

Legislative Analysis



21ST CENTURY JOBS

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 5047 as passed by the House
Sponsor: Rep. Bill Huizenga
House Committee: Commerce

Senate Bill 533 as passed by the House
Sponsor: Sen. Valde Garcia
Senate Committee: Appropriations
House Committee: Commerce

Complete to 10-10-05

A SUMMARY OF HOUSE BILLS 5047 AND SENATE BILL 533 AS PASSED BY THE HOUSE

House Bill 5047 and Senate Bill 533 together would create a new Chapter 8A in the Michigan Strategic Fund Act. House Bill 5047 contains proposed Sections 88 and 88A through 88F. Senate Bill 533 contains proposed Sections 88G through 88K. The bills would put in place a number of economic development programs to "encourage diversification of the economy and the creation of jobs" within the state.

The name of the existing Michigan Strategic Fund would be changed to the "21st Century Jobs Fund" and the board of the Fund would be revamped (as described later).

The following is a brief description of key provisions in the two bills.

Under House Bill 5047, the *21st Century Jobs Fund* would create and operate a loan enhancement program to guarantee loans made by financial institutions to businesses located in the state that have documented growth opportunities; a private equity investment program to allow the authority to invest in or alongside a qualified private equity fund that is engaged in investing in or acquiring businesses; a venture capital investment program to allow the authority to invest in or alongside a venture capital fund that is engaged in investing in or acquiring early stage businesses that have not yet demonstrated consistent profitability or a proven business model; and a mezzanine investment program, which would focus on investments ranging in size from \$250,000 to \$10 million. (Together, these programs would be known as 21st Century Investments and the funding would come, presumably, by appropriation from a new *Jobs for Michigan Investment Fund*.)

Senate Bill 533 would create a new *Competitive Edge Technology Fund* for the purpose of making grants and loans for basic research, applied research, university technology transfers, and commercialization of products, processes, and services to encourage the development of competitive edge technologies with a high probability of creating jobs in Michigan. A newly created Strategic Economic Investment Board would direct the Fund, which would be required to 1) establish a competitive process to award grants and make loans; and 2) contract with independent peer review experts to assist the board with its responsibilities.

House Bill 5047 and Senate Bill 533 are tie-barred to each other and to House Bill 5048, which is the bill that would create the ***Michigan Tobacco Settlement Finance Authority*** and allow for the sale ("securitization") of state receipts from the settlement agreement with tobacco companies. Under that bill, at least \$1 billion from the sale of tobacco settlement receipts would be deposited in the ***21st Century Jobs Trust Fund*** (which would be created by House Bill 5109).

The bills are also tie-barred to a series of other bills related to economic development activities and business tax restructuring (as listed later).

The 21st Century Jobs Fund (currently known as the Strategic Fund) would determine the annual allocation of money to the Jobs for Michigan Investment Fund and the Grant Fund. The board could not spend more than the following amounts out of the 21st Century Jobs Trust Fund for the following purposes: 25 percent for the Loan Enhancement Program; 40 percent for the Private Equity, Venture Capital, and Mezzanine Investment Programs; and 70 percent for the commercialization of competitive edge technology. Also, no more than 10 percent of the money could be awarded for basic research on competitive edge technologies. At least \$50 million per year would be allocated each year for five years for grants and loans for life sciences.

Following is a more detailed description of the bills.

HOUSE BILL 5047

Under this bill, the 21st Century Jobs Fund (currently known as the Michigan Strategic Fund) would be charged with creating and operating the following 21st Century Investment Programs:

- A loan enhancement program to guarantee loans made by financial institutions to businesses located in the state that have documented growth opportunities;
- A private equity investment program to allow the authority to invest in or alongside a qualified private equity fund that is engaged in investing in or acquiring businesses;
- A venture capital investment program to allow the authority to invest in or alongside a venture capital fund that is engaged in investing in or acquiring early stage businesses that have not yet demonstrated consistent profitability or a proven business model, with 80 percent of funds allocated to the program focused on competitive edge technologies; and
- A mezzanine investment program, which would focus on investments ranging in size from \$250,000 to \$10 million.

As mentioned earlier, the bill also would create a new Jobs for Michigan Investment Fund within the state treasury out of which to make the guarantees, investments, grants, and loans. The Fund would consist of any funds appropriated to it from the 21st Century Jobs Trust Fund (which is the repository for proceeds from the sale of tobacco settlement

revenues), as well as, generally speaking, earnings, royalties, returns on investment, returns of principal, and other payments received by the Fund from the programs instituted under the new Chapter 8A; from the state's general fund; and from tobacco settlement revenue under the Michigan Life Sciences and Technology Tri-Corridor Initiative and similar or successor programs. The Fund would be required to maintain a balance of at least \$50 million. No more tha

Constitutional Fund. The proposed Investment Fund is described as a "permanent fund" as described in Section 19 of Article IX of the State Constitution. That section prohibits the state from subscribing to or being interested in the stock of any company, association, or corporation, with some exceptions. The exceptions include retirement or pension funds; endowment funds created for charitable or educational purposes; and other funds held as permanent funds or endowment funds, which may be invested as provided by law.

MEDC. The bill would specify that the Michigan Economic Development Corporation would provide all staffing, support, and administrative services necessary to implement the new Chapter 8A but the responsibilities specifically vested in the 21st Century Jobs Fund board would have to be performed by the board and not transferred to the MEDC.

Executive Director. The 21st Century Jobs Fund board would be authorized to hire an executive director to manage the private equity investment program and the venture capital investment program. The executive director would have to be paid a salary and bonus comparable to what an individual in a comparable position with similar responsibilities would be paid in the private sector. To be the executive director, an individual would need at least 10 years of experience in private equity or venture capital.

Loan Enhancement Program. Under this program, the Fund would provide guarantees to Michigan financial institutions providing commercial loans to qualified businesses. Businesses would only be eligible if they had documented growth opportunity. A financial institution would have to charge a higher rate of interest for a loan covered by a guarantee. The term "documented growth opportunity" would refer to a plant expansion, capital equipment investment, the acquisition of intellectual property or technology, or the hiring of new employees to meet or satisfy a new business opportunity.

A business engaging primarily in retail sales would not be eligible for a loan guaranteed unless the authority board made a specific finding that the loan supported a new concept with significant growth potential.

Capital Access Program. The bill would require the Fund to re-establish, as a separate and distinct part of the Loan Enhancement Program, the capital access program previously operated for small businesses by the Michigan Strategic Fund. The program would have to operate in a manner similar to its operation before January 1, 2002. A "small business" would be an independently owned and operated business with fewer than 250 full-time employees or with gross annual sales of less than \$6 million.

The program would have to be operate on a "market driven" basis and provide for premium payments by borrowers into a special reserve fund. The program would have to

prohibit an officer, director, or principal shareholder of a participating financial institution (or an immediate family member) from receiving a capital access program loan. The proceeds of a loan could only be used for a business purpose and could not be used to construct or purchase residential housing, to finance passive real estate ownership, or to refinance debt not originally part of the program.

Michigan Forest Finance Authority. As a separate and distinct part of the Loan Enhancement Program, the Investment Fund would provide \$26 million to the Michigan Forest Finance Authority to be spent as provided in an appropriation. Funds not spent within five years would be returned to the Investment Fund.

Wimax Wireless Internet. As a separate and distinct part of the Loan Enhancement Program, the Investment Fund would have to create and operate a grant program to expand Wimax wireless Internet systems in the state. The Fund would provide grants not to exceed \$60 million over a three-year period.

Private Equity Investment Program. Under this program, investments would be made only in or alongside a private equity investment fund. The return of investment sought would have to be greater than the return of investment under the commercial loan portion of the Loan Enhancement Program. The private equity fund involved would need to have a greater amount at risk than the state Fund. A private equity fund would not be eligible to participate unless it opens a business development office in the state with at least one full-time employee actively seeking opportunities for investments in businesses in the state, unless the investment opportunity requested was targeted to a specific transaction that would save jobs and would not occur without the investment. The fund also would have to agree to make investments in the state at a percentage rate not less than the percentage the state Fund's investment in the private fund bears to the total amount in the private equity fund. Also, a private fund could not participate if its investment strategy involves the break-up and liquidation of businesses.

Venture Capital Investment Program. Under this program, the return on investment sought would have to be greater than the return on investment under the commercial loan portion of the Loan Enhancement Program. The venture capital fund would need to have more at risk than the state Fund. A private venture capital fund would not be eligible to participate unless it opens a marketing office in the state with at least one full-time employee actively seeking opportunities for investments in businesses in the state, unless the investment opportunity was targeted to a specific transaction involving a competitive edge technology that would not occur without the investment. The fund also would have to agree to make investments in the state at a percentage rate not less than the percentage the state Fund's investment in the private fund bears to the total amount in the venture capital fund. Also, a private fund could not participate if its investment strategy involves the break-up and liquidation of businesses.

The Venture Capital Investment Program would have to coordinate with the Michigan Early Stage Venture Investment Fund to ensure that a continuum of venture capital is available in the state.

Mezzanine Program. The state Fund would also have to create and operate a Mezzanine Investment Program that would invest in or alongside a mezzanine fund in a manner similar to the Venture Capital Investment Program. A "mezzanine fund" would be defined as primarily engaged in making loans or investments ranging in size from \$250,000 to \$10 million.

Selection of Funds. The private equity funds and venture capital funds would be selected through the issuance of a request for proposals. At a minimum, the RFP would require the responding entities to disclose any conflict of interest; disclose any investigations by the Internal Revenue Service, Securities and Exchange Commission, or any other federal or state tax or securities regulatory body or court; and disclose any pertinent litigation. The 21st Century Jobs Fund Board would have to establish a standard procedure to evaluate proposals submitted and appoint a committee to review the proposals. The proposed legislation requires that any equity fund or venture capital fund be managed by two or more individuals with at least five years of direct experience with the particular kind of private fund.

SENATE BILL 533

Senate Bill 533 would create a new Competitive Edge Technology Fund for the purpose of making grants and loans for basic research, applied research, university technology transfers, and the commercialization of products, processes, and services to encourage the development of competitive edge technologies with a high probability of creating jobs in Michigan.

A Strategic Economic Investment Board would direct the Fund, which would be required to 1) establish a competitive process to award grants and make loans for competitive edge technologies; and 2) contract with independent peer review experts to assist the board with its responsibilities. This board would exercise its powers, duties, and decision-making authority as an autonomous entity independent of the Fund and of the Department of Treasury.

Under the bill, "competitive edge technologies" would refer to:

- life sciences technology;
- advanced automotive, manufacturing, and materials technology;
- homeland security and defense technology;
- alternative energy technology;

The term "life sciences" would include bioengineering, biomedical engineering, genomics, proteomics, molecular and chemical ecology, and biotechnology. It would not include stem cell research with human embryonic tissue and various other activities prohibited by the Public Health Code.

Competitive Process for Grants and Loans. The required competitive process for the awarding of grants and loans would have the following features:

- Applications would be peer-reviewed by independent peer review experts based on the scientific, technical, and commercial merits, each of which would be given equal weight.
- Out-of-State businesses would need a significant existing or proposed business activity in Michigan.
- Preference would be given to proposals that can contribute to the development of economic diversification or the creation of employment opportunities in the state.
- Contracts would need to use measurable milestones, clear objectives, revocation provisions for breach of contract, and repayment provisions for loans to businesses that leave Michigan within three years.
- Applicants would have to leverage other resources as a condition of a grant or loan. If an applicant is seeking a grant or loan to match federal funds for small business innovation research or technology transfer programs, the grant or loan could not exceed 25 percent of the federal funds and must leverage third-party commercialization funding at both the Phase 1 and Phase 2 levels.
- Overhead rates would have to reflect actual overhead but cannot exceed 15 percent of direct costs.
- Grants, other than grants for federal matches, could only be made to Michigan institutions of higher education and Michigan nonprofit research institutions.
- Preference would be given to collaborations between institutions of higher education, nonprofit research institutions, and Michigan businesses.

When the board approved a grant or loan, the board would have to state the specific objective reasons the applicant was selected over other applicants for a grant or loan.

The board would have to establish standards to ensure that money spent would result in economic benefit to Michigan and ensure that a major share of the business activity resulting from the expenditures occurred in Michigan.

Strategic Economic Investment Board. The board would consist of 19 members, including as ex officio voting members the directors of DLEG and the State Treasurer (or designees from the departments). One member would be appointed by the Governor from a list of two or more individuals selected by the Speaker of the House, and one from a list of two or more selected by the Senate Majority Leader, with these two representing Michigan businesses or persons with business, technological, or financial experience related to competitive edge technology. The Governor would appoint the other 15 with

the advice and consent of the Senate, including 7 members representing business; one member representing the Van Andel Institute; one representing Automation Alley; one each representing Michigan State University, the University of Michigan, Wayne State University, Western Michigan University, and Michigan Technological University; and one from another public university. The business members would need expertise, knowledge, skill, or experience in venture capital investments, business finance, bringing competitive edge technology products to market or would need to represent a Michigan business.

Independent Peer Review Experts. These persons would need to have the appropriate expertise to conduct an independent, unbiased, objective, and competitive evaluation of activities funded under the newly created Chapter 8A. The expert or experts would have to demonstrate the capability and experience to conduct a highly competitive and intensive, independent multiphased, peer-review based evaluation process; employ personnel with appropriate business, scientific, technical, or other specialized expertise to carry out each aspect of the evaluation process; provide recommendations to or assist the board in identifying high-quality activities for funding likely to result in the development and commercialization of competitive edge technology and job creation, with the recommendations to include all materials used by the expert in making the recommendation; and assure that any peer review process maintained a high level of integrity. An independent peer review expert could not have any financial interest in a recipient of Fund proceeds.

Board Operations. The investment board could act only by resolution approved by a majority of the members appointed and serving. A majority of members in office would constitute a quorum. The board would have to conduct all business at public meetings held in compliance with the Open Meetings Act. The board could meet in person or by means of electronic communication devices that enable all participants in the meeting to communicate with each other.

Conflict of Interest. Members of the board would be considered public servants and public officers under state law. A board member could not use or attempt to use the position to influence a decision regarding a loan, grant, or other expenditure to his or her employer, and could not engage in conduct that constitutes a conflict of interest. A board member would have to immediately advise the board in writing of the details of an incident or circumstances that could present a conflict of interest. Further, a board member with a conflict of interest would have to disclose the conflict before the board takes action on the matter, and the disclosure would become part of the record of the board's proceedings. The member would have to refrain from voting on the matter; participating in the discussions and deliberations on the matter; being present when deliberation, discussion, and voting take place; and discussing the matter with other board members.

OTHER RELATED PROVISIONS IN THE BILLS

Establishing and Changing Programs. Under House Bill 5047, before adopting a resolution that establishes or changes a 21st Century Investment Program, including any

fees, charges, or penalties, the Fund Board would have to provide notice of the resolution to the Governor, members of the two Legislative Appropriation Committees, and to the standing committees in the Legislature that deal with the subject matter at hand. Notice would also have to be provided to each person who requested notification in writing or electronically. The notice, the resolution, and all attachments would have to be posted on the Fund's Internet website. A public hearing would have to be held on the resolution not sooner than 14 days or longer than 35 days from the date notice was given. The Fund Board could act on the resolution no sooner than 15 days after the public hearing and all written comments are received. The Fund Board would have to provide a final decision document describing the basis for its decision, which would have to be provided to the Legislature and published on the Fund's website. The same requirements would be imposed under Senate Bill 533 on the Competitive Edge Technologies Fund grants and loans administered by the Strategic Economic Investment Board.

Strategic Fund/21st Century Jobs Fund. House Bill 5047 would make a number of changes to the existing Michigan Strategic Fund. The Fund's name would be changed to the 21st Century Jobs Fund and the composition of the board would be changed. Currently, there is a nine-member board that includes the State Treasurer and the Director of the Department of Labor and Economic Growth and seven other members appointed by the Governor with the advice and consent of the Senate. The seven appointees can include two state employees. The bill would not permit state employees to be included among the gubernatorial appointees. It also would require that, after December 31, 2005, two members of the board must have experience in private equity or venture capital investments, at least one member have experience in commercial lending, and at least one member have experience in the commercialization of technology. (The director of DLEG would serve as president of the Fund.) Term lengths would change to four years from three years. The bill also would add additional conflict of interest provisions (similar to those described earlier) and would specify that when authorizing expenditures under the MSF Act, the board and a committee could not consider whether a recipient had made a contribution or expenditure under the Michigan Campaign Finance Act. Further, expenditures under the act could not be used to finance or influence political activities.

The board would temporarily be expanded to 11 members with the appointment by the Governor of two additional members no later than December 15, 2005, with their terms expiring December 31, 2007. After that date, the board would return to nine members. The two additional members would need to be from the private sector and have experience in private equity or venture capital investments, commercial lending, or commercialization of technology.

Audits & Reports. Senate Bill 533 contains provisions about audits and reports related to the new programs authorized by the new Chapter 8A. In addition to other audit requirements in the act, not later than April 1, 2007, and each subsequent April 1, the Auditor General would have to conduct and report a financial audit of the 21st Century Fund, the Strategic Economic Investment Board, the Investment Fund, and the Grant Fund for the preceding fiscal year. At least once every three years, the Auditor General would have to conduct a report a performance post audit. The results of the performance post audit and the post audit of financial transactions and accounts would have to be

published on the Internet and disseminated by other means to advise citizens of the results. Copies would be provided to the Governor, the Clerk of the House of Representatives, the Secretary of the Senate, and the Chairs of the Senate and House of Representatives Committees on Appropriations. The Auditor General could employ an independent public accounting firm to conduct the audits.

All contracts for 21st Century Investments and for grants or loans would have to contain a provision to ensure that the recipient provides an annual financial statement. If there is reasonable belief that a breach of contract has occurred, the Fund would have the right to have the recipient's annual financial statements separately audited by an independent certified public accounting firm. If the audit reveals a breach of contract has occurred, the recipient would have to reimburse the Fund for the fees and expenses incurred to perform the audit.

Annual reports would also be required not later than March 31 to the Governor and Legislature about the grants and loans made by the Fund and the 21st Century Investments made by the Fund Board. For grants and loans, the report would have to contain: the entities receiving funding, along with the amount and type; the number of new patents, copyrights, or trademarks applied for and issued; the number of new start-up businesses; the number of new jobs and projected new job growth; the amounts of other funding leveraged; money or other revenue or property returned to the Investment Fund; the total number of new licensing agreements by institution and the number of new licensing agreements entered into with Michigan-based firms.

For 21st Century Investments, the report would have to include: the entities receiving funding, along with the amount and type; the amount of qualified venture capital fund investments and qualified private equity fund investments under management, including year-to-year growth; the value of loan enhancement program investments, private equity fund investments, and venture capital investments in qualified businesses, including year-to-year growth; a statement of the amount of money received by the Investment Fund from each loan guarantee; a statement of the loan guarantees activity of the Fund Board; a statement of the amount of money in each loan reserve fund under the Small Business Capital Access Program; and any recommendations for needed changes.

Inquiries by the Governor. House Bill 5047 would allow the Governor to "inquire into the administration of this act" [the MSF Act]. The Governor could remove or suspend any appointive public officer for violations of the act, and could request the MEDC to remove or suspend any MEDC corporate employee for violations of the act. Further, the Governor could remove or suspend any elective public officer for a violation that constitutes gross neglect of duty, corrupt conduct in office, misfeasance, or malfeasance. (That would not apply to any public officer of the Judicial or Legislative branches.) The Governor would have to report the reasons for any removal or suspension to the Clerk of the House of Representatives and the Secretary of the Senate.

Projects and Recipients Not Eligible. Under both bills, funds could not be used for some projects and recipients; the provisions are similar but not identical. Funds could not be used for the development of a stadium or arena for a professional sports team or for the

development of a casino. Funds also could not be used to induce a business to leave the state. Also ineligible would be a corporation that is incorporated in a tax haven country after September 11, 2001, but has the U.S. as the principal market for the public trading of its stock; and grants or loans to a person convicted of certain specified criminal offenses or held liable in certain civil proceedings that reflect negatively on business integrity. Under Senate Bill 533, competitive edge technology grants and loans could not be made if the assistance would contribute to the violation of internationally recognized workers rights

Tie-Bars. The bills are tie-barred to each other and to House Bill 5048 (the tobacco settlement securitization bill), as well as to Senate Bills 298, 359, and 521, and House Bills 4972, 4973, 5108, and 5109.

FISCAL IMPACT:

A related bill, House Bill 5048, provides for the sale of the State's future tobacco settlement revenue sufficient to provide \$1 billion in net proceeds after reserves and issuance costs. As noted above, there is flexibility in determining the percentage allocated to the economic development activities enumerated in the related SB 533 and HB 5047. Additional revenue for the Jobs for Michigan Trust Fund will be derived from investments and loans as described in this bill. In addition, HB 5047 provides for return of principal and other money received under fund agreements. However, the total revenue available from all of these sources is not yet determinable. The amount of proceeds available from the sale of future tobacco settlement revenue will be depend on the prevailing bond market interest rate for this type of security at the time of sale. If such interest rates rise, the gross proceeds will be reduced.

State expenditures may increase due to the hiring of full time staff to support the Board of Directors of the 21st Century Jobs Fund, including an executive director to manage the private equity and venture capital programs. Additional expenditures will be needed for legal counsel, independent peer review experts and other consultants, and the reimbursable expenses of the non-compensated members of the Boards. It appears these costs are to be paid from the revenue sources cited above. The amount of such costs cannot be estimated until information regarding the size and composition of full time staff, and the expected annual level of economic development activity becomes available.

Legislative Analyst: Chris Couch
Fiscal Analyst: Richard Child

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.