1961

Utah State Land Board v. Utah State Finance Commission : Brief of Appellant

Utah Supreme Court

Franklin J. Allen; Attorney for Appellant;

IN THE SUPREME COURT OF THE STATE OF UTAH

UTAH STATE LAND BOARD
Appellant

— vs. —

UTAH STATE FINANCE COMMISSION
Respondent

Case No. 9354

BRIEF OF APPELLANT

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STATEMENT OF FACTS

Utah's 1959 legislature authorized investment of not to exceed 50% of the Permanent School Fund moneys in corporate securities meeting statutory standards of quality (Section 65-1-65, U. C. A. 1953 as amended 1959). Respondent refused to issue checks for the purchase of authorized securities on the ground that the purchase of corporate securities was unconstitutional.

This is an action commenced under the Utah Declaratory Judgment Act. Appellant sought a declaration from the lower court as to its rights and authority under Section 65-1-65 U.C.A. 1953, as amended 1959, in view of the provisions of Section 31, Article VI and Section 7, Article X of the Utah Constitution. It was the judgment of the lower court that the statute in question violated Section 31, Article VI and was invalid to the extent it permitted investment of school funds in corporate securities. No declaration was made as to the effect of Section 7, Article X on plaintiff's investment activity, and the only issue before this court on this appeal is the propriety of the lower court's construction of Section 31, Article VI, which reads as follows:

> "Sec. 31 (Lending public credit forbidden)
>
> The Legislature shall not authorize the State, or any city, county, town, township, district or other political subdivision of the State to lend its credit or subscribe to stock or bonds in aid of any railroad, telegraph or other private individual or corporate enterprise or undertaking."

STATEMENT OF POINTS

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ARGUMENT

Point I

THE PURCHASE OF CORPORATE SECURITIES IN ACCORDANCE WITH STATUTE IS NOT A LENDING OF THE PUBLIC CREDIT IN AID OF THE CORPORATION WHOSE SECURITIES ARE PURCHASED.

The principal proscription of Section 31, as indicated by the title, is against lending the public credit. This is a common kind of constitutional provision which has had frequent judicial scrutiny. Corpus Juris Secundum treats the generic provision at page 1167 of Volume 81. Beginning on page 1168, the editors say:

> "In order to constitute a violation of the constitutional provision, it is essential that there be an imposition of liability directly or indirectly on the state, and unless the credit or faith of the state is obligated there is no violation. The giving or lend-

> ing of credit of the state prohibited by the Constitution occurs only when such giving or lending results in creation by the state of a legally enforceable obligation on its part to pay one person an obligation incurred or to be incurred in favor of that person by another person."

In *Watrous* v. *Golden Chamber of Commerce,* 121 Colo. 521, 218 P. 2d 498, therefore, the Colorado court held that a statute authorizing the issuance of revenue bonds did not pledge or lend the state's credit because there could be no call by the bondholders upon the general funds of the state. In *Commissioners of Bladen County* v. *Boring,* 95 SE 43, on the other hand, a statute authorizing the County to guarantee road bonds of townships within the County was held, by the North Carolina Court, to violate a constitutional provision prohibiting counties from lending their credit.

It is clear from the texts and cases that a loan of the state's credit can only occur when the state enters into such a relationship that it must pay another's debt if he does not. The purchase of corporate securities does not create a relationship of the proscribed kind. The owner of a corporate bond or stock certificate has no obligation to the creditors of the issuing corporation by virtue of that ownership. A bondholder is himself a preferred creditor. A stockholder has some claim upon the assets of the corporation (Fletcher Cyclopedia of Corporations, § 8224) and no personal responsibility to its creditors (Section 16-2-13 U.C.A. 1953; 18 C.J.S. 1306).

Even if it could be contended that Appellant's purchase of corporate securities somehow lent the public

credit, such purchases would still be proper and constitutional unless they were also "in aid of" the corporation. The Virginia Court had occasion to discuss the meaning of a provision similar to Utah's in *Holston Corporation* v. *Wise County,* 131 Va. 142, 109 S.E. 180. In that case, the county entered into a contract with a corporation by which the corporation agreed to furnish gravel at a specified price to any contractor building county roads, and the county guaranteed payment. The Court said such a contract did not grant the credit of the county "in aid of" the contractors unless the contractors could not have obtained gravel on their own credit or made a greater profit by getting a reduced price because of the pledge of the county credit. Many cases have held that whether or not an action which might lend public credit was in aid of a private individual depends on the animating purpose of the public officials. (See annotation which appears at 87 ALR 168) The purpose of purchases made in accordance with Section 65-1-65 would be to improve the investment position of the Permanent School Fund, not to aid corporations.

The question of whether a purchase of corporate bonds offended the "credit clause" was squarely before the Virginia Court in *Almond* v. *Day,* 197 Va. 792, 91 S.E. 2d 667. It held a statute authorizing the purchase of corporate securities was constitutional and did not offend the credit clause of the Virginia Constitution. In particular the court said, beginning at page 667:

> "Use of the State's funds for purchase of securities for the State's benefit is not an extension

of "credit" which poses any threat to the financial security or welfare of the State. Extending its credit to aid and promote private enterprise was the evil from which the State had suffered financially. The potential danger incurred in lending credit to foster and promote the interests of those who had no rightful claim, in justice or in morals, to the State's help or relief was the evil to be arrested. When the underlying and activating purpose of the transaction and the financial obligation incurred are for the State's benefit, there is no lending of its credit though it may have expended its funds or incurred an obligation that benefits another. Merely because the State incurs an indebtedness or expends its funds for its benefit and others may incidentally profit thereby does not bring the transaction within the letter or the spirit of the 'credit clause' prohibition."

Point II

THE PURCHASE OF CORPORATE SECURITIES IN ACCORDANCE WITH STATUTE IS NOT A SUBSCRIPTION TO STOCK OR BONDS IN AID OF A CORPORATE ENTERPRISE OR UNDERTAKING.

The constitutional language which concerns us here is that which forbids authorization "to *subscribe* to stock or bonds in aid of" any corporate enterprise. If the phrase "to subscribe to" is synonymous with the verb "to purchase," a clear conflict between constitution and statute must be recognized where, but only where, a purchase is attempted the activating purpose of which is to "aid" a corporation. It is the appellant's contention that subscription is different from purchase and that the framers of the constitution were concerned about

a kind of evil which could proceed from subscription and not from the kind of purchase authorized by Sec. 65-1-65.

Reference to the standard legal texts and dictionaries clearly marks for us a distinction between "subscribe to" and "purchase." Fletcher (4 Fletcher Cyclopedia Corporations 1372) devotes some seven pages to the distinction. It is certain that a subscription can only relate to an original issue of stock and a direct transaction with the issuing corporation or other subscribers.

In *Guaranty Mortgage Co.* v. *Wilcox,* (218 P. 133; 62 U. 184) this Court noted the distinction between subscription and purchase and expressed the point of view was undoubtedly in the minds of the constitutional draftsmen. The following language of the Pennsylvania Court was cited with approval:

> "It seems to us that there is a clear distinction between a subscription agreement and a contract for the purchase of stock. Subscribers, as generally understood, are those who, upon the formation of a corporation, agree mutually to take and pay for the shares of the capital stock."

Appellant could not, acting under the authority of Section 65-1-65, enter into a subscription agreement because only securities of corporations having a five-year dividend record can be purchased.

That some real difference between subscription and purchase was recognized by the members of the constitutional convention is evident from the record of the con-

vention proceedings.[1] At page 894 of Volume I of Proceedings Constitutional Convention, there begins the record of a long and heated debate on the proposal of Mr. Roberts that the following section be added to the constitution's legislative article:

> "Neither the State of Utah nor any political subdivision thereof shall *become a stockholder in* or loan its credit to nor make any appropriation for the benefit of any person, company, association or corporation unless two-thirds of the qualified voters at a regular election to be held shall assent thereto."

It is obvious from the debate that this proposal represented the extreme limitation sought to be imposed upon the legislature by members of the convention. Those who believed the legislature should be permitted to exercise its judgment in this area were at least as vocal and unquestionably more numerous since the proposal of Mr. Roberts was defeated (p. 928) and a motion for reconsideration failed (page 1002, Vol. II).

The further records of the convention do not include discussion of the language which became Section 31 of Article VI. It is significant, however, that Mr. Roberts' proposal forbidding the State to "*become a stockholder*" was rejected and a provision was accepted which prohibited only *subscriptions* to stock and bonds of private corporations. The conclusion is inescapable that there was something about subscription not inherent in "*becoming a stockholder*" which the convention found repulsive.

[1] Proceedings of constitutional convention may be resorted to in aid of construction and interpretation of constitutional provision (Cooper v. Utah Light & Ry. Co., 35 U 570, 102 P 202).

There can be no question that the real issue in the convention was whether or not the public credit should be lent. Mr. Roberts, the proposer of the section, seemed to claim no other objective for his proposal than the avoidance of any pledge of the public credit, and the section heading would confine the scope of the prohibition to action which would pledge the public credit.[2]

1895, the year of the convention, was in the era of frantic railroad construction.[3] It had been the practice of the United States and some states to offer bounties, in the form of land or money, to railroad companies for road construction or to guarantee the payment of their debts. Tennessee in particular had suffered severe losses, and the Tennessee situation was pointed out, in the course of the convention debate, as the evil to be avoided. The activity which resulted in heavy public debt in Tennessee is summarized in the 1926 edition of "Moody's Governments" beginning at page 1878. The historical summary begins:

> "Aid to companies in the construction of public improvements was responsible for a large part of the debt of Tennessee. 'An act to establish a system of internal improvements in this State' was passed Feb. 11, 1852 and provided that State bonds to the extent of $8,000.00 per mile might be issued and lent to turnpike and railroad companies—" * * * * "Before and immediately after the war

[2] "In case of ambiguity in a statute, the title and headings may be resorted to as an aid in the ascertainment of the legislative intent." (82 C. J. S. 731, Statutes § 350)

[3] "Where the language of a statute is ambiguous, the courts will take into consideration all the facts and circumstances existing at the time of, leading up to its enactment, such as the history of the times, contemporary customs, the state of the existing law, the evils to be remedied, and the remedy provided." (82 C. J. S. 738, Statutes § 352)

> $27,678,000 state bonds were lent to railroad companies.''

The evil seen by our convention lay in the lending of credit to private corporations in this manner where the state became obliged to pay the debt which was incurred for and was the primary obligation of the railroad companies.

There is a distinct kinship between a pledging of the public credit in aid of a private corporation and a promise by government to purchase shares of such a corporation when organized. In both cases, the action of the government is promotional; the promise is given to induce investors to commit their money to an enterprise thought to be in the public interest. In both cases, the promise is or may be enforceable at the suit of the investors or the creditors of the corporation. The motivation, the risk and the mechanics are entirely different where corporate securities are acquired with accumulated funds as a part of an investment program calculated to increase the yield from public funds and protect them from the depreciating effects of economic inflation.

The constitutional convention was concerned that the Legislature should not engage in promotional activities of the kind specifically prohibited, that is — lending the public credit or entering into subscription contracts. That the state might become a stockholder in the course of a planned investment program was not distasteful to the members. They were opposed to the state's underwriting enterprises in the nature of utility expansion by new

corporations without experience or solid financial foundation whether the underwriting was done by direct guarantee or pre-incorporation subscription.

It is in this light that the court should construe the language of Article VI, Section 31. There is abundant logic and authority to support the view that investment in well-established corporate securities with public funds accumulated only for investment was never intended to be prohibited. Such investment is in aid of the State, not the corporation.

Point III

LEGISLATIVE ENACTMENTS MUST BE SUSTAINED UNLESS CLEARLY IN VIOLATION OF FUNDAMENTAL LAW.

The Court is undoubtedly aware of the principle of constitutional law that the judicial effort should be to sustain legislation, not to condemn it. The principle should apply with special force where, as in this case, the legislation passed both houses without one dissenting vote. This Court has been among the most eloquent in endorsing the principle. In *Lehi City* v. *Meiling,* 87 U 237, 48 P 2d 526, it said:

> "in approaching the subject we have in mind the rule that when an act of the Legislature is attacked on grounds of unconstitutionality the question presented is not whether it is possible to condemn the act, but whether it is possible to uphold it. The presumption is always in favor of validity, and legislative enactments must be sustained unless clearly in violation of fundamental law. * * * *

> Every presumption will be indulged in favor of legislation and only clear and demonstrable usurpation of power will authorize judicial interference with legislative action.''

To sustain the statute here in question, this Court need only recognize the well-established distinction between subscription and other kinds of securities purchase contracts, construe the ''credit clause'' as it has been construed by other courts and understood by the writers, or acknowledge that only activity primarily intended to aid corporations is prohibited.

CONCLUSION

For all of the foregoing reasons:

1. Security purchases do not lend the public credit.
2. Security purchases authorized by Section 65-1-65 cannot be subscriptions.
3. Activity contemplated by Section 65-1-65 cannot be presumed to be ''in aid of'' corporations rather than the state.

appellant respectfully requests that this Court reverse the judgment of the District Court herein and declare Section 65-1-65 U.C.A. 1953, as amended 1959, to be constitutional, valid and operative.

Respectfully submitted,

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