

January 30, 1992

Honorable Stan Hawkins
State Senator
Idaho State Senate
STATEHOUSE MAIL

**THIS CORRESPONDENCE IS A LEGAL GUIDELINE OF THE
ATTORNEY GENERAL SUBMITTED FOR YOUR GUIDANCE**

Re: 1991 House Bill 206

Dear Senator Hawkins:

This letter is in response to your question concerning the constitutionality of House Bill No. 206, approved by the legislature in 1991. House Bill 206 added new sections 67-4721 through 67-4724 to the Idaho Code. With reference to your question, the pertinent portions of House Bill 206 are as follows:

GRANTS—STANDARDS AND ADMINISTRATION. The department of commerce shall administer a program of grants prorated to private capital raised to establish financing programs for new, emerging, and expanding business enterprises. Grants shall only be made to business and industrial development corporations (BIDCOs) licensed and regulated pursuant to the provisions of chapter 27, title 26, Idaho Code. It is recognized that BIDCOs, in compliance with section 26-2716, Idaho Code, administer a program of professional consulting and financing of new, emerging and expanding business enterprises. Such financings may take the form of loans or equity participation or a combination thereof. BIDCOs must report annually to the legislature, in compliance with section 27-2707, Idaho Code, information on the impact of grants in promoting economic development in the state.

Idaho Code § 67-4722.

RETURN TO THE STATE. It is hereby recognized that the principal return to the state shall be in the form of increased tax revenues and increased job growth. A further return to the state is hereby provided as follows. Grants shall require the applicant to retain within its financing program all funds representing a return on principal until initial capitalization is doubled. Upon doubling capitalization and upon the approval of the department of finance, grantees shall distribute up to fifty

per cent (50%) of profits on a pro rata basis to the state of Idaho. Any additional returns shall be governed by the terms of the grant. In the event of dissolution of a grantee, distribution shall be made to the state and stockholders on a pro rata basis. The director of the department of commerce shall preside over liquidation proceedings in accordance with chapter 27, title 26, Idaho Code.

Idaho Code § 67-4723.

In addressing whether the above-delineated statutory provisions violate the constitution, the two preclusions contained in art. 8, § 2, will be discussed. In addition, your question also requires an analysis of the general principle of law that public funds cannot be expended for private purposes.

CONSTITUTIONALITY OF THE ACT PURSUANT TO ARTICLE 8, SECTION 2 OF THE IDAHO CONSTITUTION

Art. 8, § 2, reads in pertinent part as follows:

The credit of the state shall not, in any manner, be given, or loaned to, or in aid of any individual, association, municipality or corporation; nor shall the state directly or indirectly, become a stockholder in any association or corporation, provided, that the state itself may control and promote the development of the unused water power within this state.

Art. 8, § 2, contains two preclusions on the power of the legislature to authorize aid to private enterprise. First, the lending of the state's credit in aid of private enterprise is precluded. Second, the state is precluded from directly or indirectly becoming a stockholder in a private enterprise.

a. Lending of Credit

Pursuant to Idaho Code § 67-4722, the legislature may appropriate money to the Department of Commerce for the administration of grants to BIDCOs pursuant to the provisions contained in Idaho Code §§ 67-4721, *et seq.* The issue presented is whether the appropriation of money by the legislature is giving or loaning "state credit" as the clause is used in art. 8, § 2. In Engelking v. Investment Board, 93 Idaho 217, 459 P.2d 213 (1969), the Idaho Supreme Court held:

The word "credit" as used in this provision implies the imposition of some new financial liability upon the State which in effect results in the creation of State debt for the benefit of private enterprises. This was the evil

intended to be remedied by Idaho Const., art. 8, § 2, and similar provisions in other state constitutions. Yet that particular evil is not presented by the investment of existing funds of the State, for no new State debts are created by such action.

Id. at 221-22. See also Nelson v. Marshall, 94 Idaho 726, 731, 497 P.2d 47, (1972). Since the credit clause only prohibits the loaning or giving of state credit and not the loaning or giving of state funds, an appropriation to fund the provisions of Idaho Code §§ 67-4221, *et seq.* would not offend this portion of the constitution.

b. Subscription of Stock

Art. 8, § 2, precludes the state from directly or indirectly becoming a stockholder in a private enterprise. Two provisions of House Bill 206 require analysis to determine if there is a potential violation of this section of the constitution. First, § 67-4723 provides:

It is recognized that BIDCOs, in compliance with § 23-2716, Idaho Code, administer a program of professional consulting and financing of new, emerging and expanding business enterprises. Such financings may take the form of loans or equity participation or a combination thereof.

(Emphasis added.) Second, § 67-4724 provides:

Grants shall require the applicant to retain within its financing program all funds representing a return on principal until initial capitalization is doubled. Upon doubling capitalization and upon the approval of the department of finance, grantees shall distribute up to fifty per cent (50%) of profits on a pro rata basis to the state of Idaho. Any additional returns shall be governed by the terms of the grant.

(Emphasis added.)

In the first provision, a BIDCO is provided with the authority to become an equity participant in business enterprises it is helping to finance. The question is whether BIDCOs are public corporations and, as such, equity participation by a BIDCO would in essence be participation by the state.

BIDCOs are regulated pursuant to chapter 27, title 26, of the Banks and Banking provisions of the Idaho Code. To be a licensed BIDCO in Idaho, a company must meet the following qualifications:

Requirements for licensure.—(1) An Idaho corporation may apply to the director for licensure as a BIDCO. A person other than an Idaho corporation shall not apply for a license.

(2) After a review of information regarding the directors, officers, and controlling persons of the applicant, a review of the applicant's business plan, including at least three (3) years of detailed financial projections and other relevant information, and a review of additional information considered relevant by the director, the director shall approve an application for a license if, and only if, the director determines all of the following:

(a) The applicant has a net worth, or firm financing commitments which demonstrate that the applicant will have a net worth when the applicant begins transacting business as a BIDCO, in liquid form available to provide financing assistance, that is adequate for the applicant to transact business as a BIDCO as determined under subsection (3).

(b) Each director, officer, and controlling person of the applicant is of good character and sound financial standing: each director and officer of the applicant is competent to perform his or her functions with respect to the applicant; and the directors and officers of the applicant are collectively adequate to manage the business of the applicant as a BIDCO.

(c) It is reasonable to believe that the applicant, if licensed, will comply with this chapter.

(d) The applicant has reasonable promise of being a viable, ongoing BIDCO and of satisfying the basic objectives of its business plan.

Idaho Code § 26-2709.

A BIDCO is not by definition a public corporation; BIDCOs can clearly be private corporations created to further business enterprises. As such, a BIDCO's equity participation in an emerging business which it is helping to fund would not violate the provisions of art. 8, § 2.

In Utah Technology Finance Corporation v. Wilkinson, 723 P.2d 406 (Utah 1986), a provision of a statute allowing Utah Technology Financing Corporation to use money appropriated by the legislature to make equity investments in developing technical businesses was held by the Utah Supreme Court to be an unconstitutional subscription to

stock by the state. The Utah case is distinguishable from the provisions of Idaho Code §§ 67-4721, *et seq.* Utah Technology Financing Corporation was created by the Utah Legislature as a public corporation; whereas, HB 206 did not create one public business and industrial development company. As previously discussed, chapter 27, title 26, of the Idaho Code allows any Idaho corporation meeting the previously delineated licensing requirements to operate as a BIDCO in the state of Idaho.

However, the provision of Idaho Code § 67-4724 which requires statutory disgorgement of profits to the state is an apparent violation of art. 8, § 2. The statutory requirement that a BIDCO share its profits with the state would, in our opinion, result in the state becoming, at the very least, an indirect equity participant in a private corporation in violation of the provisions of art. 8, § 2.

Since a portion of Idaho Code § 67-4724 may be found to be unconstitutional by the courts, the question arises whether the unconstitutional portion of the Act is severable from the remainder. The general rule for determining severability is whether the unsevered portion of the Act can stand alone and serve a legislative purpose. Voyles v. City of Nampa, 97 Idaho 597, 548 P.2d 1217 (1976). Striking that portion of Idaho Code § 67-4724 which is unconstitutional would not destroy the legislative intent of the Act; the remaining portions of the Act could be implemented standing alone.

PUBLIC PURPOSE DOCTRINE

Closely aligned to, but distinct from, the issue of constitutionality pursuant to art. 8, § 2, is the fundamental principle that expenditures of public funds must be for a public purpose. The courts have held that the provisions of the constitution embody this fundamental principle. Although the courts have also recognized that states have broad discretion in determining what kind of activity constitutes a "public purpose." Loan Association v. Topeka, 87 U.S. 655, 22 L. Ed. 455 (1874); Green v. Frazier, 253 U.S. 233, 40 Supreme Court 499, 64 L. Ed. 878 (1920); Fallbrook Board of County Commissioners v. Idaho Health Facility Authority, 96 Idaho 498, 531 P.2d 588 (1975); State v. Idaho Power Company, 81 Idaho 437, 346 P.2d 596 (1959).

The legislature passed House Bill 206 which, if money is appropriated by the legislature, will provide public funding for grants exclusively available to BIDCOs for the purpose of establishing financing programs for new, emerging, and expanding business enterprises in Idaho. The public purpose as stated in the legislation is to promote economic development and improve the state's economic health through the financing of new businesses which, it is anticipated, will result in an expanded tax revenue base and increased job growth in Idaho. Idaho Code §§ 67-4721, 67-4724.

The Idaho Supreme Court has held that the mere fact that the expenditure would benefit the public does not in and of itself make it a "public purpose." The expenditure must also be directly related to some governmental function or purpose. Idaho Resource Board v. Kramer, 97 Idaho 535, 559, 548 P.2d 35 (1976). Even a finding or declaration by the legislature that a particular venture constitutes a public purpose (as denoted in the statute reviewed here), while entitled to considerable weight, is not determinative; "public purpose" is ultimately a judicial question. Bevis v. Wright, 31 Idaho 676, 175 P. 815 (1918); Village of Moyie Springs v. Aurora Manufacturing Company, 82 Idaho 337, 353 P.2d 767 (1960). It is constructive to note that the Idaho Supreme Court has found development of the state's water resources to be of benefit to the public and a function of the government, Nelson v. Marshall, *supra*; Idaho Water Resource Board v. Kramer, *supra*; and the court has also found expenditures of public funds on urban renewal to benefit a broad public purpose directly related to government, Boise Redevelopment Agency v. Yick Kong Corporation, 94 Idaho 876, 499 P.2d 575 (1972).

Based upon a review of more recent decisions by the court, it is likely that the fundamental purpose behind the statute may be found to meet the two-pronged public purpose test. However, the narrow focus of the grant program as provided by the statute may cause the court concern. The statute provides that grants of public money will go only to business and industrial development companies. Grants cannot be obtained by banks or other lending institutions for the purposes delineated in § 67-4721, *et seq.* In determining whether the "public purpose" test has been met, the courts have previously looked for evidence that no particular private interest will be discriminated for or against in the provision for public funding. *See Boise Redevelopment Agency v. Yick Kong Corporation*, *supra*. In the situation before us, the statute's narrow provision allowing receipt of grant money only by BIDCOs may not be looked at favorably by a court.

I hope this adequately addresses the questions raised in your correspondence. If I can be of further assistance, please contact me.

Very truly yours,

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Chief, Business Regulation
and State Finance Division