OPINION NO. 2000-013

Syllabus:

1. A Capital Access Program under which the Department of Development pays money into a reserve fund used to cover losses that may result from defaults on loans made by a private for-profit bank to private for-profit companies would constitute the giving or loaning of the credit of the state in violation of Ohio Const. art. VIII, § 4.

2. A Capital Access Program under which the Department of Development pays money into a reserve fund used to cover losses that may result from defaults on loans for working capital made by a private for-profit bank to private for-profit companies would be permissible under Ohio Const. art. VIII, § 13 as an arrangement to provide for the acquisition or improvement of property for industry or commerce, if it satisfies the conditions of Ohio Const. art. VIII, § 13.

To: C. Lee Johnson, Director, Ohio Department of Development, Columbus, Ohio
By: Betty D. Montgomery, Attorney General, February 16, 2000

We are in receipt of your letter asking about the constitutionality of a proposed Capital Access Program. You have raised the following questions:

1. Would the payment of funds by the Department of Development into a reserve fund held at a bank as part of a Capital Access Program be considered a "grant" of funds as was the case in the NCIC Ohio Attorney General opinion (1998 Op. Att'y Gen. No. 98-034), thereby allowing the "grantee" to do what it wished with the funds, or would this be viewed as a loan?

2. May the Department make loans for working capital? Can working capital loans be considered the "lending of aid and credit" as the phrase is used in the Constitution? Or may it be considered "commerce" as the operation and maintenance of an office building was considered in *County of Stark v. Ferguson*, 2 Ohio App. 3d 72, 440 N.E.2d 816 (Stark County 1981)?

The proposed Capital Access Program is currently under consideration by the Department of Development. You have informed us that similar programs are in effect in a number of other states. It is anticipated that, if the Department decides to proceed with a Capital Access Program, it will seek to have appropriate legislation enacted. Because the legislation is not yet in effect, this opinion considers a general outline of the form such a program would follow and addresses the question whether such a program would be constitutional.

In your letter and subsequent communications you have described the Capital Access Program as follows:

> To utilize the Program, a borrower applies to a bank for a loan, and both the bank and the borrower pay an up-front insurance premium, typically

> between one and one-half percent and three and one-half percent of the loan amount, which goes into a reserve fund held at the bank. The state matches the combined contribution with a deposit into the reserve fund. The loans, among other things, will be for working capital and other business expenses. If a default occurs, and the bank suffers a loss, the bank will seek reimbursement of its loss from this reserve fund.

In telephone conversations, your representatives have informed us that the money in the reserve fund will be property of the state and the state will earn interest on that money.[1]

The constitutional provisions about which you are concerned appear in Ohio Const. art. VIII, §§ 4 and 13. Ohio Const. art. VIII, § 4 provides that "[t]he credit of the state shall not, in any manner, be given or loaned to, or in aid of, any individual association or corporation whatever," and that the state may not become a joint owner or stockholder in any company or association.[2] This provision prohibits the state, or its agencies, from making loans, grants, or gifts to or for the benefit of a private, for-profit enterprise, or from becoming involved in a joint venture with such an enterprise. *See, e.g., State ex rel. Tomino v. Brown*, 47 Ohio St. 3d 119, 549 N.E.2d 505 (1989); *State ex rel. Dickman v. Defenbacher*, 164 Ohio St. 142, 128 N.E.2d 59 (1955); 1998 Op. Att'y Gen. No. 98-034; 1996 Op. Att'y Gen. No. 96-051. It has been found, however, that the credit of the state may constitutionally be given or loaned to nonprofit entities for a public purpose. *See, e.g., State ex rel. Tomino v. Brown*; *Bazell v. City of Cincinnati*, 13 Ohio St. 2d 63, 233 N.E.2d 864, *appeal dismissed*, 391 U.S. 601 (1968); *State ex rel. Dickman v. Defenbacher*; 1996 Op. Att'y Gen. No. 96-060, at 2-242; 1985 Op. Att'y Gen. No. 85-011, at 2-42 to 2-43.

Ohio Const. art. VIII, § 13 provides an exception to Ohio Const. art. VIII, § 4, allowing the state, its political subdivisions, taxing districts, or public authorities, agencies or instrumentalities, or nonprofit corporations designated as agencies or instrumentalities, "to acquire, construct, enlarge, improve, or equip, and to sell, lease, exchange, or otherwise dispose of property, structures, equipment, and facilities within the State of Ohio for industry, commerce, distribution, and research, to make or guarantee loans and to borrow money and issue bonds or other obligations" to provide money for those purposes. Ohio Const. art. VIII, § 13. Ohio Const. art. VIII, § 13 expresses the determination that the exercise of such authority is "in the public interest and a proper public purpose." *Id.*; *see also State ex rel. Burton v. Greater Portsmouth Growth Corp.*, 7 Ohio St. 2d 34, 39, 218 N.E.2d 446, 451 (1966). The general purposes to be served by the exercise of this authority are "[t]o create or preserve jobs and employment opportunities, to improve the economic welfare of the people of the state, to control air, water, and thermal pollution, or to dispose of solid waste." *Id.* This constitutional provision does not permit moneys raised by taxation to be obligated or pledged for the payment of bonds or obligations issued or guarantees made pursuant to laws enacted under its provisions. *Id.* Instead, projects undertaken pursuant to Ohio Const. art. VIII, § 13 are commonly funded through revenue bond arrangements, under which revenues derived from a project are used to pay any debt that is incurred, as, for example, by using

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[1]You have not indicated how such an arrangement will be established and this opinion does not address that issue.

[2]Similar language applicable to counties, cities, towns, and townships appears in Ohio Const. art. VIII, § 6. The same principles are expressed in Ohio Const. art. VIII, §§ 4 and 6, and authorities dealing with one of those sections are considered relevant with respect to the other. *See State ex rel. Eichenberger v. Neff*, 42 Ohio App. 2d 69, 330 N.E. 2d 454 (Franklin County 1974); 1985 Op. Att'y Gen. No. 85-011, at 2-42 n.3.

fees to pay for a solid waste disposal facility or using rents and admission receipts to pay for an auditorium. *See, e.g.*, R.C. 165.02-.03 (industrial development bonds).

Action taken under Ohio Const. art. VIII, § 13 need not conform to Ohio Const. art. VIII, § 4 or other sections of Ohio Const. art. VIII, but must conform to the conditions of Ohio Const. art. VIII, § 13. *See, e.g., State ex rel. Eichenberger v. Neff*, 42 Ohio App. 2d 69, 78, 330 N.E.2d 454, 460 (Franklin County 1974). Hence, an arrangement may be authorized under Ohio Const. art. VIII, § 13 even if it involves the lending of credit of the state or a joint enterprise between the state and a private, for-profit entity. *See* 1998 Op. Att'y Gen. No. 98-034.

Let us consider first the question whether payments made by the Department of Development under the proposed Capital Access Program would be considered a grant or a loan of funds. As discussed in 1998 Op. Att'y Gen. No. 98-034, a grant is generally a transfer of money with no expectation that the money will be repaid. A grant is usually made pursuant to an agreement that sets forth the manner in which the money may be expended. *See* 1998 Op. Att'y Gen. No. 98-034, at 2-198. In contrast, a loan is a financial arrangement under which there is an agreement for repayment. *See Black's Law Dictionary* 936 (6th ed. 1990).

While aspects of the Capital Access Program have not yet been determined, the basis of the Capital Access Program will be the payment of funds by the Department of Development to private for-profit banks to be placed in a reserve fund in each bank. The banks will issue loans to private for-profit companies and, if defaults occur, the banks will secure payment from the reserve funds. Thus, whatever the details of the Capital Access Program, the small amount of state funds will be used to leverage private for-profit banks in providing loans to private for-profit companies.

Ohio Const. art. VIII, § 4 is phrased to prohibit the giving or loaning of the credit of the state in aid of an individual, association, or corporation. As discussed above, this language has been found to prohibit loans or grants made to or for the benefit of private for-profit enterprises. Whether payments made by the Department of Development under a Capital Access Program are considered to be loans or grants, those payments would be made in aid of private for-profit enterprises. Such payments would violate Ohio Const. art. VIII, § 4, as it has been commonly construed and applied. *See, e.g., State ex rel. Saxbe v. Brand*, 176 Ohio St. 44, 197 N.E.2d 328 (1964); 1998 Op. Att'y Gen. No. 98-034.

Your letter suggests that if the Capital Access Program is set up to provide for grants, rather than loans, the grantee may do what it wishes with the funds. Even in a grant situation, however, there generally are limitations upon the manner in which funds may be expended. A grantee might not be required to repay a grant as it would a loan, but the grantee may expend grant moneys only in accordance with the agreement under which the grant is accepted, and that agreement must be consistent with applicable provisions of law. *See* 1998 Op. Att'y Gen. No. 98-034, at 2-202.

In the instant case, it is proposed that the Department of Development place into the reserve fund amounts of money that match percentages of particular loans made by the bank to private borrowers. If there were a default on a particular loan, the bank would access the reserve fund to reimburse its loss. The money in the reserve fund would not actually be loaned to the borrowers, but the existence of the fund would enable the bank to issue loans to persons who could not otherwise receive loans or to issue loans in amounts greater than those that could otherwise be made available. Thus, it appears that the Department's payment of money into the reserve fund would result in the giving or lending of the credit of the

state to or in aid of private for-profit enterprises in violation of Ohio Const. art. VIII, § 4. *See, e.g., State ex rel. Saxbe v. Brand.* The same result would be reached whether the payments by the Department of Development are structured as grants or loans.

You have asked also about the fact that a Capital Access Program would provide loans for "working capital," and whether this use of the money would affect the constitutional analysis. As discussed above, Ohio Const. art. VIII, § 4 prohibits the giving or lending of the credit of the state to a private for-profit enterprise for any purpose. A Capital Access Program under which the Department of Development pays money into a reserve fund used to cover losses that may result from defaults on loans made by a private for-profit bank to private for-profit companies would constitute the giving or loaning of the credit of the state in violation of Ohio Const. art. VIII, § 4. Therefore, regardless of the ultimate use of the money, the proposed Capital Access Program is not permissible under the lending credit prohibitions of Ohio Const. art. VIII, § 4.

It is appropriate, however, for us to consider the ultimate use of the money in determining whether the Capital Access Program may be permissible under Ohio Const. art. VIII, § 13. As discussed above, Ohio Const. art. VIII, § 13 provides an exception from the lending credit prohibitions of Ohio Const. art. VIII, § 4 for programs that satisfy the requirements of Ohio Const. art. VIII, § 13. A program under Ohio Const. art. VIII, § 13 may be structured to provide either grants or loans. *See* 1998 Op. Att'y Gen. No. 98-034.

To satisfy the requirements of Ohio Const. art. VIII, § 13, a program must meet several conditions. It must serve the general purposes of creating or preserving jobs and employment opportunities, improving the economic welfare of the people of the State of Ohio, controlling pollution, or disposing of solid waste. It must provide for the state, political subdivisions, taxing districts, public authorities, agencies or instrumentalities, or nonprofit corporations designated as agencies or instrumentalities, to carry out the listed activities for industry, commerce, distribution, and research. It may not obligate or pledge moneys raised by taxation to pay bonds or other obligations or guarantees. Rather, if any bonds or other obligations or guarantees are made, they must be paid with moneys from sources other than taxation, such as rents, fees, or other revenues derived from projects funded under the program.

The Capital Access Program clearly comes within the general purpose of creating or preserving jobs and employment opportunities and improving the economic welfare of the people of the State of Ohio. Further, it is anticipated that the proposed legislation will be drafted to prevent the obligation or pledging of moneys raised by taxation. *See* 1998 Op. Att'y Gen. No. 98-034, at 2-201; 1994 Op. Att'y Gen. No. 94-071; 1985 Op. Att'y Gen. No. 85-016. Therefore, our discussion centers on the question whether the proposed uses of public funds would come within the uses permitted under Ohio Const. art. VIII, § 13.

Ohio Const. art. VIII, § 13 authorizes the expenditure of public money for specified purposes, namely, "to acquire, construct, enlarge, improve, or equip, and to sell, lease, exchange, or otherwise dispose of property, structures, equipment, and facilities within the State of Ohio for industry, commerce, distribution, and research." Under the proposed Capital Access Program, public moneys will be made available to private for-profit banks to enable the banks to provide businesses with loans for working capital. In your words: "Working capital is used to fund current operations and may include, but is not limited to, payroll and payroll taxes, trade payables, accrued liabilities, inventory, computer software and hardware, rolling stock, small tools and short term equipment purchases." A common legal definition is as follows:

> **Working capital.** A firm's investment in current assets, such as cash, accounts receivable, inventory, etc. The net working capital is the difference between the current assets and current liabilities. Such represents the amount of cash, materials, and supplies ordinarily required by a business in its day-to-day business operation to meet current expenses and such contingencies as may typically develop.

Black's Law Dictionary 1605 (6th ed. 1990) (citation omitted). Hence, working capital consists of money and other assets that are used for the day-to-day operations of a business.

We consider next whether lending money for working capital comes within the purposes for which Ohio Const. art. VIII, § 13 authorizes the expenditure of public funds. That provision authorizes, *inter alia*, the acquisition or improvement of property or equipment for industry or commerce.

The term "property," as used in Ohio Const. art. VIII, § 13, has been found to include property of all sorts, intangible as well as tangible. *See* 1998 Op. Att'y Gen. No. 98-034. The courts have found it permissible for a municipality acting under Ohio Const. art. VIII, § 13 to issue bonds in order to use the proceeds to invest in other securities in an arbitrage financing arrangement, where the purpose of the transaction was to secure an option to purchase a closed limestone mine and to finance feasibility and engineering studies regarding the potential for hydroelectric energy production at the mine. *City of Norton v. Limbach*, 65 Ohio App. 3d 709, 585 N.E.2d 444 (Summit County 1989). Thus, the courts have permitted public funds to be expended under Ohio Const. art. VIII, § 13 for purposes of investment, financing, studies, and purchase of options, stating generally that the legislature has the primary responsibility for deciding what constitutes a public purpose and courts will not overrule such determinations if they are not manifestly arbitrary and unreasonable. *Id.* at 713, 585 N.E.2d at 447; *see also State ex rel. Eichenberger v. Neff*, 42 Ohio App. 2d at 78, 330 N.E.2d at 460 (Ohio Const. art. VIII, § 13 "finds it to be in the public interest, and a proper public purpose, for the state to lend the credit of the state, to make loans, and to lease lands for the purpose of industry and commerce"). It is consistent with this reading of Ohio Const. art. § 13, to permit public funds to be expended to enable banks to provide private for-profit entities with loans of working capital.

As used in Ohio Const. art. VIII, § 13, the term "commerce" has been construed broadly to include all types of business and financial interactions. For example, in *County of Stark v. Ferguson*, 2 Ohio App. 3d 72, 440 N.E.2d 816 (Stark County 1981), it was found that the acquisition, construction, operation, and maintenance of an office building with rental space for physicians, dentists, laboratories, and a public pharmacy constituted commerce for purposes of Ohio Const. art. VIII, § 13. In applying Ohio Const. art. VIII, § 13 to a situation involving the issuance of economic development revenue bonds to finance the construction of for-profit multiunit rental housing, the Ohio Supreme Court did not consider whether the act of construction itself constituted the construction of a facility for commerce and industry, but focused instead on "activities that will occur once construction is completed." *State ex rel. Board of County Comm'rs v. Zupancic*, 62 Ohio St. 3d 297, 301 n.8, 581 N.E.2d 1086, 1089 n.8 (1991). The court stated:

> The exchange of money for possessory interests in the rental units certainly constitutes "commerce" as that term is commonly used and has been defined. Furthermore, the commercial service of providing and maintaining rental housing constitutes a service industry that would be promoted by the issuance of the bonds in question.

Id. at 301, 581 N.E.2d at 1089.

It has thus been found that Ohio Const. art. VIII, § 13 authorizes the financing and promotion of service industries and retail operations, as well as manufacturing industries. The term "commerce," as used in Ohio Const. art. VIII, § 13, has been construed to include financing and rental arrangements and commercial services. *See also, e.g., State ex rel. Board of County Comm'rs v. Mong*, 12 Ohio St. 3d 66, 465 N.E.2d 428 (1984) (including farming as industry or commerce for purposes of Ohio Const. art. VIII, § 13). Both the lending of working capital and the operation of businesses with money derived from such loans would come within this interpretation of commerce.

Hence, the courts have read Ohio Const. art. VIII, § 13 to encompass expenditures for a wide variety of property, including intangible property, and to authorize the support of a wide variety of enterprises, including commercial services and retail operations. Thus, it appears that the process of making working capital available is part of the commerce or industry of Ohio and is included among the activities that are authorized by Ohio Const. art. VIII, § 13.

Under the proposed plan, no money would be paid by the Department of Development directly to a borrower. Rather, moneys of the Department would be made available to private for-profit banks as part of a reserve fund to cover losses resulting from defaults on loans. The moneys provided by the Department thus would be part of an arrangement providing for payment of the banks' loans. Hence, the arrangement would come within the provisions of Ohio Const. art. VIII, § 13 that permit the state or its agencies or instrumentalities to provide moneys for the acquisition or improvement of property, structures, equipment, and facilities for industry, commerce, distribution, and research, and the arrangement would be permissible whether the payments by the Department of Development are structured as grants or loans. We conclude, therefore, that a Capital Access Program under which the Department of Development pays money into a reserve fund used to cover losses that may result from defaults on loans for working capital made by a private for-profit bank to private for-profit companies would be permissible under Ohio Const. art. VIII, § 13 as an arrangement to provide for the acquisition or improvement of property for industry or commerce, if it satisfies the conditions of Ohio Const. art. VIII, § 13.

Therefore, it is my opinion, and you are advised:

1. A Capital Access Program under which the Department of Development pays money into a reserve fund used to cover losses that may result from defaults on loans made by a private for-profit bank to private for-profit companies would constitute the giving or loaning of the credit of the state in violation of Ohio Const. art. VIII, § 4.

2. A Capital Access Program under which the Department of Development pays money into a reserve fund used to cover losses that may result from defaults on loans for working capital made by a private for-profit bank to private for-profit companies would be permissible under Ohio Const. art. VIII, § 13 as an arrangement to provide for the acquisition or improvement of property for industry or commerce, if it satisfies the conditions of Ohio Const. art. VIII, § 13.