

Opinion No. 2012-150

April 26, 2013

The Honorable Sue Madison
State Senator
573 Rock Cliff Road
Fayetteville, Arkansas 72701-3809

Dear Senator Madison:

You have requested my opinion concerning certain debts that the Higher Education Subcommittee of the Legislative Council determined were owed to some state institutions of higher education this past biennium. You identify the debts at issue as ones owed by local businesses whose employees were provided training by local colleges. You state that many of those businesses declared bankruptcy and the debts were never paid. You express concern that all unpaid debts result in higher bills for paying students, and you ask:

Does the extension of credit to these third parties constitute a violation of [Article 16, section 1 of the Arkansas Constitution]?

The constitutional provision you cite provides as follows:

Neither the State nor any city, county, town or other municipality in this State shall ever *lend its credit for any purpose whatever*; nor shall any county, city or town or municipality ever issue any interest bearing evidences of indebtedness, except such bonds as may be authorized by law to provide for and secure the payment of the indebtedness existing at the time of the adoption of the Constitution of 1874, and the State shall never issue any interest-bearing treasury warrants or scrip.¹

¹ Ark. Const. art. 16, § 1 (emphasis added).

RESPONSE

Your reference to “the extension of credit” appears to assume that the “debts” at issue arose from some credit sale of educational services by the higher education institutions. I have no information regarding the terms of any agreement or arrangement in that regard; and in any event, I am neither authorized nor charged with responsibility to review particular transactions, the legality or constitutionality of which will have to be evaluated under their own facts by the parties’ retained counsel. This opinion consequently should not be read to comment upon the propriety or impropriety of the particular liabilities that prompted your question. I can only address, generally, Ark. Const. art. 16, § 1’s prohibition against the State “lend[ing] its credit.”

The full contours of this prohibition have not been extensively explored or defined by the Arkansas Supreme Court.² However, as noted by one of my predecessors, an apparent majority of courts in other states have construed similar so-called “credit clauses” as involving the state directly or indirectly becoming a debtor.³ This view of a “lending of credit” seems to be reflected in *Halbert v. Helena-West Helena Indus. Dev. Corp.*,⁴ where the Arkansas Supreme Court held that the part of an act authorizing the State Board of Finance to purchase bonds from local development corporations did not violate art. 16, § 1:

² As one author has observed, the phrase “lending of credit” was “very popular in the nineteenth century but now [is] relatively obsolete.” David E. Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. Rev. 265, 278-79 (1963).

³ Ark. Op. Att’y Gen. 99-160 (citing *Nelson v. Marshall*, 94 Idaho 726, 497 P.2d 47 (1972); *Continental Illinois National Bank and Trust Company of Chicago v. Illinois State Toll Highway Commission*, 42 Ill.2d 385, 251 N.E.2d 253 (1969); *Industrial Development Authority v. Eastern Kentucky Regional Planning Commission*, 332 S.W.2d 274 (Ken. 1960); *Almond v. Day*, 197 Va. 782, 91 S.E.2d 660 (1956)). See also *Wilmington Medical Center v. Bradford*, 382 A.2d 1338, 1348-49 (Del. 1978) (there is no pledge of state credit without incurring of public legal liability guaranteed by state taxing power); *Foster v. North Carolina Medical Care Comm.*, 195 S.E.2d 517, 525 (N.C. 1973); *Allen v. Tooele County*, 445 P.2d 994, 995 (Utah 1968) (county would not “lend its credit” to another unless county might in some eventuality become indebted); *Uhls v. Wyoming ex rel. City of Cheyenne*, 429 P.2d 74, 86 (Wyo. 1967) (city did not violate constitution by lending or giving its credit where no debt against city was contracted); Tex. Op. Att’y Gen. DM-382, 1996 WL 192148 (observing that “the great weight of authority from other states uniformly construes similar credit clauses as referring to the assumption of some kind of financial liability by the government....”)

⁴ 226 Ark. 620, 29 S.W.2d 802 (1956).

The State is certainly not lending its credit to the local development corporation when it purchases bonds and receives the bonds ...; until it is shown - and it has not been shown here - that the State Board of Finance has abused its discretion or that such investment *impairs the State's ability to pay outstanding obligations as they mature*, then no case is made by the appellants under this point.⁵

As my predecessor observed regarding *Halbert*:

The *Halbert* case ... appears to sanction the investment of such funds under art. 16, § 1 unless the investment "impairs the State's ability to pay outstanding obligations." This reasoning follows that of cases from other jurisdictions, which hold that a *true "lending of the state's credit" involves the creation of some new indebtedness on behalf of the state*. For the state to be a creditor, rather than a debtor, according to these cases, does not offend the prohibition. [Citations omitted.]⁶

⁵ 226 Ark. at 628-29 (emphasis added).

⁶ Op. 99-160, *supra* n. 3 (emphasis added). Construing the credit clause as implying the imposition of some new financial liability would seem to follow from the history of these kinds of prohibitions, which followed in the wake of states (and political subdivisions) assuming financial burdens to allow the building of railroads and other projects. As our court has observed, quoting from 152 A.L.R. 495:

'Early in the nineteenth century it seems to have been the general practice of states to encourage the building of railroads by permitting the state or a subdivision thereof to purchase stock in railroad corporations, to issue bonds, or lend credit in aid of railroads, or to make outright donations to them. However, due to the large number of insolvencies of railroads, caused by frauds or economic conditions, states and subdivisions thereof found themselves largely indebted, and were themselves occasionally insolvent because of large investments in such enterprises.'

Andres v. First Ark. Development Finance Corp., 230 Ark. 594, 603, 324 S.W.2d 97 (1959) (upholding, as against an art. 16, § 1 "lending the credit of the state" challenge, the Arkansas Development Finance Corporation Act, which authorized the creation of nonprofit development finance corporations to fund and promote new industry and business activities through the issuance of bonds that might be purchased by the State Board of Finance). Restrictions like art. 16, § 1, were therefore added to most state constitutions to limit in some way government's authority to incur public debt. See Tex. Op. Att'y Gen. DM-382, *supra* n. 3 (explaining the principal constitutional limitations that emerged in reaction to the public investment failures of the past century).

Consistent with this view, the Arkansas Supreme Court in *Barnhart v. City of Fayetteville*,⁷ held that the City of Fayetteville had violated art. 16, § 1, by agreeing unconditionally to pay the debts incurred by a separately organized governmental entity. The City had entered into an agreement to collect and pay over sanitation fees sufficient in amount to pay all amounts coming due on bonds issued by a sanitation authority formed by the city, another city, and a county. The trial court found that the agreement was an unconditional guaranty of the authority's debt, and that the City would become obligated to pay under the guaranty upon the default of another governmental body (the county or the other city), regardless of whether the City received any services from the authority. There was no appeal from that finding, and the Arkansas Supreme Court held that such an obligation was in violation of art. 16, § 1, as the lending of credit.

Barnhart is therefore consistent with the apparent majority view of prohibitions like art. 16, § 1, given that the City plainly incurred a liability that was guaranteed by the taxpayers.⁸ Some mention should nevertheless be made of one case in which the Arkansas Supreme Court appears to equate an "extension of credit" with a lending of credit. In *Dudley v. Little River County*,⁹ the court found that a county violated art. 16, § 1 by selling gravel to residents on credit. Such action was deemed by the court to be an impermissible "extension of credit" that fell within the prohibition against the "lend[ing]" of the county's credit.¹⁰

Turning to your particular question, assuming (as you seem to invite me to do), that the colleges sold education services on credit, and thereby "extended credit," then one might contend based on *Dudley* that such action was unconstitutional. I believe it bears noting, however – as did my predecessor – that "[a]ny public purpose for the extension of credit to such persons was conspicuously absent [in *Dudley*]."¹¹ This absence of any attendant public purpose might explain *Dudley*,

⁷ 321 Ark. 197, 900 S.W.2d 539 (1995).

⁸ *Accord* Op. Att'y Gen. 95-228 (opining that a city's mortgage of its industrial facility to secure the debt of a non-profit corporation that leased the facility would be held to be the lending of the city's credit and thus prohibited by art. 16, § 1).

⁹ 305 Ark. 102, 805 S.W.2d 645 (1991).

¹⁰ 305 Ark. at 107.

¹¹ Op. 99-160, *supra* n. 3 (opining that "the loan of state funds for investments purposes, and for a public purpose, is distinct from a loan of the state's 'credit' and does not, as a general matter, run afoul of art. 16, § 1.")

which otherwise finds no support in other jurisdictions that have construed similar credit clauses.¹² As noted above, other courts have held that in order to have a loan of public credit, the public must be either directly or contingently liable to pay something to someone. *Dudley* might suggest that our court does not ascribe to that view. But *Dudley* may also be seen as a case where financial aid was extended for a purely private purpose, whereas our court has clearly pronounced education a "legitimate public purpose."¹³ *Dudley* may therefore be distinguishable on that basis.

In sum, I cannot address the particular liabilities that prompted your question. Nor can I predict with certainty how the court would approach the general question of the state's extension of credit for education purposes. The foregoing should, however, offer some general guidance in addressing the matter.

Deputy Attorney General Elisabeth A. Walker prepared the foregoing opinion, which I hereby approve.

Sincerely,

DUSTIN MCDANIEL
Attorney General

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¹² See Tex. Op. Att'y Gen. DM-382, *supra* n. 3 (finding "no precedent for the construction of a credit clause as meaning that a state or a political subdivision lends its credit when it merely extends credit to another.")

¹³ *Cortez v. Independence County*, 287 Ark. 279, 283, 698 S.W.2d 291 (1985) (citing *Turner v. Woodruff*, 286 Ark. 66, 689 S.W.2d 527 (1985)).

