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#05006

NO. STATE OF NEBRASKA
OFFICIAL
MAR 8 2005
DEPT. OF JUSTICE

SUBJECT: Investment Authority of Cities of the Primary Class to Make *De Minimus* Investments in Federally Regulated Funds and Securities Under Applicable State Law

REQUESTED BY: Senator Chris Beutler
Nebraska State Legislature

WRITTEN BY: Jon Bruning, Attorney General
Fredrick F. Neid, Assistant Attorney General

This is in response to your request for an opinion of this Office relating to the investment authority of cities of the primary class for purposes of investing in equity securities. The specific question you ask is "whether LB 186 is consistent with the Nebraska Constitution to the extent it would permit subdivisions of the state to make *de minimus* investments in federally regulated funds and securities under applicable state investment guidelines." The legal issue framed by your question is whether the LB 186 amendments to Neb. Rev. Stat. § 15-849 (Cum. Supp. 2004) would constitutionally permit investment of city funds in capital stock and other securities of private corporations or associations.

It is our opinion that the amendatory provisions of LB 186 would not serve to constitutionally authorize nor permit cities of the primary class, subdivisions of the state, to invest city funds in equities, capital stock or other securities of private corporations or associations. Due to the constitutional prohibition of such investments, we believe that amendment of Art. XI, § 1 of the Nebraska Constitution would be necessary to obtain explicit

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STATUTORY PROVISIONS AND INVESTMENT GUIDELINES

It is generally established that municipalities hold and exercise their powers subject to legislative control and the legislative authority over the civil, political, and governmental power of municipal corporations is limited by the Federal and State Constitutions. The fiscal and investment authority of state subdivisions is reposed in statute. Neb. Rev. Stat. § 15-845 (Cum. Supp. 2004) requires the treasurer of a city of the primary class to deposit, and at all times keep on deposit in financial institutions, all money received or held by the treasurer. Neb. Rev. Stat. § 15-849 (Cum. Supp. 2004) authorizes the treasurer to purchase certificates of deposit and make time deposits in financial institutions.

Other provisions afford broader investment authority for state subdivisions. Neb. Rev. Stat. § 77-2341 (2003) authorizes cities and other governmental subdivisions, except school districts, to invest its surplus funds in any securities in which the state investment officer is authorized to invest in.[2] Section 77-2341 in relevant part states:

> (1) Whenever any county, city, village, or other governmental subdivision, other than a school district, of the State of Nebraska has accumulated a surplus of any fund in excess of its current needs... the governing body of such county, city, village, or other governmental subdivision may invest any such surplus in excess of current needs... in certificates of deposit, in time deposits, and in any securities in which the state investment officer is authorized to invest pursuant to the Nebraska Capital Expansion Act and the Nebraska State Funds Investment Act and as provided in the authorized investment guidelines of the Nebraska Investment Council in effect on the date the investment is made. The state investment officer shall upon request furnish a copy of current authorized investment guidelines of the Nebraska Investment Council.

The State Investment Officer has broad investment authority subject to the "prudent man standard" under the direction of the Nebraska Investment Council. Neb. Rev. Stat. § 72-1246 (2003) in particular part states that "[t]he state investment officer shall invest in investments of the nature which individuals of prudence, discretion, and intelligence acquire or retain in dealing with the property of another..." For purposes of providing direction and guidelines for investment of funds by the State Investment Officer as well as for political subdivisions, the Nebraska Investment Council has adopted strategies set forth in Investment Policy Statements. Various policy statements are in place for different categories of funds available for investment by the State Investment Officer. For example, policy statements have been

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[2]Similar authority is included for cities of the metropolitan class in Neb. Rev. Stat. § 14-563 (Cum. Supp. 2004).

chartered, except those funds authorized under Art. XV, § 17(2) of the Nebraska Constitution. In reaching this conclusion, the Court reasoned:

> The historical background warrants the conclusion that the constitutional provision was directed against the acquisition by a subdivision of the state of any ownership or proprietary interest in a private corporation or association...
>
> *Id.* at 129, 266 N.W.2d at 724.

The holding of the Nebraska Supreme Court in *Nebraska League of Savings and Loan Assns.* is consistent with decisions in other jurisdictions having similar constitutional limitations. *See Michigan Savings & Loan League v. Municipal Finance Commission of the State of Michigan*, 247 Mich. 311, 79 N.W.2d 590 (1956) (statute authorizing investment of school district funds in building and loan or savings and loan associations is invalid under constitutional prohibitions of subscription to corporate stock). In *West Virginia State v. West Virginia Board of Investments*, 194 W. Va. 143, 459 S.E.2d 531 (1995), the Supreme Court of Appeals of West Virginia found that trust funds in a consolidated pension fund representing money of Public Employees Retirement System were state funds subject to the constitutional prohibition on state ownership of corporate stocks. In *West Virginia State*, the state constitution provided that the State shall not become a joint owner or stockholder in any company or association in the state or elsewhere. The West Virginia Court stated:

> The clear language of Article X, section six itself stands as a bar to state ownership of corporate stocks. This result is compelled by virtue of the fact that Article X, section six is written as an unconditional proscription of the State's investment in stock of any company or association.
>
> *Id.* at 149, 459 S.E.2d at 537.

The Court of Appeals of Oregon, in *ICMA Retirement Corp. v. Executive Department*, 92 Or. App. 188, 757 P.2d 868, *review denied*, 306 Or. 661, 763 P.2d 152 (1988), held the constitutional prohibition against state's purchase of corporate stock barred investment of employees' deferred compensation in a trust plan. The courts reasoned that the state would have a proprietary or ownership interest in the deferred compensation money that would be invested in the trust plan and thereby barred.[3]

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[3]In *ICMA Retirement Corp.*, it was argued that the state, even if technically the beneficial owner of the fund, may transfer the fund to a trustee to invest in corporate stocks. The Court disagreed and stated, "That argument ignores the basic requirement that the state cannot purchase stock with money it owns, which is precisely what it would do here." *Id.* 92 Or. App. 193, 757 P.2d 871.

> physical property of such corporation for a public use, constitutionally defined and lawfully authorized by the legislature.
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> *Id.* at 766, 767, 10 N.W.2d at 794. (emphasis added).

The LB 186 amendments do not purport to authorize the purchase of stock to enable a city of the primary class to acquire physical property for a defined public purpose. Rather, the amendments would broaden the authority of cities to invest in equities and thereby become a stockholder or part owner in a private business enterprise. We believe the LB 186 amendments would be narrowly construed by a court to preclude such investments in private entities consistent with the constitutional limitation set forth in Art. XI, § 1.

OTHER AUTHORITIES

This office previously addressed the question whether the surplus funds of a county hospital may be invested in mutual funds comprised of U.S. Government Securities and obligations. In Neb. Op. Att'y Gen. No. 95041 (May 17, 1995) we concluded that it was generally permissible for a county to invest surplus funds in mutual funds comprised solely of U.S. Government obligations but, that the organization and prospectus of the investment company would have to be carefully examined to insure that the political subdivision was not acquiring an interest in the investment company. In the opinion, we commented, "[t]he Constitution's language certainly prohibits a county from investing in a mutual fund when the portfolio includes stock, but it does not specifically address the issue of mutual funds solely comprised of U.S. Government Obligations." *Id.* at 3. It was also concluded that an amendment to Art. XI, § 1 specifying that investment in management investment portfolios limited to U.S. Government securities would be required to remove the uncertainty due to the constitutional basis for the potential prohibition of such investments.

Other states' Attorneys General have addressed similar issues. An opinion of the Louisiana Attorney General concluded that Louisiana statutes allowing excess funds of political subdivisions to be invested in money market mutual funds were unconstitutional.[4] *See* 88 La. Op. Att'y Gen. No. 546 (1988). And, an opinion of the Arkansas Attorney General considered the question whether the Department of Corrections can purchase membership in a "cotton gin cooperative" which is capitalized with common stock. The Department would become a shareholder by buying stock in the cooperative and become a voting member.

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[4]Article VII, § 14 of the Louisiana Constitution includes similar language to Art. XI, § 1 of the Nebraska Constitution. The Louisiana Constitution provision states in part, "Neither the state nor a political subdivision of a state shall subscribe to or purchase the stock of a corporation or association..."

We have also reviewed the opinion of the Colorado Attorney General you referenced in your request letter. In Col. Op. Att'y Gen. No. OAG 8600818 (March 10, 1986) the questions whether existing provisions of Colorado constitutional and statutory law authorize the state treasurer to invest funds in a real limited partnership were addressed. The Attorney General concluded that present statutes do not authorize such investments and that the application of relevant constitutional provisions would depend upon whether the statutory scheme serves a sufficient public purpose. In summary, the opinion stated, "I am unable at this time to form an opinion whether future legislation authorizing an investment would be constitutional. In order to satisfy constitutional restrictions, such legislation would have to narrowly demonstrate a discrete and particularized public purpose which would preponderate over any private interests incidentally served." *Id.* at 6.

We think the Colorado opinion is of limited assistance since it concluded that the proposed investments would exceed existing statutory authority and a conclusive opinion was not rendered concerning whether the constitutional provisions precluded the General Assembly from enacting legislation authorizing investment of public funds in a limited partnership.

The predominant view of the states attorneys general is that investment of public funds in capital stock or other equity interests of private businesses is violative of state constitutional limitations; except in circumstances where the acquisition of stock or other ownership interests is necessary to acquire property for a public use or purpose. And, it is the consensus view that constitutional amendment is necessary to remove any question of application of the constitutional prohibition, even where the funds to be invested by the government subdivisions are private.

DE MINIMUS INVESTMENTS

Your question has been posed in the context of a government subdivision making "*de minimus*" investments in federally regulated funds and securities under applicable state investment guidelines. Information included in your request letter reflect that *de minimus* investments are those comprising "no more than 1% or 2%" of a particular entity's securities. We have found no case or other authority that has analyzed or decided the constitutional issue based on the percentage of ownership of the outstanding stock or capital of a private company purchased for investment.

We point out, however, that the constitutional prohibition is not aimed at control of a private concern but rather participating as an owner. The Nebraska Supreme Court's holding in *State ex rel Johnson v. Consumers Public Power District* reflects the view that purchase of a majority if not all of the capital stock of a private company to acquire physical property for public use does not fall within the constitutional prohibition. Thus, this line of authority suggests