKAN'S GUIDE, supra note 342 at 17; Persily, *supra* note.

[375] Email attachment of 8/1/05 to author, correcting facts on earlier article draft from Larry Persily, City of Anchorage Finance and Budget Coordinator and former Deputy Commissioner of Alaska Department of Revenue.

[376] Telephone interview with Laura Achee, Communications and Research Liaison, Alaska Permanent Fund Corporation (3/22/05).

[377] Persily, *supra* note 340.

the State for at least 72 consecutive hours during the prior two years (or is a child born of or adopted by such a person) receives equal payments.[378]

After the $1,000 payment in 1982, payments were based on the earnings of the APF and divided equally for every eligible resident.[379] The current dividend formula adds the APF's net income for the previous five years, multiplies it by 21% and divides by two. The effect is that about half of the APF's realized earnings for the average of the previous five years are paid out in annual dividends each year.[380] Based on that formula, the annual dividend has ranged from a low of $331.29 in 1984 to a high of $1,963.86 in 2000.[381] Investment earnings, not oil prices, drive the dividend, and the poor stock market returns of 2001 and 2002 cut into payments.[382] Regardless, the dividends have had an impact on the Alaskan economy and have been an especially important source of income in rural Alaskan communities.[383]

6. *APF Structure*

The APF is managed independently from the state treasury to separate the saving and spending functions.[384] The initial APF legislation created a quasi-independent Alaska Permanent Fund Corporation (APFC) to be insulated from day to day politics and yet accountable to the Alaskan people.[385] This critical balance is accomplished by having: a) a board made up of independent trustees, b) a requirement that the APFC report annually to the Legislative Budget and Audit Committee and c) a requirement that the APFC's annual budget be approved by the legislature.[386]

There are six trustees.[387] The four public members, all appointed by the governor, serve four-year terms, and the two members of the governor's cabinet serve until they leave their posts or the governor removes them. The public trustees should be experienced in the fields of business

---

378 ALASKA STAT. 43.23.005 (2004). Some residents, such as incarcerated criminals, are ineligible to receive dividends. *See* ALASKA STAT. 43.23.028 (a) (2004), There are various other exceptions to the residency requirements, including students and those on active military service. *See* ALASKA STAT. 43.23.008 (2004).

379 *See* Alaska Permanent Fund Corporation, The Early History of the Alaska Permanent Fund: Perspectives on the Origins of Alaska's Oil Savings Account, The Trustee Papers Vol. No. 5 67 (1997).

380 Persily, *supra* note 340.

381 ALASKAN'S GUIDE, *supra* note 342 at 28 – 29.

382 Persily, *supra* note 340.

383 ALASKAN'S GUIDE, *supra* note 342 at 29.

384 *Id.* at 11.

385 ALASKA STAT. 37.13.010 (2004).

386 ALASKAN'S GUIDE, *supra* note 342 at 33; ALASKA STAT. 37.13.050.

387 ALASKAN'S GUIDE, *supra* note 342 at 34, Achee, *supra* note 352; Persily, *supra* note 340.

and finance. The two cabinet members are the Commissioner of Revenue and another trustee of the governor's choice.

Investment decisions are based on a strategy adopted by the Board of Trustees. Ideally, the strategy protects the principal and produces an average annual real rate of return of five percent over the long term.[388]

To achieve a five percent real rate of return, the Trustees established and continuously review an asset allocation target. Asset allocation determines the types and percentages of investments (e.g., the 2001 asset allocation was 35% in domestic bonds, 2% in non-dollar bonds, 37% in domestic stocks, 16% in international stocks and 10% in real estate).[389]

Trustees employ an executive director who hires staff to conduct the day-to-day operations of the corporation. By design, the APFC outsources with investment professionals as needed to manage, analyze and monitor investments and returns. In-house staff works in the executive, investments, finance, information technology, administration, and communications areas.[390]

7. *Economic Impact of APF*

For over 20 years, every eligible Alaska citizen has received an annual dividend distribution from the APF, capitalized by a portion of the revenues from oil and gas production on publicly owned lands. As the APF has grown in value, the size of the annual dividend has increased so that in 2005 about $600 million will be distributed to 600,000 citizens.[391] In 2002, almost $1 billion[392] was distributed to 600,000 citizens, accounting for six percent of total household income in Alaska.[393]

The dividend program has disproportionately increased the incomes of the poor and rural Alaskans relative to income increases for high-income families over the same period.[394] As a result, there is a great deal of interest in the effect of the Permanent Fund Dividend (PFD) on macroeconomic indicators like job creation, wages, income, and spending and saving habits. However, Professor of Economics and Director of the University of Alaska's Institute of Social and Economic Research Scott Goldsmith notes that there is not much information available on

---

388 ALASKAN'S GUIDE, *supra* note 324 at 21-22; *See also* Persily, *supra* note 340.

389 ALASKAN'S GUIDE, *supra* note 342 at 22.

390 *Id.* at 35.

391 *See* STATE OF ALASKA DEPT. OF REVENUE, ALASKA PERMANENT FUND DIVIDEND DIVISION 2004 ANNUAL REPORT 5, *available at* http://www.pfd.state.ak.us/forms/Annual Reports/2004 Annual Report. PDF.

392 *Id.*

393 *See* Scott Goldsmith, *Basic Income Eur. Network 9th Int'l Cong., The Alaska Permanent fund Dividend: An Experiment in Wealth Distribution* 1 (2002) *available at* http://www.ilo.org/public/english/protection/ses/download/docs/gold.pdf.

394 *The Early History of the Alaska Permanent Fund*, *supra* note 355 at 38, 74.

these matters because "there has never been an audit to determine how the funds have been used –including what parents are doing with their children's PFDs."[395] Goldsmith attributes two reasons to the reluctance to study these matters: 1) Alaskans feel that they personally own a portion of the oil and thus what they do with their oil dividends is private and 2) Politicians are loath to study the subject because they do not want to give the impression they are considering changing this extraordinarily popular program.[396] Thus, "there is no evidence that the dividend has led to significant investment in new business activity, although it has undoubtedly resulted in significant investment in human capital."[397]

Anecdotal evidence of beneficiary spending habits indicates that Alaskans see the October APF dividend distribution as a year-end bonus and spend much of the money on consumer durables.[398] As a result, appliance and furniture stores, auto merchants, and travel agents do a lot of business immediately after the dividends are distributed. Retailers also advertise and compete for dividend business through the use of "Dividend Days." For example, airlines will offer bonus tickets for customers who are willing to trade in an entire check.[399]

The PFD's impact on the labor market appears small. There is some evidence that the dividend may have a negative impact on wages, offset by the dividend or may induce larger poor families to migrate to the state. However, this temptation is moderated by the one-year residency requirement[400]and the difficult climate. "Under the residency rules, a family that moved to Alaska in May 2005 would not receive their first Permanent Fund dividend until October 2007, a long time to wait for 'free' money if they are poor."[401]

The dividend has had a dramatic effect on the distribution of income in Alaska, which ranks among the most equitable in the country.[402] Data from the Economic Policy Institute shows that in the last ten years the income of the poorest fifth of Alaska families increased 28 percent compared to a 7 percent increase for the richest fifth. In contrast, for the

---

[395] Goldsmith, *supra* note 393 at 9.

[396] *Id.*

[397] E-mail correcting facts from earlier draft of article from Scott Goldsmith, Professor of Economics and Director of the University of Alaska's Institute of Social and Economic Research, to author (May 25, 2005) (on file with author).

[398] Goldsmith, *supra* note 393 at 9.

[399] Tony Lewis, *Devoted to the Dividend: Budget Crisis or Not, Alaskans Love Getting Their Share of Oil Wealth*, ALASKA MAGAZINE, Sept. 2004, *available at* www.alaskamagazine.com/stories/0904/feature_pdf.shtml; Persily, *supra* note.

[400] Goldsmith, *supra* note 393 at 9.

[401] Persily, *supra* note 340.

[402] Goldsmith, *supra* note 393 at 9.

entire United States over the same period, the increase for the poorest fifth was 0.8 percent compared to 14.9 percent for the richest fifth.[403]

Moreover, the dividend should help to empower low income Alaskans in various ways. . . (including) "increase in volunteer work,. . . increase in wage rates in unattractive work situations or reduction in instances of spousal abuse."[404] The PFD stabilizes the cash flow to rural areas where per capita money incomes are among the lowest in the U.S., and non-governmental sources of income are variable and uncertain. "In some areas the PFD. . . accounts for more than 10 percent of cash income."[405] This is particularly significant for communities that depend on fish or other natural resources, which can be prone to large fluctuations in both harvest and price.[406] It has also had a general stabilizing effect on the state economy for similar reasons.

8. *Social Impact*

Alaska has not had a personal income tax since 1979 and has never had a broad-based sales tax.[407] Instead, the State sends each resident an annual check. How has this affected social discourse on matters of public policy or public spending? No one has formally studied this,[408] but some feel this has created a generation of Alaskans whose only relationship to the State comes when they cash their dividend checks. Goldsmith contends that it has created an "environment preoccupied with consumption that may be detrimental to investment and the longer-term needs of society." Moreover, politicians have a vested interest in protecting this popular program, and therefore they evaluate every issue based on its potential impact on the dividend. "This is a problem because now oil revenues have fallen to the point where earnings from the Permanent Fund might logically be used as a replacement source of revenue."[409] Yet the communal mindset of taxpayers who are used to paying for such things has never existed for young Alaskans.

With the decrease in oil revenue, Alaska will inevitably have to reduce the dividend to pay for state services or implement an income tax. There are numerous arguments on about whether to decrease the dividend or implement a state income or sales tax or drastically cut services

---

[403] Goldsmith, *supra* note 393 at 9; JARED BERNSTEIN, ET AL., CTR ON BUDGET & POLICY PRIORITIES, PULLING APART: A STATE-BY-STATE ANALYSIS OF INCOME TRENDS (2000), http://www.cbpp.org/1-18-00sfp.pdf.

[404] Goldsmith, *supra* note 393 at 11-12.

[405] *Id.* at 12.

[406] *Id.*

[407] Persily, *supra* note 340.

[408] Goldsmith, *supra* note 393 at 12.

[409] *Id.* at 13.

– or a combination of the above.[410] One argument in favor of continuing the dividend while simultaneously instituting an income tax is that the government would have to ask the citizens for tax funds, rather than the government simply taking what it wanted from the APF.[411] Income tax proponents also argue that an income or sales tax would reduce the overall cost to Alaskans of government funding because it would be partially paid for by non-state residents and visitors. Finally, there is an argument that reducing the dividend would disproportionately burden poor Alaskans who are least able to pay.

The delay in finding a solution to Alaska's fiscal problem is due to a variety of factors. While the APF was originally envisioned as a means to help pay for government in the future, "a significant minority of the population feels that under no circumstances should the earnings of the fund be used to help pay for state government."[412] Separating management of the APF from the government has exacerbated this problem. For most of 1992-2002 the state government operated at a deficit, while the APF generated surpluses. This sends a confusing message to the public.[413]

The PFD has fostered "a feeling that the government exists to distribute cash to its citizens, but that individuals do not need to contribute to public life. These young people have not been schooled in the responsibilities that come with living in a representative democracy."[414] However, the effect of these cash transfers becomes less significant as income increases because the dividend represents a smaller percentage of total income and much of it may be dissipated in federal taxes. As a result, the dividend has the greatest immediate impact on the poorest Alaskan communities, but this use of public funds is not well focused on serving their long-term needs.

9. *APF Lesson for Creating Fair Exchange Programs*

The APF provides an excellent model for the front or income-capturing end of a Fair Exchange program. Article VIII, Section 2 of The Alaska Constitution, provides an excellent example of the concept that the State's natural resources belong to the people and should provide benefit to all the people whenever they are exploited.

Its administration provides many examples of balancing between public and private interests. The creation of the APFC as a corporation separate from, yet accountable to, the government is a valuable model.

---

410 Persily, *supra* note 340.
411 Goldsmith, *supra* note 393 at 13 – 14.
412 *Id.* at 14.
413 *Id.*
414 *Id.* at 17.

APFC must have its budget approved by the state legislature, and the governor appoints most of its trustees. Yet most of the trustees are expected to possess significant financial skills and knowledge. Initially the trustees' investment authority, including the classes of investments in which they were permitted to invest assets, was legislatively mandated and limited, although these limits have been removed and replace solely by the Prudent Investor Rule.[415] The trustees can propose new methods for inflation-proofing or allocating dividends, but these must be approved by the legislature. The principal can only be used for purposes approved by the citizens through a constitutional amendment. One benefit of maintaining the APF separate from the rest of government is that it promotes transparency.[416]

Providing a non-wage income stream to all is another feature that could be incorporated into a Fair Exchange program. However, this may be more difficult in states where the value per capita is smaller than in Alaska. Alaska's high value per capita is attributable to its huge reserve of one of the most sought after and dwindling natural resources, which produces a huge amount of income for its small population. Thus, the per capita allocation of the mineral resource income is more significant than it would be if Alaska had a population comparable to California's.

It is important for any Fair Exchange program to consider Alaska's inflation-proof system, but the APF's social impact is much less impressive. The PFD has not created a stronger sense of community in Alaska. Since Alaska's natural resource wealth is a limited resource, the consumer-oriented, individualistic mentality created by the current structure of fund distributions will harm the state when faced with a natural resource scarcity or global corporate pressure.

If a Fair Exchange program is to provide long-term strength to a community, it must instill community values in its citizens. It must help them work together for joint benefit, while simultaneously accruing individual benefits.

The APF principal is invested without any social investment criteria. Its sole investment focus is to achieve a target return. The highly commendable aspect of this policy is that it has consistently expanded the APF and provided dividends to citizens. The downside of this strategy is that the APF does not help broaden the active shareholder base of

---

415 E-mail attachment of 8/1/05 to author, correcting facts on earlier article draft from Larry Persily, City of Anchorage Finance and Budget Coordinator and former Deputy Commissioner of Alaska Department of Revenue.

416 Persily, *supra* note 340. (Email correcting facts from earlier draft of article from Scott Goldsmith, Professor of Economics and Director of the University of Alaska's Institute of Social and Economic Research, to author (May 25, 2005) (on file with author)).

global corporations. Fair Exchange should broaden that base and exert increasing citizen control over corporate governance and decisions.

Some combination of the APF mechanism for collecting revenue for citizens from private companies that exploit public assets, and the LSIF method of reinvestment in entities that commit to serve as exemplary corporate citizens (described in Section III (D) below), would be an ideal Fair Exchange program.

B. ALBERTA HERITAGE FUND

The statutory mission of the Alberta Heritage Savings and Trust Fund ("Heritage Fund") is: "To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."[417]

In 1936, Alberta was the only province in Canadian history to go bankrupt. Alberta was then obligated to pay off all of its debt to the government and to banks. It could not borrow any additional money until six years after its debt was repaid. Alberta floated a debt bond that allowed it to function. It then developed budgets that both paid down the debt and operated the province, even managing to introduce progressive legislation and social programs. The foreign debt was paid in full by 1945 and the domestic debt was paid off in 1949. In 1950, the Heritage Fund was established with the intention that in 1975 it would start paying each citizen a monthly dividend check. Money formerly used to pay debt was put into a fund that became the Heritage Fund, which was structured similarly to the APF. Ted Hinman, Alberta Treasurer, went to Alaska to help Alaska get the APF started in 1960.

It was anticipated that the Heritage Fund would start paying dividends in 1975, but the government changed its structure and plan.[418] The Heritage Fund reached an amount approximately equal to the amount of government debt of $C40 million. The province operated debt free until 1971, and the province did away with provincial income tax. The government reintroduced the income tax in 1982.[419]

In March of 2005 the entire debt had been paid off again and the government announced that there would be a prosperity dividend paid to every Albertan. It would be a one-time payment, however, and not an

[417] Alberta Heritage Fund Web Site Frequently Asked Questions,http://www.finance.gov.ab.ca/business/ahstf/faqs.html.

[418] E-mail from Chick Hurst, Alberta Social Credit Party Historian to author, (Sept. 13, 2005); *See also* Alberta Social Credit Party, *The Heritage Fund & Dividends,* http://www.socialcredit.com/subpages_history/heritage_fund.htm.

[419] *Id.*

annual event.[420] The government expected the payment to be approximately $400 per person.[421]

Between 1957 and 1958, the Alberta government experimented with paying direct dividends to citizens.[422] The dividends were around twenty dollars. The government terminated the program "when popular opinion indicated people would prefer the money be spent on schools, roads, hospitals and municipalities."[423] The government also had numerous problems of administration and fraud involving people collecting as many as fifty payments.[424] Discussion has reopened in Alberta over the proposed 2005 dividend to be distributed directly to Alberta citizens.[425]

1. *Alberta Heritage Fund Structure*

A percentage of Alberta's non-renewable resource revenue is transferred from its General Revenue Fund to the Heritage Fund in any year when the Legislature has passed a Special Act authorizing it.[426] The Provincial Treasurer administers the Heritage Fund[427]Originally there were two separate portfolios, the Endowment Fund and the Transition Fund, but the transition portfolio was phased out by the end of 2005[428] The funds in the endowment portfolio have an investment objective of "maximizing long-term financial returns."[429] There is a Standing Committee on the Heritage Fund, which oversees the Treasurer, reviews and approves the Fund's annual business plan and financial statements. It consists of nine members of the Alberta Legislature, of which at least three must be from the opposition party.[430]

Annually, the income of the Heritage Fund is transferred to the provincial General Revenue Fund, less funds appropriated or allocated by the Legislature to the Heritage Fund.[431] Beginning with the 1999-2000 fiscal year and thereafter, the Heritage Fund has been allowed to retain a portion of its income for inflation proofing. The Treasurer takes from the

---

420 *Id.*

421 Darcy Henton, *Cheques to Go to All Albertans Except Residents of our Prisons, Premier Says*, EDMONTON SUN, Sept. 22, 2005.

422 Patricia Beuerlein, *Socred Oil Dividends*, EDMONTON JOURNAL, at A2, Sept. 22, 2005.

423 *Id.*

424 *Id.*

425 *Id.*; Editorial, *Alberta Deserves More Than Rebates*, EDMONTON JOURNAL, at A18, Sept. 22, 2005¢ Graham Thompson, *'Prosperity Bonus' Blamed on Media: Alberta Government Backed Into a Corner by Reports of $300 Per Person Payouts*, EDMONTON SUN, Sept. 22, 2005.

426 Alberta Heritage Savings Trust Fund Act (RSA 2000 cH-A-23), Revised 1/1/2002, § 1(e) *available at* http://www.qp.gov.ab.ca.

427 *See id.* §3(1).

428 *See id.* §12(1)-(2).

429 *See id.* §3(2).

430 *See id.* §6(1)-(4).

431 *Id.*

Fund income an amount equal to the percentage increase in the Canadian gross domestic product price index times the total equity of the Heritage Fund, and deposits it in the Fund endowment portfolio.[432] However, until the Province's accumulated debt is eliminated, the Treasurer is not required to make the full amount of these inflation-proofing contributions to the endowment. Instead the Treasurer may only contribute an amount he "considers advisable".[433]

2. *Alberta Heritage Fund History*

The Alberta Heritage Savings Trust Fund[434] was created in 1976with three objectives: 1) to save the proceeds of the non-renewable resource wealth of Alberta for the benefit of future generations, 2) to strengthen or diversify the economy, and 3) to improve the quality of life of Albertans.

The Fund received 30% of the Alberta government's non-renewable resource revenue from April 1, 1976 to March 31, 1977. This amounted to $620 million. In addition, a special contribution of $1.5 billion of cash and other financial assets was transferred from Alberta's General Revenue Fund to the Heritage Fund on August 30, 1976. Between 1977 and 1982, six Canadian provinces borrowed a total of $1.9 billion from the Heritage Fund at below market rates.

In the late 1980s some money from the Heritage Fund was used to diversify the economy and to fund capital projects, such as developing parks, enhancing libraries, and maintaining forests and to diversify the economy. These projects included the Alberta Heritage Foundation for Medical Research, the Alberta Heritage Scholarship Fund, the Alberta Children's Provincial General Hospital (Calgary), the Walter C. Mackenzie Health Services Centre (Edmonton), the University of Alberta Clinical Research Building, the Pine Ridge Reforestation Nursery Enhancement, and the Alberta Family Life and Substance Abuse Foundation. In 1987 the government ceased the transfer of natural resource royalty revenues to the Fund.

In 1995 the government surveyed Albertans about the Heritage Fund and Albertans decided to keep the Fund for future generations and focus on generating better returns on long-term investments. As a result of the 1995 survey, the Heritage Fund was restructured such that the government could no longer use it for direct economic development or social investment purposes. A new business plan was implemented to increase long-term investments. A new Legislative Standing Committee

432 *Id.*

433 *Id.*

434 *See* Alberta Heritage Savings Trust Fund Act, *supra* note 426 at Chapter A-23 Preamble.

operating at arms-length from the government was created to review and approve the business plan and to ensure that the objectives of the Fund were met.

In 1998 the government surveyed Albertans about their fiscal priorities. Albertans rated elimination of debt, tax reduction and increased spending in certain vital areas ahead of increasing savings in the Heritage Fund. In the fall of 2000, the government surveyed Albertans about their priorities after the debt is eliminated. Their highest priority was one-time tax rebates, followed by saving for the future. A much lower percentage of respondents favored one-time government spending.

In December of 2000, all the loans made to other provinces from 1977 to 1982 had been repaid in full. In a March 2003 survey of over 77,000 Albertan households, 61% agreed that the Fund should continue to operate primarily as an endowment fund. The Fund 2003 annual report showed that the Fund closed out the year with a fair market value of $11.1 billion, a decrease of $1.3 billion from the previous year, losing equity due to the poor stock market results, which were offset by other investments, such as real estate. In the first quarter of 2003 the Heritage Fund transferred $199 million in earnings to the General Revenue Fund to support program spending in health care, education and infrastructure. During the first nine months of the 2004-05 fiscal year, the Alberta Heritage Savings Trust Fund contributed nearly $850 million to Alberta's General Revenue Fund (GRF).

As of February 2005, the Heritage Fund's fair value stood at $12.2 billion.[435] Note that although the Alberta Heritage Fund and the Alaska Permanent Fund began at roughly the same time with the Alberta Heritage Fund initially having more funds appropriated, the total fund balance of the Alaska Permanent Fund as of February 2005 was $47.8 billion.[436]

3. *Heritage Fund Results*

Over the past 28 years, more than $26 billion in investment income from the Heritage Fund has been transferred to the Province's General Revenue Fund to support program spending in areas such as health care, education, infrastructure, debt reduction and social programs.[437] About

---

[435] The information in this historical section is summarized from the Alberta Heritage Fund Web Site *Heritage Fund Historical Timeline*, http://www.finance.gov.ab.ca/business/ahstf/history.html.

[436] *See Fund Financial History & Projections as of February 25, 2005*, ALASKA PERMANENT FUND CORPORATION, FUND FINANCIAL HISTORY & PROJECTIONS AS OF FEBRUARY 28, 2005 4-5 (2005), http://www.apfc.org/iceimages/financials/2005_2_Fin.pdf.

[437] Alberta Heritage Fund, *FAQ available at* http://www.finance.gov.ab.ca/business/ahstf/history.html (March 24, 2005).

$3.4 billion[438] has been invested in capital projects, at least some of which provide ongoing economic and social benefits for Albertans.

Alberta has managed the Heritage Fund as an income fund rather than as an endowment. It has provided its residents with lower taxes and utility rates than they would have otherwise had, and has created jobs by funding projects that were otherwise unaffordable.[439] From an investment standpoint, it probably misallocated funds by subsidizing its own Crown corporations such as telephone service and natural gas. There was no explicit policy or formula created to describe or measure a proper social rate of return[440]

However, the Albertans were aware of the Alaska Permanent Fund. As time went on, the Alaska Fund grew and the Alberta Fund remained stagnant. In response to a 1995 survey of Albertans, steps were taken in January 1997 to restructure the Heritage Fund. Two new portfolios were created, Endowment and Transition. Transition was created to hold the old fund assets in the five divisions. Over 10 years $1.2 billion per year was to be transferred to the Endowment Portfolio. The asset mix in the Endowment Portfolio was now 35-65% fixed income securities and 35-65% equities, similar to a traditional endowment portfolio. By comparison, at the end of 1996, the Heritage Fund was only 8% invested in equities.[441] In addition, the post 1997 fund has an inflation-proofing mechanism.[442] Yet, all these funds are still operated directly within the government. Unlike Alaska's APF, there is no separate trust with independent trustees.

C. COMPARISON OF ALASKA AND ALBERTA FUND INTENTIONS AND OUTCOMES

Alberta and Alaska have many similarities. They are relatively young as human settlements, are sparsely populated, and have substantial mineral resources that form a large portion of their economic bases. Both share a northern climate. Both also inaugurated resource funds in 1976 based on their substantial mineral wealth and a desire to reduce the volatility of their economies.[443]

---

[438] The information in this historical section is summarized from Alberta Heritage Fund, *FAQ available at* http://www.finance.gov.ab.ca/business/ahstf/history.html (March 24, 2005).

[439] Allan Warrack & Russel Keddie, Natural Resource Trust Funds: A Comparison of Alberta and Alaska Resource Funds, 72 W. CENTRE FOR ECON. RES. INFO. BULL. 7, (Sept. 2002), *available at* http://www.bus.ualberta.ca/wcer/pdf/72.pdf.

[440] *See id.* ("To determine a social rate of return on the funds used by Heritage Fund, the private rate of return would need to be taken and adjusted with both positive and negative externalities. No attempt has been made here to measure externalities.").

[441] *Id.* at.7.

[442] *Id.* at 9.

[443] *Id.* at 3.

However, Alberta made very different choices than Alaska. The Alberta system is more focused on community needs, while the Alaska system focuses on benefit to individual Alaskans. Alberta has used more of its Fund to pay for economic development projects and regular government expenses. Alberta also administered its Heritage Fund from within the government.

Alaska's Fund arose in a much more deliberate and rigorously debated fashion than the Heritage Fund. Creation of the APF required a Constitutional amendment passed through a statewide referendum. A three-year process determined its objectives.[444] Conversely, the Heritage Fund was created by the legislature and functions as a part of the provincial government. Consequently, it has been subject to politics' constantly shifting winds.

The difference between Canadian and U.S. political culture also plays a significant role. Alaska exemplifies individualistic American culture. Alberta started with more typically Canadian community-focused investment strategy. Canadians (as will be demonstrated in the section on Labor Sponsored Investment Funds below) have an historic concern about growing indigenous Canadian economic institutions, so as not to become a financial colony of the U.S. In recent years, however, Alberta has begun to realign its investment strategy for the Heritage Fund to obtain more market level returns.

It is difficult to properly compare the results of the Heritage Fund and APF because so many of the non-financial impacts ("externalities" is the economists term) have not been measured. Below are a chart and several bar graphs created by Allen Warrack comparing the two programs based on available data.

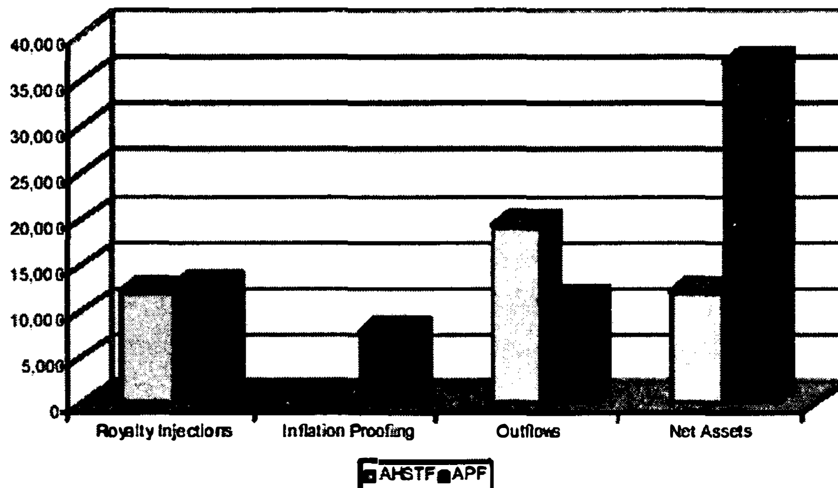
---

[444] *Id.* at 14.

TABLE 2. COMPARISONS: ALBERTA HERITAGE FUND VS. ALASKA PERMANENT FUND[445]

	Heritage Fund	APF
Time Era	Mid-1970s	Mid-1970s
Resources Base	Hydrocarbons	Hydrocarbons
Philosophy	Nationalization	Privatization
Establishment	Legislation	Referendum
Governance	Bureaucracy	Trustees
Economic Development	Yes	No
Social Dividends	Yes	No
Financial Management	Income	Endowment
Stocks Holdings	No/Changing (1997)	Yes
Inflation Proofing	No/Changing (1997)	Yes
Investment Profile	Inward/Changing (1997)	Outward
Fund Size	Smaller	Larger
Fund Growth	No	Yes

FIGURE 3. COMPARISON CHART[446]



Clearly, the APF is much richer financially than Alberta's Heritage Fund as of 2005. (See comparison chart, Figure 3 above.) The consequences for the social fabric are much harder to compare. The Albertans continue to use their Fund income (beyond inflation proofing) to provide

[445] Allan A. Warrack & Russell R. Keddie, Western Centre for Economic Research School of Business, University of Alberta Edmonton, Canada T6G 2R6 www.bus.ualberta.ca/ CIBS-WCER, NUMBER 72, SEPTEMBER 2002 p.23, NATURAL RESOURCE TRUST FUNDS: A COMPARISON OF ALBERTA AND ALASKA RESOURCE FUNDS, Figure 5.

[446] Source of Figure 3: Allan Warrack & Russell Keddie, Natural Resource Trust Funds: A Comparison of Alberta and Alaska Resource Funds, 72 W. CENTRE FOR ECON. RES. INFO. BULL. 5, at 21 (Sept. 2002), available at http://www.bus.ualberta.ca/wcer/pdf/72.pdf.

community services traditionally provided by government out of taxes, with allocation decisions being made by the government. According to First Ontario Fund Director, Ken Delaney, Alberta is the only debt-free province and has lower taxes than the others.[447] In Alaska, a large portion of the APF income goes directly to individuals. Such distributions have helped decrease the gap between rich and poor. It is hard to make a comparison to Alberta on that front because the Canadian social economy is much larger than that in the U.S. Canadians have other programs, such as national health insurance, which help reduce the differences between rich and poor.

Alberta has income taxes and government is a respected institution in Canada. The concern Goldsmith raises, about the detrimental effect the PFD has on the ability of young Alaskans' to function as contributing citizens, is an important concern. As the oil resources are depleted, and the Alaskan population grows, only time will tell whether dependence on the dividend has undermined social cohesion.

The Alaska Permanent Fund trustees invest as traditional endowment trustees. They use no social criteria at all for their investments. They are not pro-active on governance issues as is the California pension fund (CalPERS). They do not screen for social criteria, as does a social index fund like the Domini Social Investment Fund, or the Canadian Labor Sponsored Investment Funds. Thus, for example, they have no mechanism by which the APF Trustees could be instructed not to invest in one or more companies seen as particularly destructive to Alaskan environmental, economic or social interests.

D. LESSONS FROM APF AND HERITAGE FUND FOR FAIR EXCHANGE

There are few regions in the world containing both huge natural resource wealth and a small population. Therefore, neither the Alaska nor Alberta situations are easily replicable. (There are, however, suggestions that the oil wealth of Iraq should be owned and managed for the Iraqi people in a manner similar to the APF.[448]) These models do, however, provide examples that can be used on a smaller scale. They enable us to compare the pros and cons of using a trust to hold and invest citizen funds compared to a government. They demonstrate the importance of inflation proofing for fund longevity.

---

[447] Telephone interview of Ken Delaney, Executive Director, First Ontario Fund (Aug. 5, 2005).

[448] In Congressional testimony, U.S. Secretary of State Colin Powell specifically mentioned the Alaska dividend model for Iraq in response to question from Senator Allen. "AN ENLARGED NATO: MENDING FENCES AND MOVING FORWARD ON IRAQ" HEARING BEFORE THE COMMITTEE ON FOREIGN RELATIONS, UNITED STATES SENATE 108TH CONGRESS, FIRST SESSION, April 29, 2003 at 38, http://www.access.gpo.gov/congress/senate/ U.S. Government Printing Office, Washington, 2003.

In Alaska, the fund income is divided to provide for inflation-proofing and citizen dividends, while leaving some of the fund available for the legislature to allocate to government functions. Even if the portion available for government is not sufficient long term, the structure is in place when the political will is.

Alaska's sophistication in caring for the Fund's survival, income to citizens and government provides a good platform from which to develop a Fair Exchange model.

A Fair Exchange model would add a mechanism to use the government investment in private and public companies to impact their corporate governance and investment or disinvestments policies. The Alberta's Heritage Fund focused on developing the Albertan economy, decreasing the cost of utilities, creating jobs, and making low interest loans to other Canadian provinces. Undoubtedly, it has served a real, if difficult to measure, social/economic function in Canada. Another example is the Canadian Labor Sponsored Investment Funds (LSIFs).

E. CANADIAN LABOR SPONSORED INVESTMENT FUNDS (LSIFS)

Considering LSIFs in the Fair Exchange context, we must view them in at least two ways: 1) as private companies receiving government subsidies for which a fair exchange is expected; and 2) as a model for the distribution mechanism of the fair exchange proposals described in this article.

"Canadian innovations in labor-friendly asset management offer rich lessons for those seeking new ways to organize and control capital. . . eThe best of the LSIFs mobilize workers' savings to invest in good jobs within local communities. The investment strategies of these LSIFs are rooted in a broader social agenda that promotes worker participation, training, and respect for stakeholders."[449]

1. *What are LSIFs?*

Labor Sponsored Investment Funds (LSIFs) are union-sponsored, tax incentivized investment funds that supply venture capital (VC) financing to small and medium-sized enterprises in Canada. They were first created in the mid-1980s, and have grown in number, size, and importance over the past 20 years. The funds are established to fulfill specific federal and/or provincial goals, with each level of government enacting statutory restrictions to help guide investments to achieve their public policy objectives.

---

[449] Archon Fung, Tessa Hebb & Joel Rogers, WORKING CAPITAL: THE POWER OF LABOR'S PENSIONS 128 (Cornell University Press 2001).

> Since 1991, they have raised the largest amount of capital ($10.6 billion or 44 percent of the VC market) and invested the largest amount of total VC ($5.3 billion or 24% of the VC market). They currently have the largest share of VC under management in Canada ($9.2 billion or 41% of the Canadian market as of 2003). These fundraising and investing activities, however, have not been without costs – the federal government alone has foregone $1.8 billion in tax revenue to cover tax credits since 1991.[450]

Since 1991, 90% of LSIF capital has been raised in Ontario and Quebec, and 85% has been invested in those two provinces.[451] The vast majority of the funds' billions in assets come from small investments made by average working people.[452]

2. *How and Why LSIFs Were Created*

The specific trigger for the creation of the initial funds was the 1981-83 recession and persistent levels of high Canadian unemployment. The labor sponsored venture capital corporation model was initiated by the Quebec Federation of Labor (FTQ) in the Province of Quebec in 1984 to meet identified equity capital gaps for small and medium sized businesses in a manner which would address additional social policy concerns. The idea of a labor sponsored fund was the most recent development in a long tradition of capital retention strategies in Quebec, which include the pooling of pension funds to assist local economic activity and the development of a comprehensive network of credit unions which re-lend deposits locally.[453] Four additional funds have been created which follow the Quebec model,[454] the Working Opportunity Fund in B.C.,[455] the Worker Investment Fund in New Brunswick,[456] the Crocus Fund in Manitoba[457] and the First Ontario Fund in Ontario.[458]

---

[450] Thompson Financial Venture Capital Reporter Database 2005 (This is a proprietary database accessed by Industry Canada under a license agreement with Thompson Financial, for a study that has not been and will not be released by Industry Canada. Interested parties can find the data by entering into a licensing agreement with Thompson Financial).

[451] Thompson Financial Venture Capital Reporter Database 2005.

[452] Sherman Kreiner, *Labor-Sponsored Investment Funds in Canada*, http://www.uswa.org/uswa/program/content/437.php).

[453] *See id.*

[454] E-mail from Don Allen, Regional Data Corp., to author (Aug. 2, 2005).

[455] Employee Investment Act, R.S.B.C. ch. 112 (1996).

[456] Registered Labour-sponsored Venture Capital Corporations Regulation-Income Tax Act, N.B. Reg. 2001-11 (2001); New Brunswick Income Tax Act, S.N.B. ch. N-6.001 (2000).

[457] Crocus Investment Fund Act, S.M. ch. 48 (1991-1992) (Can.).

[458] Community Small Business Investment Funds Act, S.O. ch. 18 (1992) (Can.).

> These funds are committed to earning competitive returns. At the same time, the funds set out to provide capital to needed sectors, and, in addition, to meet social goals the unions have established, including job creation and retention, and regional economic development. As part of their social mandate, each fund undertakes some form of "social audit" of each firm it finances, which includes examining labor relations, health and safety, ethical employment and environmental practices. The funds also take a proactive approach to the workforce - encouraging improvements such as financial education for workers, encouraging a high performance workplace, participatory management, and worker ownership.[459]

The Crocus Fund was the only fund with a formal social audit was. However, First Ontario Fund uses a seven-page "Economic Impact Assessment" questionnaire filled out by prospective investee companies that covers all the same subjects.[460]

> The target market is small and medium sized businesses. Typically, an equity interest is sought in companies employing less than 500 workers that have total assets of less than $50 million. Most investments range from $C500,000 to $C2 million. In raising capital these funds are committed to participation by a broad base of average working people, through marketing by the sponsoring unions or labor federations. The maximum annual individual investment which qualifies for tax credits is legislatively mandated and has ranged from $C3,500 to $C5,000.[461]

3. *Quebec Solidarity Fund (Solidarity FTQ) – the first LSIF model*

The Fonds de Solidarité des Travailleurs du Quebec (Solidarity FTQ)[462] was the first fund to be created. The initial plan called for a 35% provincial tax credit only for individual investors. The plan was then presented to the Federal government, which agreed to match the provincial government seed equity commitment of ($C10 million each) and to

459 *See* Kreiner, *supra* note 452.

460 Analysis of Fiscal Costs and Fiscal and Economic Impact of Ontario Labour-Sponsored Investment Funds (Regional Data Corporation, Don Allen) Sept. 2004 [hereinafter Analysis of Fiscal Costs].

461 *See* Kreiner, supra note 452.

462 R.S.Q., chapter F-3.2.1.

provide matching tax credits, provided that the total tax credits did not exceed 40% (20% provincial and 20% federal).[463]

However, in the 1996 federal and Quebec budgets each tax credit was reduced from 20% to 15%.[464]

> The Fund undertook negotiations with the provincial securities commission to permit sales to be made by volunteer members of the Solidarity FTQ. The Fund raised approximately $C500,000 during its first sales season. The Fund. . . [had, as of 1995,] $C1.5 billion dollars in assets. The bulk of sales are made through lump sum investments into from their Registered Retirement Savings Plans (RRSP), which is the Canadian equivalent of an Individual Retirement Account (IRA) in the U.S. These revenues are supplemented by investment via payroll deduction. In addition to mandating employers to implement payroll plans, Solidarity FTQ affiliated unions have undertaken a major initiative to establish collective bargaining agreement language which compels employers to match employee contributions made via payroll deduction on a dollar for dollar basis. Statistics as at December 31, 1995 indicate that about 65% of the Solidarity Fund's 238,000 shareholders are affiliated with the labor movement, the highest percentage among all Canadian labor sponsored venture capital corporations.[465]

The Solidarity FTQ has several features that made its LSIF model a unique innovation. Quebec legislation provides that the Quebec Federation of Labor (FTQ) is the sole sponsor of the Solidarity FTQ. FTQ appoints 10 of the 16 Fund board members and has input on the appointment of the other six, including the chief executive officer.[466] The Fund goals as stated in the legislation indicate the importance of collateral benefits beyond the purely financial. The stated purposes of the Fund[467] are to:

> "Invest in firms within Quebec whose total assets are less than $50 million, or whose net assets are not greater than $20 million, to create, maintain and protect jobs; promote the training of workers in economic matters and

463 *See* Kreiner, *supra* note 452.

464 *See* Allen, *supra* note 454.

465 *See* Kreiner, *supra* note 452.

466 WORKING CAPITAL: THE POWER OF LABOR'S PENSIONS 138 (Archon Fung et al. eds., 2001) [hereinafter WORKING CAPITAL].

467 *Id.*

> enable them to increase their influence on Quebec's economic development; stimulate the Quebec economy; and invite workers to subscribe to the Fund."[468]

Individual workers invest in LSIFs by contributions from their RRSP. The LSIF tax credit allows a maximum of $C5,000 to be invested by a person each year, for which he receives a 15% federal tax credit and a 15% provincial tax credit, for a maximum rebate of $C1,500. Because the contribution can be made with tax deferred RRSP funds, the deferral is generally worth an additional approximate 30% of the contribution for the average wage earner.[469]

LSIF investments are intended to be long-term patient capital. Thus, the Quebec Fund requires contributions to remain in the fund until retirement, or the contributor will incur tax penalties. The other LSIFs allow for a withdrawal after eight years without a penalty.[470]

> The provinces of Quebec, Manitoba and British Columbia have each added a second LSIF, under pressure to end the monopoly of their first fund. A number of other LSIFs have been created in the provinces of Ontario and Saskatchewan, which may be considered more private sector oriented and less social goals oriented, although they are also mandated to invest in small/medium business and create employment. Therefore, Canada now has 27 labour-sponsored investment funds.[471]

Although there is now another LSIF in Quebec, the Solidarity FTQ Fund is unique. It is the oldest and largest LSIF. The strong link between the labor movement and the Quebec government enabled it to establish itself as a substantial economic force in Quebec with a uniquely close involvement with the economic development functions of the Quebec government. Its economic strength and size have been enhanced by its low cost structure, a consequence of having functioned for many years with no LSIF competition. It has economies of scale that none of the other LSIFs have, and it has had many years to grow as the sole Quebec LSIF, without needing to market in competition with others in Quebec. It garnered the support and participation of most of the unions in Quebec. Whereas there are 18 LSIF funds in Ontario competing with each other for investors from their various sponsor unions or organizations, and by paying big commissions to brokers and financial planners to sell to the

---

468 *Id.*
469 *Id.*
470 *Id.*
471 *See* Allen, *supra* note 454.

public. In Quebec, union members can sell LSIF stock directly, whereas in Ontario a licensed broker must supervise such sales.[472]

4. *Impact of LSIFs*

a) Filling the Capital Gap

Canada historically has not had adequate access to venture capital.[473] LSIFs made a huge contribution to filling the venture capital gap for small and medium-sized companies in Canada. In 1990 when LSIF vehicles were not fully developed, the Canadian venture capital industry stood at $3 billion with investments of $200-300 million annually. By 1998 the total sector stood at $8.4 billion. In 2000, the LSIFs accounted for 50% of the venture capital in Canada and were the fastest growing segment of the market.[474]

In 1997, the entire Canadian venture capital industry invested $1.8 billion in 794 companies and the LSIFs invested $671 million of that amount. In fiscal year 1997-98, the Solidarity FTQ Fund alone invested $614 million. Due to the work of the Solidarity FTQ Fund, Quebec went from being a province with limited venture capital sources to one gathering the largest share of overall venture capital in the country.[475]

On August 29, 2005 the Ontario government announced its intention to end its 15% tax credit no earlier than the end of the 2005 tax year for LSIFs in Ontario. The reason they gave was that Ontario no longer needed a subsidy to make venture capital available.[476] The Ontario LSIFs contest this reasoning.[477] In 2005, the Association of Labour Sponsored Investment Funds (ALSIF)[478] indicated that lack of capital access put emerging Canadian technology companies at a competitive disadvantage with American counterparts.[479] The ALSIF concluded that the problem of venture capital supply was worsening,[480] and that in the years since

472 Interview with Ken Delaney, President and CEO, First Ontario Fund (8/2/05).

473 See Canadian Venture Capital and Private Equity Association, 2004 Review of Venture Capital Investment Activity in Canada 2, 3, 5, 8 (Feb. 16, 2004), *http://www.altassets.com/pdfs/CVCAYearEnd2004.pdf.*

474 *See* WORKING CAPITAL, *supra* note at 466.

475 *Id.* at 139-140.

476 Press release, from Manuel Alas-Sevillano, Ontario Minister of Labour, 8/29/05 "Ontario Plans to End Tax Credit for LSIFs: Incentive to investor no longer needed in healthy venture capital market". (Aug. 29, 2005) (17.1.3) http://ogov.newswire.ca/ontario/GPOE/2005/08/29/c3815.htm.?lmatch=&lang=_.html (found 952005).

477 David Levi, President and CEO of GrowthWorks (an Ontario LSIF) in its press release August 29, 2005 ("There is already a shortage of venture capital in Canada and this decision will make the situation even worse for emerging Ontario companies.") (17.1.3) http://www.press.arrivenet.com/pol/article.php/686556.html.

478 Regional Data Corporation, Jay Heller & Don Allen, *Review of Financing Issues Raised by the Institute for Competitiveness and Prosperity*, May 2005.

479 *Id.*

480 *Id.*at 14.

LSIFs were created the LSIFs had not crowded out other types of venture capital firms[481] and there had been an increase in foreign (primarily U.S.) venture capital funds in Canada. The ALSIF study states that LSIFs had performed at least as well as other Canadian venture capital funds during the previous 5 years (2000-05) and better than the Canadian technology funds.[482]

The two largest sources of venture capital (VC) in Ontario are LSIFs and foreign companies.[483] From 2002-04, foreign VC companies directed only 9.6% of their Ontario investments to first round investments, while Canadian VC firms (LSIFs holding the majority of these assets) invested 35% of their assets to companies not previously receiving VC.[484] This study concluded: "Ontario companies generally only succeed in attracting foreign venture capital if they already have domestic investors in place,"[485] whereas "LSIFs are guaranteed to invest domestically."[486]

b) Job Creation

A 1997 study showed that, on average, venture backed investee firms increased their employment base by 26% per year as compared to 1.2% for the Canadian economy as a whole. A 2004 study of economic impact of Ontario LSIFs found that a sample of 187 investees of the funds had a total work force of 9,000 at the time that the funds first invested in these firms. By 2002, their work forces had grown to 32,000. If the firms had grown at a pace consistent with all Ontario firms of the same size, they would have reached only 11,000 employees by 2002.[487] The estimated direct, indirect, and induced impact of the Ontario LSIFs through 2001 on employment was 27,000 jobs in Ontario and 29,400 jobs for all Canada.[488]

c) Return to Government on LSIF Tax Credit Investment

The above-mentioned 2004 study of fiscal and economic impact of Ontario LSIFs estimated that the cumulative fiscal cost to taxpayers of Ontario funds from inception during the 1990s to tax year 2000 was $C494 million for the Ontario government and $C489 million for the federal government. Most of the funds raised are placed in company investments, although a portion is placed in marketable securities to reduce

---

481 *Id.* at 11.
482 *Id.* at 9.
483 *Id.* at 14.
484 *Id.*
485 *Id.*
486 *Id.*
487 *See* Analysis of Fiscal Cost, *supra* note 460.
488 *Id.* at 2.

risk. The funds placed in companies led to an economic impact in terms of the start-up, growth and maintenance of firms. In the year 2002, this economic impact was estimated to have led to incremental government revenues of $357 million for Ontario and $449 million for the federal government. This implies a payback period of costs since inception of 1.4 years for Ontario and 1.1 years for the federal government. Therefore, by mid-2003, all of the cost invested up to 2000 would have been recovered and incremental government revenues would have carried on subsequently, since the vast majority of investees were still operating and growing.[489] LSIFs are a relatively new experiment. Although this is not conclusive evidence that LSIFs provide a fair exchange financially, it is evidence that they are moving in that direction.

d) Broader Social Return on LSIF Investment

In addition to the benefits noted above, in Ontario LSIF investees invested in research and development at quadruple the rate (from $137 million to over 700 million) of comparable Canadian firms that did not receive LSIF investments.[490] Through 2001, beyond what would have otherwise been expected without them, Ontario LSIFs created a large export income gain of $1.5 billion,[491] contributed $C2.3 billion to the Ontario GDP and $C2.6 billion to the Canadian GDP.[492] All have been created to provide venture capital for local Canadian firms using capital from a source formerly largely untapped - individual investors, and particularly union members. The LSIF funds enable many working people to save more for their retirement than they would have otherwise.[493] The union connection appears to make LSIF investments more accessible and worthwhile to workers with incomes under $100,000 per year.[494] Some LSIFs perform social audits and have high labor and environmental standards as well (see following sections.).

The LSIFs have been a good investment and a fair exchange for the communities.

e) Creation of Regional Financial Networks

In the early days of the Solidarity FTQ Fund, its officials realized that there were many investment opportunities outside the Montreal area that never came to the attention of the Fund. Often firms from such rural areas did not approach the Solidarity FTQ Fund because it seemed too

---

489 *Id.*
490 *Id.*at 3.
491 *Id.* at 8.
492 *Id.* at 2.
493 *Id.* at 2, 5.
494 *Id.* at 5.

removed from their community or because it required travel to Montreal. The Solidarity FTQ Fund overcame this barrier by developing a regional partnership with Quebec's government. The network now operates seventeen regional funds, each with offices and managers assigned to local areas, which invested $C41.7 million in 155 firms with investments in the $C50,000 to $C500,000 range. Proximity to the investments increases knowledge of opportunities and enables closer monitoring of the loans. It also builds the involvement of local people who, in turn, are more likely to invest in the trust and to obtain the financial education offered by the Solidarity FTQ Fund.[495] This led to an even more localized development of SOLIDE funds to provide pre-start-up financing in the $C5,000 to $C50,000 range. As of 2001 there were 86 SOLIDEs in Quebec that had invested in 490 enterprises.[496]

f) LSIFs Throughout Canada

In 1988, Canada passed national legislation followed by provincial legislation in British Columbia, Manitoba, Ontario and New Brunswick. In four of these provinces, a sole labor sponsor, the provincial labor federation, was named in the legislation. However, in Ontario, which includes Canada's financial center, Toronto, the financial community fought creation of a labor-controlled fund. There was strong disagreement within the Ontario labor movement about the appropriateness of LSIFs. Thus, when LSIF legislation passed in Ontario, the labor federation could not be named as the sole sponsor. Rather, any labor organization or trade association could sponsor an LSIF.[497] As of July 2005, 18 of 27 LSIFs exist under Ontario legislation.[498]

Five of the six funds with a sole labor federation sponsor formed an alliance[499] and created a Statement of Principles to set a standard for themselves, and to distinguish themselves from what they perceived as a lack of concern, in many of the Ontario LSIFs, for the social benefits, beyond rate of return, which they believe are fundamental to LSIFs. The Statement of Principles of the Labour Sponsored Investment Fund Alliance is:

1) organization and direction by a labor body (meaning a board of directors controlled by a labor organization with at least 100,000 members);
2) commitment to meeting social goals (including job retention, regional economic development, social audit, and requiring inves-

---

[495] *See* WORKING CAPITAL, supra note 466, at 150-52.
[496] *Id.* at 150.
[497] *See* Fung, Hebb & Rogers, supra note 449, at 131.
[498] *See* Allen, *supra* note 454.
[499] *See* Fung, Hebb & Rogers, supra note 449, at 131.

tee companies' commitment to improvement of labor-management relations);

3) commitment to provide an equitable rate of return to shareholders, risk capital in a diversified portfolio, and participation by a broad base of average working people; and,

4) facilitation of cooperation between labor and business.[500]

Because the Alliance has not met since 1998, the distinction between Alliance and non-Alliance funds is no longer very helpful.[501] A number of funds have merged or been restructured so that only two now meet the original criteria, Solidarity FTQ and First Ontario Fund.[502]

g) Social Audit and Worker Education

The Alliance LSIFs require their investees to be fair, safety conscious employers and good environmental stewards. They do not require them to be unionized firms. Solidarity FTQ, the largest of the Alliance funds provide worker education to train their sales force made up of union members. They provide financial literacy classes for their investors to learn to manage their retirement accounts. The Solidarity FTQ Fund requires management in its investee firms to open their ledgers to their employees and assists those firms in training their employees to understand these ledgers. As the year 2000, sixteen thousand workers in Quebec had participated in these two-day financial courses. A 1999 study found that all surveyed investee companies reported varying degrees of improvement in labor management trust and communication after these training programs.[503]

5. *Financial Performance of LSIFs compared to Comparable Commercial Funds for Individual Investors*

LSIFs have provided clear benefits to Canadian communities. As outlined above in the section entitled "Broader Social Return on LSIF Investments, the LSIFs now have $C5.955 billion in assets in Quebec and $C3.386 billion in the rest of Canada for a total of $C9.3 billion invested in funds aimed at building local economies.[504] LSIFs repay the

---

500 *Id.* at 133-34.

501 Interview with Ken Delaney, President and CEO, First Ontario Fund, interview with author 8/2/05.

502 *Id.*

503 WORKING CAPITAL, *supra* note 466 at 152 (citing a 1999 study by Paul Laliberte at the University of Massachusetts.

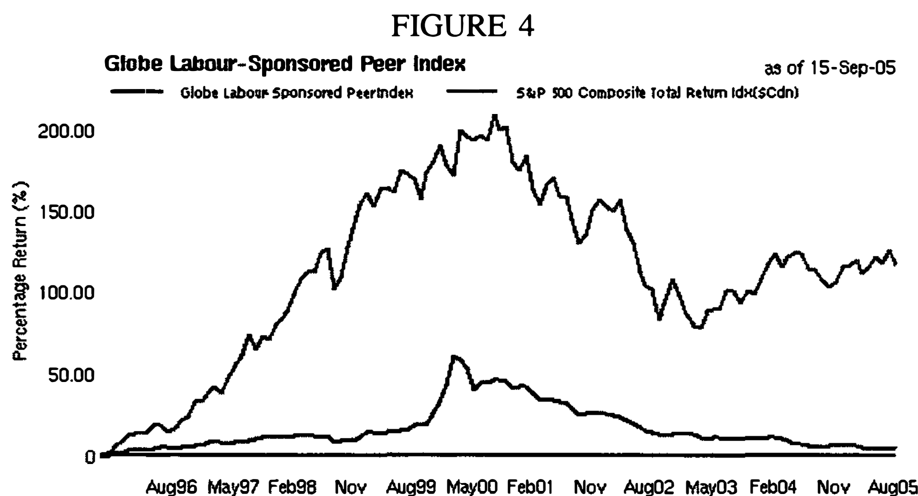
504 Thomson Financial Venture Capital Reporter 2005, a copyrighted proprietary database, is the main source of data on the Canadian venture capital market. The information cited herein was accessed by Industry Canada under a license with Thompson Financial, for an Industry Canada study that has not been and will not be released. The author obtained the data from the unpublished study. The Thompson Financial Venture Capital Reporter is found at http://www.canadavc.com/.

government for its investment, so they provide a fair exchange. However, the issue of return on individual investment is not really a Fair Exchange issue.

a) Impact on Individual Investors

There should be concern about how the average citizen investor is treated. So we will explore briefly these three questions. 1) Should unsophisticated investors be putting their discretionary savings in venture capital funds? 2) If unsophisticated, working-class investors are using LSIFs to save for retirement, are they getting an appropriate return on investment for the risk they take? 3) Do LSIF worker-investors have different LSIF investment objectives than commercial venture capitalists?

FIGURE 4



Most investment advisors would not advise unsophisticated investors to put a large portion of their discretionary savings in traditional venture capital funds. Figure 4 provides a comparison of the *Toronto Globe & Mail*'s LSIF Index compared with the S&P 500 Composite in Canadian dollars[505] to give a general idea of the alternate equity investment returns available to a Registered Retirement Savings Plan (RRSP) investor. The LSIFs have not performed as well as the S&P 500. The section below "Financial Return Comparison Data" shows that the LSIFs have not performed as well as small cap funds since 1999, although they outperformed them up to 1998. However, many Ontario modest income investors, who have not otherwise made RRSP contributions, have invested in LSIFs.[506] The proportion of union members who invest in

---

[505] *See http://globefunddb.theglobeandmail.com/gishome/plsql/gis.show_chart?comp_id =0&fid1=5117&period=120&indx1_id=3140&fid2=0&pi_mov_type=SMA&pi_mov_avg1= &pi_mov_avg2=&pi_mov_avg3=&iaction=Go&pi_universe=PUBLIC_FUND* 9/12/05
[506] *See* Analysis of Fiscal Costs, *supra* note 460.

LSIFs is larger than their proportion amongst Ontario taxpayers.[507] Canada has a national pension system to which everyone contributes and from which everyone receives benefits. The RRSP is an inducement to personal savings via income tax incentives and is strictly voluntary.[508] The LSIF investors are likely making small LSIF investments for reasons not completely based on financial return, but perhaps based on concern for maintaining the local economy and jobs: "One theory is that individual investors are less sensitive to rates of return given the up-front tax credit and the small amount of each investment. By comparison, those that invest in private funds tend to be sensitive to rates of return and have large amounts of capital at stake. This theory suggests that LSVCC (LSIF) managers are less driven to produce high returns than their private sector counterparts. Theoretically, this may manifest itself in investments that private funds would have rejected or negotiated for a better position, a more passive approach to investment monitoring and offering little value added to the investee firm.[509]

If unsophisticated, working-class investors are using LSIFs to save for retirement, are they getting an appropriate return on investment for the risk they take? LSIFs, particularly the Solidarity FTQ, make a concerted effort to provide financial literacy training to their worker-investors[510] so that they do not remain unsophisticated investors and can properly judge the risk of investing in the LSIFs compared to alternative RRSP investments. Additionally, it is hard to use the existing fund indices to compare return on investment with other similar stock or venture capital funds because the LSIFs report their return on investment after costs and not including tax benefit, whereas the other Canadian venture capital funds report their return on investment before expenses.[511]

[507] Regional Data Corporation, "Analysis of Fiscal Costs and Fiscal and Economic Impact of Ontario Labour-Sponsored Investment Funds", May 2004 at 5.

[508] Keith Wilde, senior model analyst, DYNACAN, Micro-simulation, Canadian Social Security, email to author 9/22/05.

[509] D. SANDLER & J. MACINTOSH. *Mutual Funds that Invest in Private Equity? An Analysis of Labour-Sponsored Investment Funds 33*, (Working paper, University of Alberta and University of Toronto, 2003b).

[510] The second of four key objectives of the Solidarity Fund FTQ is "To promote economic training of workers in order to enhance their contribution to Quebec's economic development." *See* Fonds de Solidarity FTQ, *About the Fund, at* http:/www.fondsftq.com/internet fonds.nsf/VwebTimpAN/AprAcc?opendocument.

[511] *See* Delaney, *supra* note 501.

b) Methodology Problems Comparing LSIF Returns to Commercial Returns

It is not proper to compare the *Toronto Globe & Mail* globeinvestor.com LSIF index[512] with other non-venture capital stock indices, as they really represent other asset classes. There are additional problems with comparing other stock fund data. It is hard to use the existing fund indices to compare, return on investment with other similar stock or venture capital funds because the LSIFs report their return on investment after costs and not including tax benefit, whereas the other Canadian venture capital funds report their return on investment before expenses.[513] The tax benefit of an LSIF may not legally be included in the return on investment calculations shown in any offering publication for LSIF participants.[514]

An example will demonstrate why this matters. The author compared various small cap and venture indices against the LSIF index. The 10-year cumulative return for BMO Nesbitt Burns Small Cap Index had a return on investment over 10 years of 10.33%. The LSIF Index had a return on investment of 0 .53%. If a worker invested $100 in an LSIF with provincial and federal tax credits, his $100 investment at the end of 10 years would be $105.30, but his actual investment would have been $70, not $100, whereas the person who invested $100 in BMO Nesbitt would have $110.30 on his $100 investment. So the LSIF investor made $105.30-70 = $35.30 on his investment, and the BMO Nesbitt investor made $110.30 – 100.00 = $10.30 on his investment. In this case, the LSIF investor made over 3 times the return of the small cap investor. The LSIFs are explicitly prohibited by law from showing prospective customers return on net (after tax credits) costs.[515]

The LSIF index, although it lists the Solidarity FTQ, does not have cumulative data for return on investment or many other categories on that fund, as Solidarity FTQ does not provide that information to the index makers. So the absence of the Solidarity FTQ data skews the LSIF index considerably.

Any proper comparison between the other indices and the LSIFs would need to include the Solidarity data, as it comprises almost half the LSIF funds invested in Canada. Solidarity FTQ has $5.9 billion in assets, whereas the rest of the LSIFs combined have $3.38 billion in assets. Solidarity FTQ, in its own reports shows much better performance than the other LSIFs, which is likely due to its economies of scale, historic mo-

---

512 A fund index of 130 Canadian LSIF funds and sub-funds http://globefunddb.theglobeandmail.com/gishome/plsql/gis.gen_fr?in_rep_type+ADM&in.

513 *See* Delaney, *supra* note 501e

514 *Id.*

515 *Id.*

nopoly on LSIF business in Quebec from the early 1980s until after 2000; and its size in relationship to the entire Quebec economy.[516] This author found only annual, and not cumulative rates of return in the English language data available on the Solidarity FTQ website[517]. It did show an average annual rate of return since inception of 4.9%,[518] which is substantially better than that of the rest of the LSIFs, and would clearly change the overall LSIF figures if included in the index. Table 5D (below) shows this comparison.

c) Financial Return Comparison Data

Table 6.4[519] (*see* Table 5A below) in Fung, Hebb and Rogers showed one, three and five year returns as of December 1998 from the February 1999 *Globe and Mail Fund Report*. It shows the Alliance LSIF Funds outperforming the non-Alliance LSIF funds substantially on one, three and five year average rates of return. Fung, Hebb and Rogers attributed some of this Alliance LSIF success to the strengths their social audits gave to their investment decision-making process.

> By using social audits, investors screen out attributes that can be associated with bad management, including poor labour relations, dangerous environmental practices, and disregard for consumers and communities. Economically Targeted Investments (ETI) opponents see these screens as distractions from securing the best possible return. The Alliance funds contend that social performance improvements require the sacrifice of profitability is simply inaccurate. At the close of 1998, Alliance-controlled funds, operating with a broad social and economic agenda, solidly outperformed mixed-board LSIFs, small-cap funds, and the Toronto Stock Exchange total return for that year.[520]

Below is a summary of the information on Fung, Hebb and Rogers, table 6.4 (Table 5A below) and more recent data from the Canadian Social Investment Organization. (SIO). The SIO data does not compare Alliance with non-Alliance funds. In 1999 (Table 5B) it compares Alliance funds against the average for small and mid –cap funds and in 2004 (Table 5C) it compares a group of LSIFs including Alliance and non-Alliance funds to a small cap index.

---

[516] *Id.*

[517] Fonds du Solidarit' FTQ Website http://www.fondsftq.com/internetfonds.nsf/VwebTimpAN/AprAcc?open document.

[518] *Id.*

[519] *See* Fung, Hebb & Rogers, *supra* note 449 at 143.

[520] *See id.* at 142.

TABLE 5A

As of 12/31/98 % return	1-year	3-year	5-year
Alliance Fund Average	6.27	6.94	7.01
Non-Alliance Fund Average	−5.33	0.16	2.11

From p. 143 of *Working Capital: The Power of Labor's Pensions*

The assertion about outperforming other funds may have been true in the late 1990s.[521] However, since the technology bubble burst in 2000, LSIF performance compared to listed small cap stock funds has not been good due to weak private equity markets and decreases in the tax incentives provided to LSIF investors.[522]

TABLE 5B

As of 12/31/99 % return	1 mo.	3 mo.	1-year	3-year	5-year	10-year
Alliance Fund Average	5.6	11.3	17.9	5.4	5.6	NA
All Canadian Small to Mid Cap Equity Funds Average	8.5	9.3	17.6	2.8	9.9	8.3

From *Socially Responsible Investment Organization Newsletter* Feb.2000 p.8 – Fund Performance

TABLE 5C

12/31/2004 % return	1 mo.	3 mo.	1-year	3-year	5-year	10-year
Labour Sponsored Venture Capital Funds	—	0.6	−1.3	−7.3	−6.0	0.9
BMO Nesbitt Burns Canadian Small Cap Index	—	9.9	14.1	17.3	12.4	10.7

From *Socially Responsible Investment Organization Newsletter* Website – Fund Performance 2004 (www.socialinvestment.ca/MutualFunds/Dec322004) This list includes Alliance and some of the non-Alliance LSIFs.

First Ontario's Ken Delaney opined that it was inappropriate to compare the LSIFs, which are required to invest in small and medium sized local businesses, to small cap stock indices comprised of publicly traded companies such as those in Tables 5B and 5C.[523] He said that the better comparison is to the rest of the venture capital industry. Indeed, a number of the LSIF funds are included in the Canadian Venture Capital and Private Equity Association data on venture capital companies.[524]

[521] *See* Delaney, *supra* note 501.

[522] *Id.*

[523] *Id.*

[524] Canadian Venture Capital & Private Equity Association, May 20, 2005 press release "Canadian venture Capital & Private Equity Performance Data" – the list of firms included

When compared to the whole Canadian venture capital industry[525] the LSIF returns seem comparable. Since 1996, LSIFs tend to invest a majority of their funds in later stage venture capital rounds. So it seems reasonable to compare their return on investment to those of other later stage venture capital investors in Canada. (See Table 5D) By that measure, they are behind their cohort in one and 5-year rate of return, but ahead of them in 3- and 10-year rates of return. So they are on a par with their cohort.

TABLE 5D. COMPARING RATE OF RETURN FOR OF LSIF INDEX[526] WITH CANADIAN VENTURE CAPITAL INDEX[527]

Investment % Returns	Total Assets	1-year	3-year	5-year	10-year	15-year	From Inception
Later Stage Venture Capital in Canada as of 12/31/04	NA	5.6	−4.3	−4.3	0.0	NA	
Toronto Globe Labour Sponsor Peer Index[528] 8/31/05	$3.4 billion[529]	−1.3	−3.23	−6.21	0.53	1.54	
Solidarity FTQ[530] as of 5/31/04	$5.9 billion[531]	5.0	NA – but annual return in 2002 −11.4%	NA but annual return in 2000 8.6	NA but annual return in 1995 11.6%		Average annual return since inception 4.9%

d) Do LSIF Rules Negatively Affect Returns on Investment

Do the LSIF rules regarding reinvestment within the province and the pacing rules put too many restraints on LSIF management, decreas-

---

traditional venture capital companies and some LSIFs – found 9/12/05 at http://www.cvac.ca/files/CVCA_Press_Release_Performance_Study_Dec_2004_final_May_20_2005_R.pdf.

525 Many of the LSIFs, like the First Ontario Fund, and GrowthWorks Working Opportunity Fund, are included in the Canadian Venture Capital and Private Equity Association, Press Release "Canadian Venture Capital & Private Equity Industry Performance Data" May 20, 2005 at 4.

526 Toronto Globe and Mail financial web site globeinvestor.com, found on 9/9/02 at http://globefunddb.theglobeandmail.com/gishome/plsql/gis.gen_fr?in_rep_type+LT&in_sor

527 Canadian Venture Capital & Private Equity Association, May 20, 2005 press release "Canadian venture Capital & Private Equity Performance Data" – the list of firms included traditional venture capital companies and some LSIFs – found 9/12/05 at http://www.cvac.ca/files/CVCA_Press_Release_Performance_Study_Dec_2004_final_May_20_2005_R.pdf".

528 This index does not include 3,5,10 and 15-year cumulative figures for Solidarity FTQ, so it covers only 43% of the LSIFs.

529 Author added all the assets listed for the 130 funds on the globeinvestor.com Labour Sponsored Venture Funds. Some of them did not list assets, including Solidarity FTQ. http://globefunddb.theglobeandmail.com/gishome/plsql/gis.gen_fr?in_rep_type+ADM&in.

530 The remaining 57% of the LSIF results are these from Solidarity FTQ, "Financial Highlights, Fund Returns" http/:www.fondsftq.com/interntefonds.nsf/VwebTimpAN/AprSta?opendocument.

531 *Id.*

ing the available eligible deal flow and forcing them to make some riskier investments than they would otherwise make if they had more latitude? Unlike private venture capital funds, LSIFs are required to reinvest in their home province and have "pacing rules" which require them to invest 50% of capital raised in January-February by December 31of that year and another 20% in the next year.[532] The geography may limit the available deals, especially when some qualified investments must be made within a time period in which the deal flow is not good. This author could not find sufficient data to address this question. But it is a question that should be considered by anyone seeking to replicate the LSIF model. Mismanagement seems to have been the primary problem leading to the Manitoba Crocus Fund going into receivership in 2005.[533] However, there is also speculation that Manitoba was too small a market to be able to successfully manage a fund with the requisite geographic and pacing restrictions. As a province with only one million people and 35,000 businesses, there may not have been adequate deal flow for Crocus to choose better investments and still follow the rules.[534]

> Do the LSIFs have adequate business oversight to protect them from making investments based on political pressure? A labor-sponsored fund is inherently subject to pressure from the labor unions that sponsor it to make investments to protect jobs in companies where its members work. However, a fund cannot survive if it gives in to such pressures. If labor is to have a major ownership position in such a fund, it must provide fund managers enough protection to allow them to do what is financially necessary, regardless of politics. The First Ontario Fund (FOF) has such a mechanism, which was sorely tested in a recent case of a USWA organized firm that was an FOF investee was losing substantial market share to Chinese competition. The FOF board of directors had 11 members, 6 from labor and 5 from business. However, the investment committee is comprised of the 5 business members. So when a decision had to be made whether to reinvest in the company in question, the investment committee determined that reinvestment was

532 Office of the Canadian Auditor General, Jon W. Singleton, Examination of the Crocus Investment Fund May 2005, Appendix G – Sections of the Income Tax Act Related to the Pacing Requirements of a Labour-Sponsored Fund.

533 *Id.* at 1.

534 Interview with Robert Warren, Executive Director, Asper School of Business Centre for Entrepreneurship, University of Manitoba (April 21, 2005).

> unwise, and FOF let the company close instead of reinvesting.[535]

6. *Devaluation of the Crocus Fund and its Implications*

The Manitoba Crocus Investment Fund was one of the small LSIFs, with total assets of approximately $100 million or less in 2004.[536]

On April 4, 2005, the Manitoba Securities Commission issued allegations against the Crocus Fund for mismanagement leading to a sharp drop in share value from $10.45 per share to less than $7 per share, which it did not determine or report in a timely manner to investors.

In the investigation, the Auditor General found many instances of mismanagement at Crocus but did not generalize these to the LSIF industry.[537] In fact, the Auditor General's report described the socially responsible investment process, as one that should have been a good Crocus safeguard. However, it was not always followed:

> Socially Responsible Investing (SRI) reviews have had a positive impact on the investment decision-making process. However, there have been instances where the former CEO and former CIO have curtailed the review process. Had these SRI reviews been completed, the results may have influenced the Board's decision to invest.[538]

The Crocus board of directors was comprised primarily of union leaders. The board members had little experience sitting on fund boards or dealing with venture capital decisions. It is likely that they relied heavily on their staff. Their staff was small and had not only the normal venture capital staff duties of seeking, analyzing, structuring and financing deals, but also had to perform social audits, train union leaders to sell securities and sold securities to inexperienced investors including their Board members union constituents. Unlike the First Ontario Fund, whose investment committee is made up of its board members from the business community (who have the final say on investment decisions), Crocus left this work to its staff.[539] Staff can have trouble staying detached

---

535 *See* Delaney, *supra* note 501.

536 JOHN W. SINGLETON, OFFICE OF THE CANADIAN AUDITOR GENERAL, EXAMINATION OF THE CROCUS INVESTMENT FUND 30-31 (2005), http://oag.mb.ca/reports/2004/crocus/OAGcrocus.pdf. However, the exact value of the Crocus assets is a key question in the Auditor General's report, as the Fund was place in receivership by the Canadian Securities Commission in 2005, when serious questions arose about overvaluation of its investments.

537 *Id.* at 6-12.

538 *Id.* at 10.

539 *See* Delaney, *supra* note 501.

from companies they know very well as investees.[540] The Crocus Fund lacked the oversight of a sufficient number of hard-nosed business people. It may also be that Crocus was operating in too small a universe to successfully accomplish all its diverse objectives. The pacing rules, requiring fairly quick investment of funds, upon receipt, may have contributed to Crocus's problems. Additionally, the fund was required to invest in Manitoba companies within tight time limits, but the provincial population was only 1,000,000 with 35,000 businesses.[541] In such a small universe they likely lacked the diversity and size of deal flow necessary to choose optimum investments. Operating within the same limitations, but in the larger Quebec economy, the very large Solidarity FTQ, has avoided these problems so far.

The LSIF model is not inherently flawed, but if it is to be used as a model for Fair Exchange community trusts, several important lessons must be taken from the Crocus experience. A Fair Exchange trust board must have a more balanced board including a more equal distribution of labor, business and government members. Additionally, any founding legislation must provide latitude to invest as slowly as necessary in the local community to make sound investments. It should also provide guidance similar to the Alaska Permanent Fund legislation regarding specific types of safer investments permitted or even required for some portion of the fund.

7. *Difficulty in Comparing Performance of LSIFs (Alliance and Non-Alliance) to Comparable Commercial Funds*

It is as difficult to compare Alliance LSIFs with traditional investment funds, as it is to compare the Alaska Permanent Fund and the Alberta Heritage Fund. Just as the Heritage Fund seeks to provide a variety of non-financial community benefits to Albertans, Alliance LSIFs are focused on job retention and investing in successful local companies that are socially and environmentally responsible. These criteria narrow considerably the universe of companies in which Alliance LSIFs can invest. They are especially restricted for an LSIF such as Crocus in Manitoba. Whereas the APF's goals are to grow, inflation-proof itself and generate dividends, regardless of the social impact of the companies in which it invest; the Heritage Fund and Alliance LSIFs have numerous other social goals.

Measurement of these alternate goals is difficult because there is not an alternate reality for comparison. Whatever the socially active funds did to change employment or environmental circumstances, they

[540] *Id.*
[541] *See* Warren, *supra* note 534.

changed the circumstances against which they would otherwise be measured. This issue presages a discussion in the section below on Community Benefit Agreements about developing metrics to measure social and community benefit. As we do not yet have these metrics, or at least no consensus on them, it is easy to overlook these benefits and concentrate on the available hard numbers. The three studies by Regional Data Corporation cited above have attempted to measure community benefit by creating a model of the economy as it would likely have grown without the LSIFs, and measuring the additional impact of the LSIFs.[542]

The hard numbers are provided in Tables 6A-D above. But they do not present the whole story. Economist Melissa Moye discussed this issue in her comparison of three early studies on the efficacy of the LSIFs.[543] Moye argued that,

> The narrow cost-benefit analysis method, used primarily in evaluating private sector investments, compares only direct dollar benefits with direct costs in assigning a value to an investment project. In the public setting, however, most economists reason that such narrow cost-benefit analyses should not be the only method used for valuing a potential public investment. The narrow cost-benefit study should be used to identify and minimize costs. However, most analysts agree that indirect effects (such as increased tax revenue due to increased production among supplier firms), induced effects (such as increased tax revenue from higher consumer spending resulting from more employment) and intangible or qualitative effects (such as increased networking among

---

[542] Regional Data Corporation, "*Analysis of Fiscal Costs and Fiscal and Economic Impact of Ontario Labour-Sponsored Investment Funds*", May 2004 at 6-15.

[543] Melissa Moye, "*Review of Studies Assessing the Impact of Labor-Sponsored Investment Funds in Canada*," Work & Technology Institute, (no date, after 1995) found at http://www.uswa.org/uswa/program/content/438.php (3/27/05) The three analyses of LSIFs she examined were: "*The Fonds de Solidarité des Travailleurs du Québec: A Cost-Benefit Analysis* by Suret, *Impact Economique et Fiscal Des Investissements du Fonds de Solidarité des Travailleurs du Québec (FTQ), 1984-1993*, by Lamond, Martineau and Allen and *Economic and Fiscal Impacts of the Fonds de Solidarité des Travailleurs du Québecès Investments, 1984-93* by Jackson and LaMontagne. The Suret study was commissioned by the Fraser Institute and resulted in a negative evaluation of the net benefit of the FTQ. The Lamond, Martineau and Allen study was commissioned by the FTQ through Quebec's Institut National de la Recherche Scientifique (INRS) to assess the overall fiscal impacts of the fund's investments on the Quebec economy. The results of the INRS study, in contrast to those of the Suret study, showed a positive net impact. The INRS study's methods for computing the costs and benefits of the FTQ became the basis for a study by the CLMPC research team of Jackson and LaMontagne. The latter study used essentially the same methodology on an expanded sample of cases of seven FTQ investee firms and three investee firms of the Working Opportunities Fund in British Columbia."

> regional businesses) should also be considered when making public investment decisions."[544]

Moye concluded that comprehensive methods, which include collateral effects, but make conservative assumptions to guard against exaggerating benefits, are the best methods for evaluating the return on LSIF investments.[545]

The figures in the Tables 6 B and C above make a comparison on very narrow financial criteria. Fair Exchange, community benefit agreements, LSIFs, the Alaska and Alberta Funds and all similar ventures would benefit greatly from a comprehensive, uniform and agreed-upon system for measuring collateral social benefit, just as financial markets benefit from the existence of Generally Accepted Accounting Practices (GAAP).

8. *Lessons for Fair Exchange from LSIFs*

LSIFs have a 15 to 20 year history of providing a critically important community-based source of capital and creating and saving local jobs. In this era of mobile capital, having a source and mechanism for generating and growing productive capital is important for maintaining communities. LSIFs are a new and complex phenomenon. Just as the Alberta Heritage Fund stumbled before it reorganized itself as an endowment, LSIFs undoubtedly will make mistakes before they stabilize and become stronger. Fair Exchange community trusts should study the various LSIF funds as they develop. They have diverse experiences because they operate under different provincial laws and economic conditions. It is important to note that the size and diversity of Solidarity FTQ has enabled it to reap economies of scale and its stock value to rebound to reasonably good returns after taking a value hit in 2002-03.[546] Fair Exchange programs need to learn from the governance and management problems that undermined Crocus. Furthermore, the sheer number of LSIFs in Ontario, plus the requirement that a licensed broker must supervise union member salespeople, causes those funds to have much higher expenses than Solidarity.[547]

The language in the Airline Stabilization Act, the Chrysler Loan Guarantee Act or the Alaska Constitution seem like the best models for Fair Exchange programs to acquire equity or funds. LSIFs provide important models and lessons to consider in structuring asset management and distribution mechanism for the Fair Exchange Community Trusts de-

---

544 Melissa Moye, *supra* note 543, at 3-8.

545 *Id.* at 8.

546 Fonds de Solidarité, FTQ *Financial Highlights, Fund Returns,* Sept. 9, 2005, http://www.fondsftq.com/intemetfonds.nsf/VwebTimpAN/AprSta?opendocument.

547 *See* Delaney, *supra* note 501.

scribed in the Fair Exchange model legislation (section IV below). Those interested in Fair Exchange should consult with LSIFs' executive staffs to solicit ideas about how they might change LSIFs if they could start from scratch.[548] Perhaps the best asset management and distribution model would combine the best features of the LSIF and Alaska Permanent Fund models. Such a fund might manage a portion of its fund using portfolio diversity rules based on the conservative Alaska investment rules, while investing another fund portion with a well-governed and socially responsible focus on local re-investment. Or perhaps it would provide that a portion of the Community Trust interest or dividends would go into individual citizen accounts, as in Alaska, but the actual equity shares or funds would be controlled by a more diverse version of an LSIF board. In order to ensure that the individual accounts were used for economic development, one might limit citizens' use of their individual account assets to education, business investment, home purchase, retirement and medical emergencies.

The advantage of using an LSIF-type entity for asset management and distribution is that its investment strategy has a clear focus on the needs of the local citizens, and strives to maintain a clear business focus and discipline when making investments. Their success at maintaining this discipline has been hampered by size and pacing rules, which must be considered when adapting them to Fair Exchange models. Although the Alaska Permanent Fund Trustees do not focus their investments in Alaska or use any social investment criteria, they do use standard endowment management practices and investment discipline successfully. By contrast, Alberta found its Heritage Fund less focused and too susceptible to political pressure because it is operated entirely within the government. These concerns seem to be balanced by LSIFs such as Solidarity FTQ, which uses the provincial labor federation as a stand-in for informed citizen interest. The labor federations include financial professionals on the LSIF boards and hire professional staff to perform financial due diligence and social audits.

Thus, the LSIF boards serve a function similar to the Alaska Fund Trustees, with a greater focus on preserving local jobs and economic vigor, but without the pressure of being elected government officials. The role of the labor movement in Canada enables labor to serve as a well-informed citizen-surrogate. In states and countries where a social contract is understood to exist between labor, management and government, this arrangement should be replicable. In countries such as the U.S., a tri-partite board is a more attainable objective.

---

[548] *Id.*; Author's telephone interview with Lawrence Euteneier of Industry Canada on 9/16/05 in which he described an upcoming meeting of LSIF leaders to discuss best practices.

To make the LSIF model work one must find a strong organization committed to working people, with checks and balances that help it withstand corruption and ensure proper financial and social oversight, to fill the well-informed citizen-surrogate role. A cooperative federation might also fill this function, as in Mondragon.[549]

It is worth considering the TVA board as an alternative model that could be used in a large community trust. Its advantage over the well-informed citizen-surrogate leadership model is that such board members are usually part-time or volunteer, while TVA board members work full-time in their roles. Furthermore, TVA board members are appointed by the President and can be removed by Congress. This is similar to the role of the Alaska Permanent Fund Trustees. However, unlike the Alaska Fund trustees, who invest in Wall Street, the TVA invests its resources entirely for local development.

There have been suggestions of creating something similar to the TVA to deal with rebuilding Louisiana, Mississippi and Texas after the enormous damage caused by hurricanes in 2005. For example, Senator Ted Kennedy (D-MA) proposed establishing a Gulf Coast Redevelopment Authority based on the TVA.[550]

F. NEW YORK STATE INVESTMENT FUNDS

The State of New York has several public investment funds that incorporate aspects of Fair Exchange and aspects of the LSIFs.

The New York State Common Retirement Fund (CRF) has $120 billion in assets, overseen by its sole trustee, State Comptroller Alan Hevesi. The CRF created an in-state private equity investment program and committed $364 million to eleven private fund managers throughout the state. The program supplies capital for local businesses and provides market-rate returns for the pension fund.[551] On July 26, 2005, CRF announced that through one of its private equity funds it had invested $2.1

---

[549] Mondragon is a cooperative community in Spain that has created and operates over 100 cooperative industrial businesses over the past forty years that now operate an external corporation. They created a community bank that enabled their phenomenal growth. Mondragon is likely one of the models considered by those who created the LSIFs. *See* RACE MATTHEWS, JOBS OF OUR OWN: BUILDING A STAKEHOLDER SOCIETY 240-44 (Pluto Press 1999), *See generally* WILLIAM FOOTE WHYTE & KATHLEEN KING WHYTE, MAKING OF MONDRAGON: THE GROWTH AND DYNAMICS OF THE WORKER'S COOPERATIVE COMPLEX (ILR Press 1988) (analyzes the unexpected success the worker cooperative of Mondragon and its demonstrated capacity for economic growth and long term survival).

[550] WSVN-TV and Associated Press, "Rebuilding Gulf Coast after Katrina most expensive U.S. reconstruction project to date", *at* http://wwwd.wsvn.com/news/articles/national/MIA7332.

[551] Press Release, Alan G. Hevesi, New York State Comptroller, To Announce Investment in Binghamton Firm Knovel Corp. to Use Funds to Create 30 Jobs in Binghamton, Norwich and New York City (July 26, 2005), *at* http://www.osc.state.ny.us/press/releases/jul05/072605a.htm (last visited Oct. 23, 2005).

million in Knovel Corporation, a provider of online information services for scientists and engineers. The company plans to create thirty new jobs between 2005 and 2008.[552] The advantage of this arrangement as compared to tax abatements with job promises is that even if all the jobs do not materialize in New York State, the CRF will benefit from the success of this company. If Knovel is a smashing success, the CRF will see significant upside benefit on its investment, and the State of New York may obtain more than thirty jobs. In this instance, the public's money is being invested for a true market type of Fair Exchange. Although $364 million is a small fraction of the $120 billion fund, it would be imprudent for a large portion of the pension fund to be invested in such venture capital schemes.

New York also has a Small Business Technology Investment Fund (SBTIF).[553] SBTIF makes early-stage equity and debt investments in technology-based companies in New York State. The companies must have innovative products that materially advance technology and provide the state and local communities with an economic benefit. Established in 1981 with federal and state funds, the total capitalization of SBTIF from 1981 to1995 was $15.3 million. It approved over 130 investments, closed 110, and 38 remain active. Using funds acquired from returns on its equity investments the Fund had $40 million invested in 2005. Since 1981,it has created more than 2,500 jobs, with an average salary of $60,000. SBTIF achieved evergreen status in 1995, with all expenses being paid by the Fund since 1990. Therefore, the Fund currently operates at no expense to taxpayers. Similar funds include Connecticut Innovations, the Ben Franklin Fund of Pennsylvania, and U.S. government-funded research and development initiatives.[554]

These New York funds demonstrate pro-active fair exchange investments, where the government gets an upside reward for taking risks and reinvests those funds to create additional jobs and economic activity. These models are likely easier to replicate than the LSIF or Alaska models. However, the government ownership aspect of the New York funds may be more politically acceptable in liberal New York than in other states. For other states, models, such as the Alaska Permanent Fund, that provide direct payback to citizens may be more politically viable.

---

[552] *Id.*

[553] Presentation by Jack VanWie, retired Executive Director, Small Business Technology Investment Fund (SBTIF) (taken from a PowerPoint presentation created by Jack VanWie for a Fair Exchange conference held on Oct. 7, 2005).

[554] *Id.*

G. COMMUNITY LAND TRUSTS (CLT)

1. *What is a CLT?*

A community land trust (CLT) is a private non-profit corporation created to acquire and hold land for the benefit of a community. CLTs are commonly used by community development organizations to provide secure affordable access to land and housing for community residents.[555] Environmental groups commonly use CLTs to obtain land and preserve it in its natural state or to gain significant leverage in negotiations with governments or developers concerning contiguous developments.

Although different communities use them for different purposes, the E.F. Schumacher Society, which provides technical assistance in creating CLTs, defines a CLT as a form of common land ownership with a charter based on the principles of sustainable and ecologically sound stewardship and use. A democratically governed group holds the land in a CLT in trust, while individuals own the buildings and the improvements created by their own labor and investment. Through an inheritable and renewable 99-year lease, the trust removes land from the speculative market and facilitates multiple uses such as affordable housing, agriculture, and open space preservation.[556]

For example the Institute for Community Economics (ICE) uses CLTs to:

> attempt to meet the needs of residents least served by the prevailing market. Community land trusts help communities to: gain control over local land use and reduce absentee ownership; provide affordable housing for lower income residents in the community; promote resident ownership and control of housing; keep housing affordable for future residents; capture the value of public investment for long-term community benefit; and build a strong base for community action.[557]

ICE's model CLT provides affordable housing by allowing the homeowner to purchase a home on land leased from the CLT. The 99-year renewable lease permits the homeowner and his descendents to live there for as long as they wish. However, when homeowners want to sell, the land lease requires them to sell back to the CLT or to another low-income household at an affordable price.[558]

---

[555] Institute for Community Economics web site www.iceclt.org.clt (last visited 3/28/05).

[556] E.F. Schumacher Society web site; http://www.schumachersociety.org/frameset_land.html (found 3/28/05).

[557] Institute for Community Economics web site www.iceclt.org.clt (last visited 3/28/05).

[558] *Id.*

The ICE model is a membership organization with two classes of voting members. One group is composed of people who live in the homes or use the land in other ways, such as for agriculture. The other group is made up of other community members or organizations interested in perpetuating the CLT's goal. Usually a CLT board has three types of members: representatives of the land users, representatives of the non-resident members, and representatives of the broader community interest.[559]

If the founding organization is a community development corporation, it may fill the role of non-resident members and have a strong voice in filling the broader community interest seats. For example, the Cowichan Community Land Trust Society objective is: "In the face of increasing pressure on land, CCLT is committed to conserving, protecting, and enhancing the quality of the human and natural environment in and near the Cowichan Valley Regional District, British Columbia, Canada."[560] To accomplish this objective, CCLT works with other groups and with government, educates people in the community, provides assistance and guidance to landowners, promotes a cooperative approach to conservation, protects critical land, and holds conservation covenants.[561]

2. *Lessons from CLTs for Fair Exchange*

CLTs are private non-profit undertakings. Similar to cooperatives or charitable non-profits, CLTs are private entities financed by their organizers, private donors, or foundations. Unlike most of the examples described above, they generally have no direct connection to a government. They benefit Fair Exchange programs as examples of long-term structures that balance diverse interests in shared property.

CLTs governance structure achieves an important balance between the needs of individuals and the community. Fair Exchange programs will need to develop long-term structures that balance the needs of individuals, business, community, and government.

H. RELATIONSHIP OF PRECEDENTS TO FAIR EXCHANGE MODELS

At least three aspects should be considered when evaluating Fair Exchange precedents and considering potential models: 1) acquisition, 2) distribution, and 3) governance. Acquisition is the means used by the community to obtain ownership interests in the businesses it aids. Distribution is the mechanism used to allocate assets to citizens, either jointly or severally. Governance describes how a board of directors, represent-

---

559 *Id.*

560 Cowichan Community Land Trust Society web site, http://www.island.net/~cclt/whatwedo.htm (last visited 3/28/05).

561 *Id.*

ing the citizens, asserts its ownership prerogatives. The historical examples above were provided as working models of some Fair Exchange features in the following categories.

Acquisition examples include: TVA, Lockheed, Conrail, Alaska Permanent Fund, Alberta Heritage Fund, Chrysler and the Airline Stabilization Act. The last four provide the best examples of a fair exchange acquisition.

Distribution examples include: the Homestead Act Alaska Permanent Fund, Canadian LSIFs, and community land trusts. I favor some combination of the Alaska Permanent Fund and the LSIF models for distribution.

Governance in Fair Exchange trusts will likely require use of features of the Airline Stabilization Act, the Alaska Permanent Fund, the Labor Sponsored Investment Funds, community land trusts, and possibly the TVA.

Negotiation of a Fair Exchange agreement will require a standard system for quantifying those community benefits that cannot easily be monetized.

IV. FAIR EXCHANGE MODELS

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

A. International Trade Rules

The following federal legislation would also make sense as a requirement in international agreements, or at least as an exemption from rules that prevent communities from giving preference to local businesses. This paper was funded by a source focused solely on the United States. However, Kenneth Thomas, an expert on international trade agreements, reviewed the Fair Exchange proposals herein and concluded that they would not violate the World Trade Organization's Agreement on Subsidies and Countervailing Measures. Furthermore, Fair Exchanges would likely pass the European Union rules for government subsidies to businesses under the Treaty of Rome because they are structured like market transactions.[562]

---

[562] Kenneth Thomas, *Fair Exchange at the National and International Level* (October 14, 2005) (post – Fair Exchange Confernce paper) *available at* http://www.capitalownership.org.

B. FEDERAL LEGISLATION TO LEVEL THE PLAYING FIELD BETWEEN STATES AND COMMUNITIES

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

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

C. FEDERAL "SAFE HARBOR" MODEL FOR LOCAL LAWS

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

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

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

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

"*Quid pro quo*" means an amount equivalent to the Government Investment in corporate common stock or preferred stock or stock war-

rants convertible into such common stock if the Company is a stock company, or its equivalent in cash), or similar ownership rights in any other business form (hereinafter collectively referred to generally as "Company Stock") in the Company. Said Company Stock shall have the greatest voting and dividend rights of any other class of Company Stock owned by the Company. For liability reasons, a community trust may prefer to refrain from becoming partners or LLC members with a company, and instead obtain escrow or bonds.

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

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

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

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

model – such as that used in Alberta; or 4) to try something based on the TVA model.)

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

D. MODEL FOR INVESTMENT OF FEDERAL FUNDS IN BUSINESSES: THE FAIR EXCHANGE INVESTMENT AND TAXPAYER PROTECTION ACT (FAIR EXCHANGE ACT) OF 2005 DRAFT, ("FAIR EXCHANGE ACT")

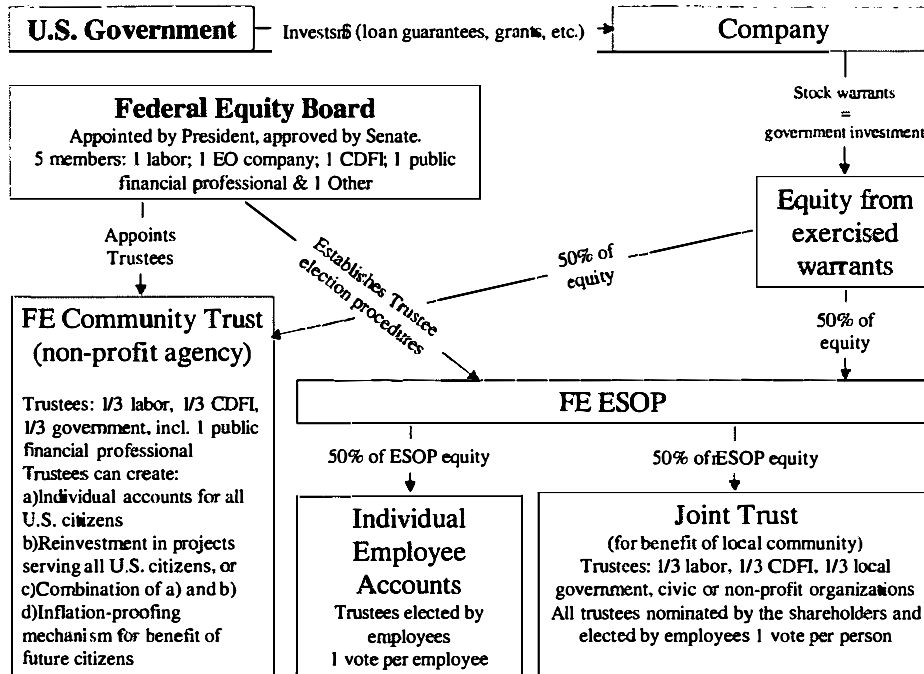
In summary, the sample Fair Exchange Act language below provides the following.

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

The Fair Exchange Community Trust (Community Trust) is a nonprofit entity whose board is appointed by the Equity Board. It decides how to allocate its half of the stock between individual and community needs and future security within certain parameters. It is the body

charged with being the LSIF- type board or Alaska Permanent Fund-type trustees.) Figure 6 (below) is a diagram of the trusts created under the Fair Exchange Act, the trustee appointments and uses of funds.

FIGURE 6. FAIR EXCHANGE TAXPAYER INVESTMENT PROTECTION ACT OF 2005



FAIR EXCHANGE ACT ARTICLE I – PREAMBLE

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

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

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

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

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

Whereas, many individual taxpayers are also harmed by loss of employment due to the circumstances that cause companies to seek govern-

ment grants, loans and/or loan guarantees, tax abatements, favorable licenses, etc. (hereinafter referred to as "Government Investment"), and

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

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

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

FAIR EXCHANGE ACT ARTICLE II – CREATING THE FEDERAL EQUITY EXCHANGE BOARD

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

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

B) The Equity Board shall include five members appointed by the President with the advice and consent of the Senate. However, there must be at least one each from a community development financial institu-

tion, one from a national labor federation, one from a majority employee owned business and one with substantial experience investing assets for public benefit or a broad based pension plan.

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

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

FAIR EXCHANGE ACT ARTICLE III - POWERS AND FUNCTIONS OF THE EQUITY BOARD, FESSOP AND FAIR EXCHANGE COMMUNITY TRUST

A) The Equity Board shall obtain contracts under which the Government, the Business's employees and all current U.S. taxpayers shall participate in gain of the participating Business and/or its security holders through use of common or preferred stock and instruments such as warrants and stock options or other appropriate equity instruments as follows:
   1) In exchange for any direct grant of funds to the Business, the Business shall provide stock (or its equivalent in a non-stock business) meeting all the requirements of IRC Sec.409 (a) (with the exceptions noted in paragraph 2 below) and shall contribute qualifying employer securities, as defined in IRC Sec.4975 (e)(7) and (8), with fair market value, as defined in ERISA 29 USC Sec. 1108(e) equivalent to the value of the grant made, which shall be divided equally between:
      a) a Fair Exchange ESOP, defined in Section A (2) below (hereinafter "Fair Exchange Fair Exchange ESOP") and
      b) a Fair Exchange Community Trust (hereinafter "Community Trust"), defined in Section A (4) below.
   2) The Business shall create a qualified Fair Exchange ESOP that shall be:
      a) An employee stock ownership plan meeting the all the requirements of IRC Sec.409 (a) (with the exceptions noted in paragraph 2(b) below) and shall contribute qualifying employer securities, as defined in IRC Sec.4975 (e)(7) and (8), with fair market value, as defined in ERISA 29 USC Sec. 1108(e) equivalent to 50% of the value of the grant made.
      b) A qualified Fair Exchange ESOP shall include the following features in addition to the requirements noted in paragraph 2(a) above, and (where these conflict with IRC Sec. 409(a), the requirements of this paragraph shall take precedence). These requirements include:

i. The majority of the Trustees of the Fair Exchange ESOP shall be elected on a one vote per person basis by the Fair Exchange ESOP participants, pursuant to procedures and regulations established by the Equity Board.

ii. Allocations to the individual accounts of individual participants in a Fair Exchange ESOP shall be made from one half of the contributed stock;

iii. The other half of the stock contributed to the Fair Exchange ESOP shall be allocated to the "Fair Exchange ESOP Joint Trust". The Fair Exchange ESOP Joint Trust shall hold its interest in the Fair Exchange ESOP stock for the benefit of current and future employees and the local community. Its Trustees shall be elected as follows: 1/3 by shareholders; 1/3 by the employees on a one vote per person basis; and 1/3 shall be comprised of representatives of local governmental, civic or non-profit organizations (located in communities where the Business has facilities) nominated by the shareholders and approved by vote of the employees on a one vote per person basis.

3) The Equity Board shall create a qualified Fair Exchange Community Trust (Community Trust) to which the Business will give the remaining 50% of the stock or equivalent required in Section a (1)(b) above.

4) A Community Trust shall be a non-profit agency with a board appointed by the Equity Board. Its board shall include an equal number of representatives from labor, community development financial institutions and government and at least one member with substantial experience investing assets for public benefit or a broad based pension plan.

The Community Trust is empowered to:

a. Create individual accounts to annually allocate the equity or its income equally to each person who that year qualifies as a citizen of the U.S.; or

b. Create a community reinvestment plan to use the equity or its income for projects that serve all the citizens of the U.S.; or

c. Create some combination of the individual accounts and community reinvestment plan described above;

d. Use its best efforts to create an inflation-proofing mechanism to provide a stream of income for future citizens as well as current citizens.

E. STATE STATUTORY LANGUAGE EXAMPLE

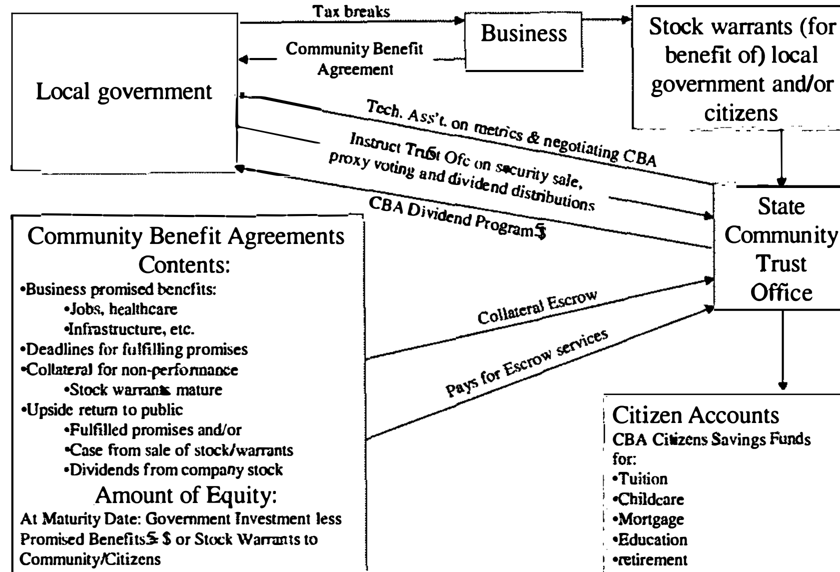
There is not a single model for Fair Exchange; it is a concept in need of pilot projects. Therefore, this single state model is not intended to be the primary state or local model, but rather one example of applying the information garnered from this article to create a model fitting a particular legislator's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

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

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

In summary, the sample language below: 1) creates a trustee in the state treasurer's office who can hold stock, warrants, other securities or escrow funds negotiated in a Community Benefit Agreement, and paid for our of the trusts it manages; 2) defines a Securitized Community Benefit Agreement as a contract between a community, a business receiving special government benefits and a community trust organization in which the business promises to provide very specific benefits to the community in exchange for its investment in the Company; 3) requires the parties to agree on metrics to measure performance of these promises and firm dates by which performance is required; and 4) provides that to the extent full performance is not timely performed, a corollary percent of the security becomes permanently vested in the community trust. (See Figure 7)

FIGURE 7. STATE (TRUST OFFICE) FAIR EXCHANGE MODEL



EXAMPLE:

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

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

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

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

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

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

NOW THEREFORE, the State of _________ hereby creates a structure enabling the State and local governments to enter into community benefit agreements with businesses. It provides a State trustee to hold collateral or escrow from companies for communities derived from community benefit agreements. Nothing herein shall prevent a local government from creating its own community trust to hold and manage such assets, nor require that the State trustee hold such assets. The trust structure is intended to provide cost savings and enhance expertise by pooling trustee services for interested communities. The trustee services will be

paid on a fee for service basis by the trusts utilizing it. The trustee disperses the funds at the direction of the community government for any of the permitted purposes.

a. The State of ________ hereby creates a statewide community trust office in the State Department of Treasury, "________ Community Trust Office" ("Trust Office"), which shall administer assets obtained as security for Community Benefit Agreements (CBAs).

b. Any "Community," defined in Sec.(c) below, may enter into a "Securitized Community Benefit Agreement" ("Securitized CBA"), defined in Sec.(c) below, with a "Business", defined in Sec.(c) below. Any Securitized CBA which meets the requirements of this statute may, upon community request, be administered by the Trust Office in cooperation with the local Community as provided in this statute.

c. When a "Community" *(NOTE: as defined in whatever section of ________ Code defines all boards of directors for governments in ________ from the state on down to the township and school authority – citation to be added)* invests in a private business (hereinafter "Business") by providing it with special benefits not given to all taxpayers in the ordinary course (hereinafter "Government Investment"), such as a tax abatement, a gift of land or any other thing of value for which less than a market price is paid to the Community; the Community may enter into a securitized Community Benefit Agreement (Securitized CBA) defined as:

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

d. The Trust Office shall hold the Securitized CBA Security in trust for the Community in accordance with the terms of the Securitized CBA.

e. Every Security Agreement shall have one Maturity Date or series of Maturity Dates. The Securitized CBA may state specific non-Securitized CBA "Promised Benefits" (Company Promised Benefits) to be provided to the Community by the Company by no later than the Maturity Date(s) specified in the Securitized CBA;

f. The Securitized CBA shall include metrics (meeting the requirements of Trust Office regulations *to be promulgated*) to quantify the Government Investments and any Company Promised Benefits enumerated in the Securitized CBA to enable both parties to

measure partial and complete Company Promised Benefits performance;

g. Upon the Maturity Date the Securitized CBA Security shall mature. For any portion of Company Promised Benefits not performed by the Maturity Date, that portion of the Securitized CBA Security shall become the inalienable property of the Trust Office for the benefit of the Community

h. Unless another type of Securitized CBA Security (meeting requirements of Trust Office regulations to be promulgated) is mutually agreed upon by the parties, the Securitized CBA Security shall be corporate common stock (if the Company is a stock company), or similar ownership rights in any other business form (hereinafter collectively referred to generally as " Securitized CBA Stock" in the Company with the greatest voting and dividend rights or preferred stock convertible into such common stock or its equivalent in cash. For liability reasons, a community trust may prefer to refrain from becoming partners or LLC members with a company, and instead obtain escrow or bonds.

i. The Securitized CBA shall provide that no later than the closing date of the Government Investment transaction, the Company issue Securitized CBA Security warrants in the name of the Trust Office for the benefit of the Community. Said warrants shall mature on the Maturity Date(s) in the total amount of the Government Investment less the value of the Company Promised Benefits (as measured by the agreed upon metric described in Sec. (f) above) as of the relevant Maturity Date

j. The matured warrants shall then be retained or sold by the Trust Office as directed by the Community government. A Community may direct the Trust Office to use the dividends and/or proceeds from sale of the Securitized CBA Stock for any of the following within the Community's jurisdiction (as instructed by the Community governing Board of Directors): utility subsidy to every Community ratepayer; public parks, public schools, public safety, fire protection, environmental clean-up, arts & culture or savings funds for every citizen which may be withdrawn without penalty for tuition, licensed child care for children of working or studying parents, home purchase, local business investment (to be further defined), retirement or health care.

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

F. FAIR EXCHANGE ADDS SELF-ENFORCEMENT FEATURE TO COMMUNITY BENEFIT AGREEMENTS

Note that the state model, with the community benefit agreement (above), unlike the other models, does not require that the business give up any equity permanently as an upside for risk. This model is designed for those situations where the community is more interested in getting other benefits such as jobs with health insurance, than it is in getting an equity investment. The new feature this state Fair Exchange model adds to community benefit agreements is self-enforcement. Unlike a typical contract or a state clawback law, which courts would need to enforce, the equity collateral or escrow is in the hands of the community trust when the subsidy deal closes.[563] Non-compliance by the business triggers maturity of the warrants, and the community trust owns stock or retrieves the escrow. Such escrows are fairly standard in substantial business contracts.

V. ISSUES CONFRONTING POTENTIAL FAIR EXCHANGE LEGISLATION

A. THE BENEFITS OF MANDATORY FEDERAL LEGISLATION

Given the competition for the location of new business facilities among local governments, mandatory federal legislation is the best option for fair exchange programs. One of the most difficult obstacles to implementing a Fair Exchange proposal is the competition between communities when companies are seeking locations for new facilities and jobs.[564] There are many examples of companies asking communities to make bids for a plant, and significant examples where the community paid for far more than it received.[565] Many local leaders and politicians see the logic of the Fair Exchange idea, but believe it is politically impossible to create any such obstacles to potential new jobs in their communities. This way of thinking has led to ever-larger public incentives and investments in private businesses, without protection.

The fact that the U.S. government required, received and made a profit on its Chrysler stock warrants is not widely known.[566] Even more obscure is the fact that every loan and loan guarantee given by the Airline Stabilization Board required and received stock warrants.[567] These

[563] LEROY, *supra* note 1, at 43-54.

[564] *See id.*

[565] *See id.* at 4-5.

[566] *See supra* Part I(F) discussing 1979 Chrysler Corporation Loan Guarantee Act.

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

are clear federal precedents. Furthermore, in a report by the *(GAO),*[568] one of the key recommendations is for the government to get potential "upside" benefits should it decide to make such an investment again. With the change of a few words, the language of the ASTSSA could be amended to require equity in any situation where the federal government makes a loan or loan guarantee or other such investment. It need not be limited to airlines.[569] The FEITPA 2005 model above is based on existing ASTSSA and ESOP laws.

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

B. GETTING INITIAL LEGISLATION PASSED ARGUES FOR OPTIONAL AND LOCAL

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

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

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

---

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

569 Compare the language in the "Model for investment of federal funds in businesses: The Fair Exchange Investment and Taxpayer Protection Act of 2005" with ATSSSAl 15 Stat. 230, 49 U.S.C. 40101 Sections 102 (b) and (d).

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

C. FORM OF FAIR EXCHANGE

Many communities negotiating with businesses over development funds are more interested in immediate benefits such as jobs, than in ownership of stock, which may be volatile or not readily marketable. Use of stock warrants as collateral to ensure performance of other types of promises enables FE to be incorporated in a broad array of community benefit agreements. "State Statutory Language Example" above addresses this problem.

Prof. Lawrence Mitchell noted that the complexity of the FE could make it quite difficult to get legislation enacted. He suggested that a Fair Exchange Commission, like the Securities and Exchange Commission, could be created. The law would provide a set of general principles and rules and allow the Commission rulemaking authority to deal with the myriad details.[570]

D. TYPES OF GOVERNMENT LARGESSE FOR WHICH TO REQUIRE FE

Certain forms of special government benefits to companies are obvious candidates for FE rules, for example tax abatements, royalties for use of natural resources, grazing rights, pollution permits, grants of cash or land and loan guarantees to create jobs. One area where FE requirements might generate less of the necessary public good are loan subsidies to create low-income housing. Here, the government might be trading needed new housing stock for equity. Yet even in the housing programs there may be room for more FE. There are housing subsidy programs in which the developers are only required to make the units available at a subsidized rate for a specified period. One should consider whether, at the point the subsidies end, the government or a community land trust should have a first right of refusal to buy those assets to retain their subsidized character, and to be credited in the purchase with some of the financial benefit gained by the developer.

E. COMPOSITION OF THE COMMUNITY TRUST TO ADMINISTER THE FAIR EXCHANGE ASSETS

As the historical examples above show it is tough to find the right combination to protect the interests of the government, individual citizens as employees, job seekers, investors and neighbors to the develop-

[570] Professor Lawrence Mitchellz oral presentation at the COG Fair Exchange Conference, George Washington University Law School (Oct. 7, 2005).

ment. The examples in the above "Fair Exchange Models" section are an attempt to synthesize some of the best qualities of the Alaska Permanent Fund, the Alberta Heritage Fund and the Labor Sponsored Investment Funds. In each instance the government body creating the Fair Exchange system needs to balance its goals on several parameters: 1) economic development/ social investment (as in the LSIF Alliance Principles) versus maximizing return on invested capital (as the Alaska Fund does); 2) payment of normal government expenses to lower taxes, as in Alberta, versus investment in highly screened local sustainable productive business assets such as the Alliance LSIFs, versus maximizing income for individual citizens (as in Alaska); 3) considering what effect the new program may have on increasing or decreasing citizens' responsibility towards the community compared to their personal interests.

Once those decisions have been made it may be easier to determine who represents the citizens. These may include government appointees or well-informed-citizen-surrogate representatives from specific interest groups (unions, community organizations). The board thus created usually chooses the investment/business professionals for the trust. Yet the government body creating the program should maintain both financial and social oversight to ensure the Trust serves the public/citizens' interests. Alaska solves that problem by requiring its APF Trustees to report to and have their budget approved by the legislature. In Alberta, the government serves all these functions. At the TVA, the board is appointed by the U.S. President, can be removed by Congress, and reports to the government, but is otherwise free to run its business. The LSIFs are formed by the labor federations and choose the financial sources or experts for their funds. The only government control for LSIFS is deciding whether to make tax deductions available or not.

F. WILL FAIR EXCHANGE KEEP PRIVATE BUSINESS FROM DOING BUSINESS WITH GOVERNMENT? AND IF SO, IS THAT BAD?

It is possible that if there were widespread FE legislation, companies would be less willing to take money from governments, because they would not want to provide the equity quid pro quo. This could be a positive development because it would allow communities to preserve or use their development funds for projects that provided a more obvious long-lasting benefit to the community. The behavior of Northwest Airlines in initially seeking ATSSSA funds, and then dropping its application when they understood the equity kicker, is very instructive. The purpose of most government development incentive funds is to provide financing truly needed by a company and generally unavailable from the private sector.

G. What about companies that have securities the Trust does not want to hold?

Does every business entity have securities that the Community Trust wants to or can hold, such as closely held company stock, or partnership or limited liability company interests? If the company is worth giving subsidies to, it should have valuable stock warrants. Remember, the Chrysler stock warrants were considered almost worthless when the U.S. government took them, yet they ended up providing over $350 million in profit. For liability reasons, a community trust may prefer to refrain from becoming partners or LLC members with a company, and instead obtain escrow or bonds.

Of course if the stock were marketable securities, the trustees could sell the stock or warrants and use the proceeds to diversify. If there was no such public market the trust might still take securities, but only after serious due diligence conducted on its behalf by knowledgeable advisor. Alternatively, the trust might ask for an escrow account or bonds instead of equity to collateralize its loan or to insure performance of promises. The trust could make disbursements upon completion of specific negotiated contract goals. Escrows are commonly used in business contracts, and may be more palatable than stock warrants or options, especially to closely held businesses that do not want to risk sharing ownership. Investors use various types of bonds in cases where equity seems too risky, but the target company is strong enough to be considered a good credit risk.

H. Defining and measuring "Community Benefit"

There is substantial literature documenting the problem of competition between communities to provide subsidies to attract company investments.[571] The parties to such negotiations are not fairly matched. The investor, seeking the subsidy, operates in an environment of ever more mobile capital. He works with location consultants who have more consolidated information about the subsidies available from various communities, which is public information. Communities have no way of knowing what investors may really be looking for and they have no knowledge of when the next big deal may arise for their community.[572]

Community organizations have taken the lead in pushing back unfair subsidies by insisting on greater transparency, or repayment of subsidies if businesses renege on promises ("clawback laws").[573]

Community Benefit Agreements (CBAs) are an innovation created by the Los Angeles Alliance for a New Economy (LAANE). A CBA is a

---

[571] *See supra* note 1.
[572] Thomas, *supra* note 1, at 1-2.
[573] LeRoy *supra* note 1, at 43-54.

contract among a business or developer, a government body, and a community organization (often working with labor unions). In a CBA, the business agrees to provide specific benefits, such as creating a certain number of jobs paying designated fair wages including health insurance or other such benefits, building and maintaining specific buildings or infrastructure, or requiring tenant businesses in a new development to hire a certain percentage of its employees from the local community. In exchange for these benefits, the community organization agrees to support the developer's proposal and the government gives the developer the necessary approval and usually tax subsidies, free land or other financial incentives.[574]

The LAANE book on CBAs points out that a heavy emphasis on monitoring and enforcement in negotiation of CBAs may make them more difficult to achieve.[575] A state FE law, such as the state statutory language example above, could use stock warrants or cash escrow to make the CBA self-enforcing. Such escrow arrangements are quite standard in commercial contracts, and may seem more palatable to developers. Otherwise, a standard contract generally requires enforcement through litigation or arbitration. But if the government or community trust received stock warrants or an escrow that automatically matured upon default by the developer, enforcement would be easier and the agreements much stronger:

> Coordination of government policies is the only logical way to blunt the dynamic of competition for investment; the only truly successful (sic example) of this is the European Union, where favorable basic law (the Treaty of Rome) and a centralized monitoring and enforcement capacity have enabled the E.U. to exert some control over the investment-attraction activities of Member States, and local governments within its territory.[576]

Federal Fair Exchange laws could serve to blunt this dynamic if localities were required to implement and enforce FE laws in order to obtain some federal funds, as in the "Federal legislation to level the playing field between states and communities" section above.

In the above sections on LSIF and the Alberta Heritage Fund, we encountered the problem of measuring community benefits. Melissa Moye pointed out the disparate cost-benefit analysis paradigms used by

---

[574] Julian Gross, Greg LeRoy and Madeline Janis-Aparicio, *Community Benefit Agreements: Making Development Projects Accountable*, Good Jobs First and California Subsidy Project (2002) at 1-2.

[575] *Id.* at 48.

[576] Thomas, *supra* note 1.

different sets of researchers,[577] and the methods used by Regional Data Corporation to determine the economic impact of Ontario LSIFs by comparison to an extrapolated "but for" reality.[578] The Alberta Heritage Fund has either had difficulty quantifying the benefits that went into its investments in Crown Corporations, development projects and tax reductions, it was never pressed to do so, or there was negligible benefit; although major projects employing a substantial number of people were created. Alberta converted its Fund to be invested as a more traditional endowment to resolve this vagueness and show more concrete results.

If a community seeks to enter into a CBA, the agreement must have a way to quantify the results so that both parties will know if and when any automatic enforcement mechanisms will be triggered. The subsidy and the contract generally lasts for a set term of years, and calls for the creation of a certain number of jobs at a certain level of quality. Often these agreements fail to specify the longevity of the jobs.

To date, I have found no agreed-upon methodology and few examples using measures common to business transactions, such as calculating the present value of the income stream from a promised job over a projected number of years of employment. The technical assistance project envisioned by Capital Ownership Group will work on this problem and develop some objective measures. Many state and local governments lack the expertise to negotiate appropriate equity agreements, so any FE legislation must address the expertise gap. Here are some examples of how the parties might quantify the value of various community benefits using fairly standard business concepts.

1. The value of each job created would be measured by the real wages, benefits and taxes paid on behalf of each employee in one of the newly created jobs for the entire term of the subsidy. This would include any employees replacing those who terminate employment on the basis that it is a single job slot. Since the subsidy and the employment costs each usually accrue over time, there would be no need to calculate the present value of either.
2. If one party provides cash, land or other valuable property at closing, while the other party makes its contribution over time, it is proper to discount the contribution over time to the present value at closing.
3. Infrastructure improvements and proposed environmental mitigation should be valued by getting an independent bid or valuation for the work as though the municipality were to build it itself.

---

[577] Moye, *supra* note 543.

[578] *See* Analysis of Fiscal Costs, *supra* note 460.

4. The multiplier effect of job creation is an assumption made by an economist. The parties can consult economics professors to get proposals for standard assumptions and negotiate an agreed upon multiplier, such as the University of Toronto model used in the Ontario LSIF study.[579]
5. Similarly, the parties may have to agree upon a discount to make the transaction more attractive to the investor (especially in early legislation that is non-mandatory and not required under federal or state legislation). For example, instead of the community receiving 100% in fair value in exchange for its contribution, a FE law might provide that 85% was sufficient.

The community needs to be careful to count in the agreement the value of everything it invests. Tax abatements or subsidies are fairly easy to calculate in cash. The contract should also include the value of any physical improvements or special services provided to the company by the community, such as worker training, staff time seeking grants from other government or private bodies and locating other resources.

I. COMMUNITY TRUST NETWORK

1. *Fiduciary Issues and Voting Clout*

Under a FE law, a community trust would begin to own shares in local companies. If the community trust sees itself as an endowment, trustees will have fiduciary concerns about holding too much of certain securities and not enough of others. Diversification of assets is a typical fiduciary strategy. For example, the Alaska Permanent Fund is required to invest in a broad range of investments. However, that same diversification dilutes the ability of the trust to exert its interest in corporate governance as a substantial shareholder in an investee company.

2. *Community Trust Network Mutual Fund with Voting Agreements is a Solution*

If federal FE legislation were enacted, then many local community trusts would be obtaining equity interests in a diverse array of companies, even though each community might have only a few local companies' stock in its portfolio. (See Figures 10A and 10B.)

Portfolio diversification could be achieved, while still preserving voting clout for the local community trusts, by forming a community trust network. The network would be like a mutual fund. Communities would trade shares of FE acquired stock into a pool of such stock held by the network mutual fund. In return they would receive an equivalent dollar value of network mutual fund shares. The local community trust

[579] *See id.* at 11-13.

would also enter into a voting agreement with the network mutual fund, as part of this swap. The voting agreement would enable the community trust to direct the voting in the shares of local companies it contributes to the mutual fund.

For example, the hypothetical Detroit Community Trust discussed in the Introduction, Section I A above, could diversify its portfolio by trading some or all of its $5 million dollars worth of MMM stock to a national mutual fund of Community Trusts (Community Trusts) for $5 million worth of shares in the mutual fund made up of stock obtained by all the other Community Trusts. The mutual fund and the Community Trusts could have voting agreements allowing the Detroit Community Trust to continue to vote the proxies on all the MMM shares it traded to the mutual fund.

Efficiency and high quality management would be other advantages to creating the network and its mutual fund. The larger pooled funds could employ high quality professional staff to help communities negotiate FE agreements, administer and invest funds, coordinate proxy voting, and wield more clout in proxy voting.

If thousands of communities had these community trusts, over time a significant amount of corporate stock would be held by the trusts. If this stock is voted in conjunction with public and union pension funds and other socially responsible investment funds, it could have a significant impact on corporate behavior.

FIGURE 8A. COMMUNITY TRUST NETWORK AND MUTUAL FUND

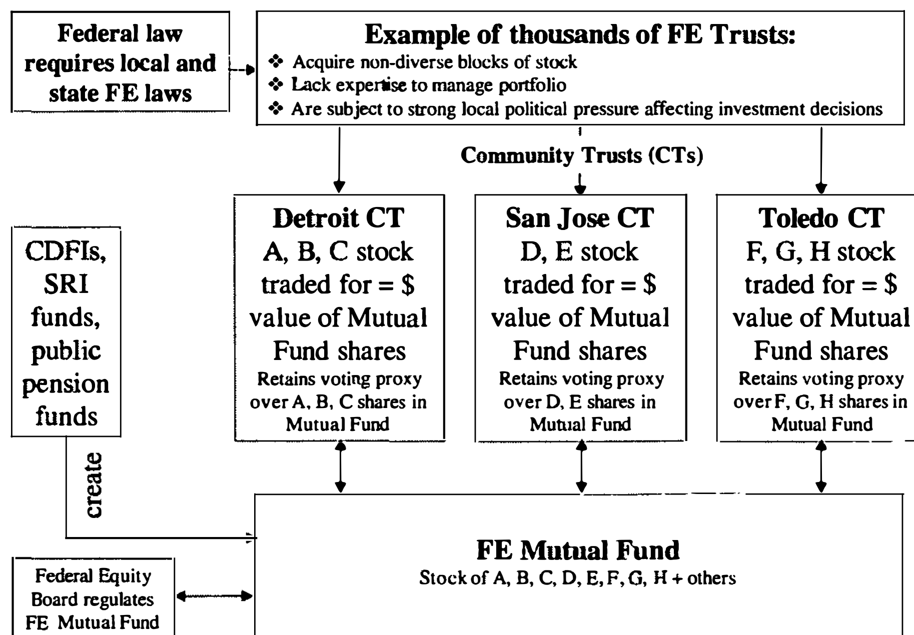
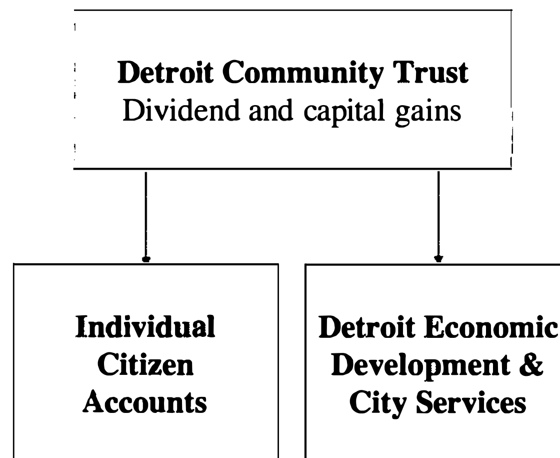


FIGURE 8B. DETROIT COMMUNITY TRUST (EXAMPLE)



VI. HOW GOVERNMENTS, INTELLECTUALS, COMMUNITY AND NON-PROFIT ORGANIZATIONS COULD USE FAIR EXCHANGE

National, state and local governments and global trade organizations could use Fair Exchange (FE) to obtain revenue without increasing taxes. They could also create mutual fund networks of community trusts to create diversified investments and even voting blocs that may influence corporate behavior. They could use FE to save money when companies refuse subsidies rather than give up equity; and obtain resources to implement locally focused economic development.

Local governments and community organizations could negotiate community benefit agreements that include stock warrants as collateral for promised jobs or other benefits promised to communities in exchange for subsidies. Community development financial institutions and microlenders could serve as honest brokers to manage FE funds, especially in countries where a corruption is a major issue. They could be recipients of a portion of the FE proceeds to loan out as local micro loans. They could create and administer individual account plans that allocated funds to all individual citizens.

Socially responsible investment professionals and funds could provide the expertise required to create and manage the community trust and mutual fund mechanisms. Upon reinvestment of fund assets, one method of ensuring community beneficial investment would be to create investment screens such as those used by socially responsible investment funds. The negative screens might explicitly prohibit Community Trusts from investing in companies: 1) that produce alcohol, gambling or weapons; 2) that are on the EPA's 100 top polluters list; or 3) that are on labor federation boycott lists. Positive screens might give preference to: 1) en-

ergy star companies; 2) companies engaged in organic agriculture or producing products from organics; 3) companies listed as the 100 best places to work or similar lists; 4) employee owned companies; 5) unionized companies; 6) companies that provide good health care and pension plans for their employees; 7) producers of renewable energy; or 8) vendors of products that enhance energy efficiency. Based on the LSIF experience, smaller communities should not utilize so many screens. However, regional or national funds could successfully use such screens.

President Bush has used the term "ownership society" in his campaign to privatize the social security system, although he's been silent on it in relationship to employee ownership.[580]Sympathetic think tanks and intellectuals could reorient use of the President's term "Ownership Society" from his January 2005 State of the Union address, by demonstrating that FE is the fairest and most business-like method of organizing transactions between governments and businesses while providing citizens a useful equity stake.

Fair Exchange provides a powerful argument to counter any call for private equity accounts as part of social security, while emphasizing the importance of broad equity ownership including FE. I agree with the major critiques of plans calling for the privatization of social security plan, including: 1) that it would require major government debt increases; 2) that it encourages individuals to borrow funds to buy stock, which is margin buying, a practice frowned on by most financial advisors for average working people; and 3) that there would be a risk of unaffordable loss in retirement benefits. However, there is good reason to advocate in favor of providing every citizen with a non-wage additional stream of equity income. A combination of global wage competition and technological advance may well be decreasing the number of jobs available as the population increases, at least in the U.S. According to the Economic Policy Institute (EPI) in its *State of Working America 2004 –2005*, "From 2000-2003, long-term unemployment increased 198%. For those with a Bachelor's degree or more, the increase was 299%".[581] EPI says that in the previous seven post-World War II recession recoveries, all lost jobs were recovered within the first 20 months of the recovery, except in the 1990s recession it took 30 months to reach this break even-point, and in the current recovery, "39 months after the peak, we are still 1.2 million jobs short".[582]

---

580 *ESOP Report*, November 2005 at 1, "Presidential Tax Reform Panel Report Would Eliminate ESOPs".

581 Press release, Economic Policy Institute, Jobs Fact Sheet for LAWRENCE MISHEL, JARED BERNSTEIN, & SYLVIA ALLEGRETTO, THE STATE OF WORKING AMERICA2004/2005, (Sept. 5, 2004) at http://www.epinet.org/books/swa2004/news/swafacts_jobs.pdf.

582 *Id.*

Fair Exchange provides a much better source for a second stream of income unconnected to wages. The current Social Security system could remain untouched and intact, while citizens got FE equity accounts, as all Alaskan citizens now have under the Alaska Permanent Fund. Then most citizens would have some equity ownership, without the government debt or the individual retirement risk involved in the privatization of social security.

The Capital Ownership Group (COG) would like to provide technical assistance to governments at all levels to craft FE models to fit their circumstances. This would include working with attorneys, bankers, accountants, other professionals and community representatives to devise model FE legislation, community benefit agreements, FE collateral stock warrants, metrics for community benefit agreements, and other necessary FE technology. COG is expanding the research begun in this article by creating and collecting information on FE examples. It aims to create a clearinghouse for materials, research, training and/or technical assistance for all the parties contemplating, developing and managing FE programs. COG would also be able to assist in the creation of community benefit agreements using FE concepts.

A. RANGE OF ISSUES, VENUES, AND JURISDICTIONS IN WHICH FE MIGHT BE USED

1. *Voluntary and Local*

Without passing any new laws, FE concepts can be incorporated in voluntary agreements. Currently, some communities require job quality standards from companies receiving development subsidies.[583] In other communities, such standards are attained by means of a community benefit agreement among a company, a government board of directors, and a community organization.[584]

2. *FCC Licenses: Taxpayers should get part of the profits generated when private companies use public airwaves*

Free distribution of the airwaves may be the most glaring of current unfair exchanges. The government has given away or sold licenses at very low prices to media companies. The companies make enormous profits, and do not provide free access for election purposes. Our political system has become corrupted by money because candidates must raise huge war chests to pay for advertising on the public's airwaves.

---

583 Anna Purinton, Nasreen Jilani, Kristen Arant & Kate Davis, *The Policy Shift to Good Jobs: Cities, States and Counties Attaching Job Quality Standards to Development Subsidies* (Good Jobs First, Washington D.C.), Nov. 2003, at 1-5.

584 Gross et. al., *supra* note 574.

This need not be so. Federal legislation could require FE in all transactions with the federal government as described in the proposed FEITPA 2005 legislative model above. It could extend beyond loans, loan guarantees and tax abatements to the use of collective resources such as the airwaves. The Media Access Project estimates that the U.S. radio spectrum is worth $771 billion.[585] FCC licenses should require for-profit companies to pay royalty fees based on the income derived from the use of this public asset, just as the oil companies pay royalties to the Alaska Permanent Fund.[586] Companies could pay some of these royalties in the form of broadcasting company stock to the relevant community trust, which could in turn provide citizens with equity and dividends on a percentage of profits made from the licenses, and perhaps eventually some shareholder clout. This royalty structure could go a long way toward providing public television and election coverage, as well as improvements in schools, health care, and infrastructure without increasing taxes on average citizens.

B. FEDERAL FINANCING OF PILOT FE PROJECTS

In order to find effective, efficient, and practical FE models, the federal government could fund some local or state pilot projects. The government could also create a TVA type program for the Gulf Coast hurricane damage reconstruction and include well-conceived mechanisms used by the New Deal to get funds to people who need them most, provide decent-wage jobs to displaced people to do reconstruction, and prevent the corrupt use of funds. The government could require a high FE requirement when no-bid contracts are granted, in order to discourage that practice, which would provide greater opportunities for local and small businesses.[587]

---

585 "The Citizen's Guide to the Airwaves", Media Access Project (MAP), New America Foundation (2003) and on their web site the MAP states, "The electromagnetic spectrum represents on of our greatest public resources. Unlike grazing land or old growth forests, however, use of spectrum can be virtually inexhaustible. . . tthe FCC issues exclusive licenses to use spectrum. Until recently, the FCC gave away (sic) limited number of licenses for free on condition that the licensee serve their local community. Since 1993, the FCC has sold the right to use spectrum at auction." New technology is changing the need for exclusively allocated spectrum, and new policies are decreasing the public interest obligations of broadcasters. J.H. Snider, "The Decline of Broadcasters' Public Interest Obligations – a Policy Backgrounder", New America Foundation (3/26/2004).

586 *See* http://www.pfd.state.ak.us/ - from original FN 289.

587 *See* Weisman, Jonathan & Witte, Grief, "Katrina Contracts will be Reopened", *Washington Post,* October 7, 2005 at 1, reporting that in the rebuilding after Hurricane Katrina, there were numerous instances of large out-of-state companies allegedly receiving no-bid contracts, causing small local companies whose owners and employees were direct victims of the hurricane to miss out on the work.

C. HOW FAIR EXCHANGE CAN HELP COMMUNITIES SURVIVE THE GLOBAL "RACE TO THE BOTTOM" AND IMPROVE GLOBAL CORPORATE RESPONSIBILITY

From 2000 to 2004, the EPI shows that Indian software jobs producing exports to the U.S. increased 120%, while, between 2000 and 2002, U.S. software occupations decreased by 154%.[588] As an increasing number of higher skilled jobs leave the U.S. for lower-wage and lower-benefit countries, communities in the U.S. and, ultimately in all countries, will need to adjust their relationships with corporations they aid and subsidize. As the corporations they invest in continue to move jobs out of the communities for cheaper wages, communities and citizens should be receiving market-level compensation for their investments in those companies. Otherwise, the communities could be left with the short end of the stick, suffering economically while the companies' profits increase.[589]

One distinct advantage to the FE approach is it does not pit higher-wage countries against lower-wage countries. FE does not prevent companies from moving to lower-wage countries when competition calls for it. Rather, FE requires that the community, which invested in the company making such a move, receive a benefit comparable to that of other company shareholders. Thus, FE does not penalize developing economies. Developing countries can also be hurt by capital mobility. The U.S.'s recent lifting of textile quotas exemplifies this proposition. Factories in many developing countries were threatened with closure as China absorbed a huge segment of the textile market.[590] If FE rules were applied universally, it could aid poor countries that have invested in business infrastructure by returning to their citizens and communities a portion of the profits they helped generate.

In recent years the quality of life in the U.S. has decreased due to global competition, with economic growth feeding corporate profits and lost U.S. manufacturing jobs not being replaced with similarly high-paid,

---

[588] Lawrence Mishel, Jared Bernstein & Sylvia Allegretto, "Facts & Figures – Wages" p.2, *The State of Working America2004/2005*, Economic Policy Institute, Cornell University Press, January 2005 found at http://www.epinet.org/content.cfm/books_swa2004 (4/7/2005).

[589] *See id.* (showing how from 2000 to 2004 Indian software jobs producing exports to the United States increased 102%, while from 2000 to 2002 U.S. software occupations decreased by 154%).

[590] Cecil Yancy Jr. "End of Textile Quotas to Further Hurt Industry" *SouthEast Farm Press, October 6, 2004,* "When the World Trade Organization (WTO) lifted quotas on 29 categories of manufactured goods in 2002, China's share of the U.S. market in those products went from 9 percent to 65 percent. . .. In an ironic twist, many of the same developing countries who once clamored for repeal of the quotas have now signed the Istanbul Declaration. When their voices were loudest in support of repeal of the quotas, the developing countries did not anticipate Chinese dominance and China was not yet a member of the WTO."

full-time jobs with benefits.[591] The pay and benefits in the jobs replacing these lost manufacturing jobs are considerably less than those in the jobs they replaced.[592]A smaller percentage of the U.S. workforce is employed full-time.[593] Full-time employees are likely to have less comprehensive health care benefits today than fifteen years ago (if they have any); pay higher co-pay for benefits they receive, and are less likely to have a defined benefit pension plan.[594] The U.S. economy has grown in the past decades without significant increases in employment rates or wages.[595] Private sector unions are smaller than they were fifty years ago and are losing members and benefits every year.[596] All of these phenomena are, largely attributable to pressure from the global marketplace. Simultaneously, virtually all state governments are financially strapped and cutting already meager budgets for education, healthcare, transportation and other essential services.

At this writing the entire airline industry is going through a transition, fueled by low-cost carriers providing lower wages and benefits to their employees than more established airlines. In order to survive financially, older companies have been reducing their labor and benefit costs

---

591 News Release from EPI announcing the book , LAWRENCE MISHEL, JARED BERNSTEIN & SYLVIA ALLEGRETTO, THE STATE OF WORKING AMERICA 2004/2005, (Economic Policy Institute, Cornell University Press, January 2005) found at http://www.epinet.org/content.cfm/books_swa2004 (4/7/2005). ". . [s]ince the recession began in the first quarter of 2001, 85% of the growth of corporate income has accrued to profits, and 15% to compensation. In contrast, compensation comprised 79% of the income growth in the corporate sector in eight prior business cycles, with profits contributing 21% of the growth."

592 *See id.* (comparing industries that are adding jobs faster than average (expanding industries) with those that are losing jobs faster than average (contracting industries), "Contracting industries paid $61,983 in annual compensation, including all wages and benefits, while expanding industries paid $35,546 in compensation. . .or 42% less.").

593 *See id.* "The underemployment rate (including part-time workers who want to work full-time and discouraged workers who've given up looking for jobs) increased 9.6% as of June 2004." "The employment gain during the latest recovery was only 0.2%. On average, employment increased by 9.5% in the previous nine economic recoveries."

594 Facts and Figures: Wages, *The State of Working America2004/2005*, (Economic Policy Institute, Cornell University Press, January 2005) found at http://www.epinet.org/content.cfm/books_swa2004 (4/7/2005). "Health insurance coverage eroded for all wage groups in the 2000-02 period. Over the longer period, 1979-2002, health insurance coverage declined sizably, and comparably, across the wage spectrum. Less than half the workforce is covered by employer-provided pensions. Pension coverage fell from 48.3% in 2000 to just 45.5% in 2002."

595 *See* News Release from EPI, *supra* note 592, "After almost three years of recovery, . . .unemployment is essentially unchanged, job growth has stalled and real wages have started to fall behind inflation. Today's picture is a stark contract to the full employment period before the recession, when the tight labor market ensured that the benefits of growth were broadly shared. . .. This is a worse position, in terms of recouping lost jobs, than nay business cycle since the 1930s."

596 In 2003, 15.8 million U.S. workers belonged to unions12.9 percent of the U.S. workforce (Bureau of Labor Statistics). Fifty years ago, 16.8 million workers belonged to unions—but they made up 33 percent of the U.S. workforce (Bureau of Labor Statistics) found at http://www.aflcio.org/aboutaflcio/ourfuture/facts_densityunion.cfm (04/07/2005).

as best they can. For example, United went to bankruptcy court to unload their pension liabilities on the public.[597] The extra cost to the public does not end with the extra pension benefits. Every uninsured person who is treated in a hospital is paid for through the ever-increasing insurance premiums paid by the companies and individuals who still have health insurance. Those increased costs, in turn, make the companies that provide health insurance and retirement plans, less competitive than those that do not. For example at General Motors (GM) health care alone account(s) for $1,400 in the cost of every vehicle built in the United States. GM's Japanese competition spends less than $400 per vehicle for health care, leaving General Motors with a penalty of $1,000 a vehicle or $4 billion annually.[598]

According to David Cole, Chairman of the Center for Automotive Research (CAR).

Domestic manufacturers. . . pay $2,000 to $2,500 per car in current work health-care and retiree legacy costs – costs that are unsupportable in a world with capacity of 80 million units and demand of 60 million.[599]

This is a key reason why they U.S. automakers, such as General Motors, are losing market share to younger foreign companies.[600] This vicious cycle is called the "race to the bottom." FE will not stop this race, but it does provide an effective means for communities to reap some of the rewards of global economic restructuring for which they are now paying the bills.

CONCLUSION

In order to create a humane and sustainable global community that properly balances the needs of communities with the important economic interests of business, several strategies should be pursued simultaneously. These strategies include: 1) creating enforceable agreements on environmental sustainability and human, civil and labor rights; 2) elevating the sovereign rights of communities in relationship to businesses; 3) reorganizing the international financial institutions, internalizing of the costs of products and services (through corporate accountability mea-

---

597 *BNA Pension & Benefits Reporter* Vol.32, No.5, Feb.1, 2005 at 263 –64.

598 James E. Harbour, *"Why GM's profits really hit the wall: While legacy costs are real all-new cars may pose a real problem"* DETROIT NEWS, March 27, 2005 found at http://www.detnews.com/2005/editorial/0503/27/A15-129850.htm (4/7/05) (Indicating that General Motors (GM) health care alone account(s) for $1,400 in the cost of every vehicle built in the United States while Japanese counterparts spend less than $400 per vehicle for health care.)

599 Tom Henderson, *"What Drives Detroit"* FACSNET BUSINESS & ECONOMICS April 7, 2005, found at http://www.facsnet.org/tools/biz_econ/detroit_auto.php (4/7/05)

600 C. Loomis, Fortune, *"The Tragedy of General Motors"* at 5, Feb. 6, 2006, found at CNNMoney.com.printthis.clickability.com/pt/ctp?action=CP&title:The+Tragedy+of+General+Motors, 2/8/06.

sures) now externalized onto the public; and 4) providing a source of non-wage income through broad ownership to offset the loss of jobs caused by technology.

A. FAIR EXCHANGE IS ONLY ONE OF THESE STRATEGIES

(FE) is not a solution to all of the problems mentioned in this article and it does not address all the above-mentioned strategies. It is one of several important strategies, however, which, when pursued in tandem with the above-mentioned strategies, can help bring balance back into the relationship between businesses and communities.

FE provides a businesslike approach in which companies treat communities as investors. FE can be used to retain and rebuild community assets that have increasingly been privatized, and to provide a second stream of income for all citizens. It can be utilized to build the asset base for all citizens to truly be stakeholders in the community. It can be a first step towards reclaiming the commons for the community.

This article was written during 2004 and 2005 when direct government ownership and management of business operations was an extremely unpopular idea, and elimination or privatization of public services was the trend. The political climate in the U.S. may change as the consequences of privatization and tax cuts take their toll on public well being. The cumulative social cost of tax cuts, the Iraq war, and the reconstruction following the hurricanes of 2005 may change the political climate regarding government spending, which could make the New Deal programs like the TVA more appealing and more politically viable. A key feature that made the New Deal work was stringent oversight and controls that prevented corruption and patronage. The model legislation provided herein provides a system of checks and balances. However, any FE program would require a strong external oversight mechanism to monitor the possibility of corruption and patronage.

This article aims to open a new field of study and policy to discussion. Many ideas and proposals herein require further development and refinement. I intend to pursue this development and invite readers to do the same.[601]

Acknowledgements

Deborah Groban Olson wrote this article with substantial research and editing assistance from Laura MacNewman and Cheryl English. Laura wrote much of the Homestead section. Special thanks to Laura Achee, Don Allen, Gar Alperovitz, Ron Blackwell, Bill Bratton, Elyse Cherry, Mary Pat Clarke, Ken Delaney, Carla Dickstein, Steve Dubb,

---

[601] For more information on current projects or to inquire about beginning a Fair Exchange project contact the Capital Ownership Group at cog@kent.edu or 313-331-7821.

Michael Ettlinger, Scott Goldsmith, Bob Jensen, David John, Diane Keefe, Scott Klinger, Mary Landry, Greg LeRoy, Michael Lipsky, Steve Lydenberg, Frank Mauro, Larry Mitchell, David Morris, Larry Persily, Kenny Thomas, Jack VanWie and Keith Wilde for their thoughtful comments. Special thanks to Gail Pesyna for requiring the policy conference that added so much depth to this paper, and to Larry Mitchell at George Washington University Law School and Bill Bratton at Georgetown University Law Center, Domini Social Investments, PaxWorld Funds and the MLG Foundation for making that conference possible. Special thanks to Gene Fisher and Hon. Carolyn Cheeks Kilpatrick for their sustained interest in and support for the development of Fair Exchange information. The Fair Exchange research project was funded by an Alfred P. Sloan Foundation grant, administered by Ohio Employee Ownership Center (OEOC) at Kent State University. OEOC hosts the Capital Ownership Group (COG) on-line conference center, think tank and library. Special thanks to Richard Olson for his support and thoughtful editing; to John Logue for helping to make COG possible; to Dan Bell, Steve Clem, Chris Cooper, Mary Landry and Jacqueline Yates for their dedicated work on the COG web site, publications, working groups and conferences; to the COG Advisory Board and all the working group participants in the COG network for their excellent work, participation and support; and to Bill Greider for the inspiration.

APPENDIX A. STOCK WARRANTS ISSUED BY EACH AIRLINE[602]

Carrier	Website	Amount borrowed in millions $	Stock warrants issued	Comments
America West	http://www.americawest.com/default.asp (then go to About AWA, Investor Relations, Press Releases and pick desired year)	380	Issued to ATSB warrants for the purchase of 18.75 million shares of Class B common stock at an exercise price of $3.00 per share. Exercise period of 10 years. Additional 3.8 million warrants with same terms will be issued to other participants in the loan.	In conditional letter from ATSB - Government needs to receive warrants that represent 33% of AWA's common stock on a fully diluted basis. . . . MSN article says 5%
American Trans Air	http://www.ata.com/sitemap.html	148.5	11% of ATA stock – according to MSN report	No information available re: warrants on ATA website or ATSB press release
Aloha Airlines	http://www.alohaairlines.com/fly/index.htm (No loan information on website)	40.5		
Frontier Airlines	http://frontierairlines.com/	63	Issued warrants to purchase 3,833,946 shares of common stock at $6.00 per share to the ATSB (and two other guarantors). The warrants had an estimated fair value of $9,282,538 when issued and expire 7 years after issuance. Subsequently re-priced from $6.00 to $5.92 per share. . . .	Already repaid loan (02-14-03); not due until 2007.
US Airways	http://usairways.com/	900	Warrants representing 10% of reorganized equity. . . .	
World Airways	http://worldair.com/	27	Issued to ATSB warrants to purchase an aggregate of 2,378,233 shares of Common Stock. . . (see pg. 34 of Ann Rep – stock staggered over years and prices)	

602 Appendix A, showing the stock warrants issued by each airline, was compiled from data taken from the ATSB website and the airlines' websites.