Coates' Canons Blog: Public Hearings for Economic Development Incentives: An Unwritten Rule?

By Tyler Mulligan

Article: https://canons.sog.unc.edu/public-hearings-for-economic-development-incentives-an-unwritten-rule/

This entry was posted on August 26, 2009 and is filed under Community & Economic Development, Economic Development, Open Government, Public Hearings

North Carolina local governments frequently use cash grants as an economic development incentive to lure businesses into their respective jurisdictions. The grants are authorized under the Local Development Act, G.S. 158-7.1 *et seq.*, but a quick read of the statutes might obscure the need for a public hearing prior to approving such incentives. To understand the source of this hearing requirement, you have to look closely at the statute and the case law.

Those familiar with the Local Development Act are aware of the stringent notice and public hearing requirements for activities related to acquiring, improving, and conveying property authorized by subsection (b) of G.S. 158-7.1, such as constructing and conveying shell buildings, extending utility lines to a facility, and engaging in site preparation. For those enumerated activities, the hearing requirements are clearly spelled out in G.S. 158-7.1(c) and (d).

But what about an appropriation for a *cash* incentive to induce a company to bring jobs and capital investment to North Carolina? Some argue that the award of a cash grant is not authorized by the property-related provisions of *subsection (b)* ; rather, they suggest that the authority to offer cash incentives is likely derived from the general grant of authority described in G.S. 158-7.1*(a), which is a catch-all authorization for economic development appropriations*. If that were the case, then a cash incentive would conveniently avoid all of the procedural requirements associated with property-related activities authorized under subsection (b). That argument just doesn't hold up under closer examination. This post explains why.

North Carolina's seminal economic development case, *Maready v. City of Winston-Salem*, 342 N.C. 708 (1996) examined 24 cash incentives. Every company receiving an incentive in that case promised to create a substantial number of jobs and to increase the property tax base by constructing taxable improvements. The court even pointed out that each local government in the case expected to recoup its entire investment within "three to seven years" as a result of anticipated tax revenues from those taxable improvements. An incentive for jobs alone (without a requirement for capital investment) would fail to ensure that a company would construct the requisite real property improvements to generate sufficient tax revenue for the local government to recoup its incentive. Thus, to the extent that a local government strives for its incentives to be comparable to the incentives approved in *Maready*, the local government should require both job creation and capital investment.

G.S. 158-7.1 likewise suggests that both job creation and capital investment are required. G.S. 158-7.1(h), enacted in 2007, requires incentive agreements to include provisions for the recapture of sums appropriated in the event that the company fails to create the promised number of jobs and fails to make the promised capital investment. Thus, capital investment is essentially required to be part of every incentive arrangement.

Furthermore, often-overlooked G.S. 158-7.2 requires a local government to approve all expenditures of its funds by an outside entity—such as a company receiving an incentive payment—with a full accounting of the expenditure at the end of each fiscal year. Indeed, the North Carolina Supreme Court in *Maready* noted that the "typical procedures" for incentives in that case involved paying companies on a reimbursement basis, rather than making unrestricted cash grants. A local government, acting in compliance with G.S. 158-7.2, will therefore be aware when its cash incentive is being used to make improvements to real property.

As Professor David Lawrence points out in his book on economic development law, cash reimbursements to companies are the "economic equivalent" of engaging in the induced activities directly. If a properly noticed public hearing is required by G.S. 158-7.1 when a local government improves real property for economic development, then a cash payment to induce a company to engage in the same activity must also trigger a properly noticed public hearing. Case law backs this up. As noted above, all of the *Maready* incentives were paid "in the form of [cash] reimbursement to the recipient." Many of

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the reimbursements went toward activities that properly fell within the purview of subsection (b), such as land purchases and construction of improvements on land, but the local governments did not engage in those activities directly; rather, they subsidized companies in support of those activities through reimbursements.

The local governments in *Maready* did not try to avoid the procedural requirements associated with subsection (b) by suggesting that the use of cash reimbursements somehow placed the incentives under the purview of procedure-free subsection (a); rather, the local governments followed the procedural requirements applicable to subsection (b) activities. The court took note, citing the trial court's finding that incentives "made pursuant to the provisions of N.C.G.S. § 158-7.1(b) through (f) were approved … following publication of a notice of a public hearing … as provided in said statute." This statement would make little sense if the court believed that cash reimbursements are authorized pursuant to procedure-free subsection (a); that would have meant that none of the Maready reimbursements would have triggered the procedural requirements imposed on subsection (b) activities. Arguably the Maready court cut through the form of these transactions to get at their substance—implicitly recognizing that subsidies for activities enumerated in subsection (b) were essentially equivalent to engaging in the activities directly and therefore trigger all of the requirements of subsections (c), (d), and (d2), such as notice, a public hearing, substantial job creation, and a contract for investing in property improvements.

Accordingly, every incentive that subsidizes a subsection (b) activity should be approved following a public hearing as required by subsection (c). Notice to the public must be made at least ten (10) days in advance of the hearing, and the contents of the notice must follow the prescribed form in the statute (see this blog post for advice on writing the notice).

One related question must be addressed. The local governments in Maready reimbursed companies for specific, named activities—for example, construction of "site improvements." It is more common today, however, for cash incentive grants to be paid to companies in exchange for job creation and making a capital investment that increases the tax base, without further specifying how funds are to be spent. The difference is irrelevant. G.S. 158-7.2 will require a local government to learn how its funds were spent, and regardless, it should be obvious that today's cash grants subsidize subsection (b) activities whether or not those activities are specifically named. Practically every conceivable manner in which a company can increase the tax base—purchasing property and constructing facilities and other improvements on that property—involves subsection (b) activities and therefore implicates the procedures imposed thereby. To argue otherwise—to suggest that a local government can avoid the "strict procedural requirements" of G.S. 158-7.1 by cleverly omitting any reference to the activities that must occur in pursuit of increasing the tax base—would strain logic and elevate form over substance.

And finally, what if a local government is able to secure new revenues from a company without requiring the company to engage in property-related activities listed in subsection (b)? One example might include an incentive for installing taxable business property or equipment (however, this is an unlikely scenario, since major equipment installations often require modifications to buildings as well). In *Maready,* the local governments approved incentives for some unusual activities – even a few that weren't specifically enumerated under G.S. 158-7.1(b), such as "relocation assistance" for spouses (if anyone connected to the case knows exactly what that particular incentive involved, please enlighten me). Those "outside-the-box" (or "outside-the-G.S. 158-7.1(b)-box") incentives must have been approved pursuant to the general authority of G.S. 158-7.1(a), since they cannot be found among the enumerated incentives in subsection (b). And even though they were "outside-the-G.S. 158-7.1(b)-box," what do you think the governing boards did prior to approving those outside-the box incentives? You guessed it: *they held public hearings anyway*.

So, to the extent that the N.C. Supreme Court sanctioned "outside-the-box" incentives as serving a public purpose, they did so subject to the condition that "strict procedural requirements" are followed. Local governments are therefore advised to hold a public hearing prior to approving any incentive.

Links

- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_158/Article_1.html
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=158-7.2
- www.sog.unc.edu/publications/books/economic-development-law-north-carolina-local-government
- www.sog.unc.edu/blogs/coates-canons/notice-hearing-cash-economic-development-incentives

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