

MEMORANDUM

February 2, 1987

TO: All Justices
FROM: Justice Wintersheimer
RE: Hayes v. State Property & Bldg. Com.
(Toyota) 86-SC-918-1041-1042

After considerable review of the record and the briefs it is my opinion that the result of the circuit court should be affirmed in most respects.

The unique feature of this particular bond issue is that the real property is to be conveyed first without any security interest. In my opinion that changes the conventional method of title transfer and security in such projects. My examination of SB 361 indicates that the unsecured transfer of the real estate is not absolutely necessary. Therefore, it is my recommendation that safeguards be required in the deed of conveyance so as to provide for a written security interest, vendor's lien or other security for the Commonwealth.

The wisdom of the Toyota transaction lies with the legislature and the executive. Our role is not that of a super legislature. Our only function is the interpretation of the acts of the other branches of government in the light of the Constitution, existing legal precedents and the legislation. In that context, I do not believe the legislation is unconstitutional per se.

Initially, we must observe that the law is well settled that the wisdom of legislative action may not be reviewed by the courts. Whether such a project is based on sound economic theories is not within the scope of judicial review. Such considerations are matters of legislative and executive judgment and do not affect the constitutionality of the conduct. See Dalton v. State Property and Buildings Commission, Ky. 304 S.W.2d 342 (1957); 11 Am.Jur.2d Constitutional Law § 141.

Section 177

The intention of the Commonwealth to convey the project location and real estate to Toyota at the inception of the financing without any evident concrete financial consideration is a disturbing innovation in regard to Section 177 of the Constitution and traditional and customary practice in this field. The Constitution prohibits the state from making any donation to any company, association or corporation. The present proposed form of the deed and the agreements relating to the deed appear to result in a donation.

In an obvious effort to avoid Section 177, SB 361 requires the State Property and Buildings Commission to make a finding that the incremental taxes to be derived as a result of the project are calculated to equal the amount of the bond principal. Another sound requirement is that the company must agree that if they transfer the project and a deficit occurs between the incremental taxes which are collected and

the principal amount of the bonds, the company will pay the difference to the Commonwealth.

The evidence in the records indicates that incremental taxes to be collected in order to constitute sufficient consideration for the conveyance of the property are estimated at \$13 million per year. Clearly this source alone does not satisfy a \$35 million acquisition and improvement cost. Some additional safeguards must be employed to meet the requirements of Section 177. The transfer must be conditioned upon the receipt of other security in addition to the incremental taxes in order to avoid a gift.

In my view incremental taxes are those taxes which would never have existed but for the inducement of the facility to locate in Kentucky. See Grimm v. Maloney, Ky. 358 S.W.2d 498 (1962) and Watkins v. Fugazzi, 394 S.W.2d 594 (1965). The successful inducement of location of a revenue producing facility is an important element which provides new value to a government which did not previously exist. It is important to remember that both in Grimm, supra, and in Watkins, supra, the governmental entity involved was a municipality and title to the real property remained in a governmental agency as distinguished from a private corporation. In my opinion the overriding lesson of both Grimm and Watkins is that the inducement of the new facility provides new revenues which would not have existed but for the location of the plant.

Ultimately the state income tax is expected to benefit in relation to a payroll in excess of \$75 million in new wages resulting from an employment of up to 3,000 new jobs. There is clearly a difference in the taxable value of the previously rural farm land which now will become an industrial complex and there are undoubtedly new corporate taxes which will be assessed. In addition there is a ripple effect in that other plants will also produce new wages and new property and corporate taxes. The fair market value of the real estate itself is also enhanced by the development of the plant. All of this produces new sources of revenue for the state.

The important question is when does this revenue begin to return to the citizens and taxpayers of this state. Remembering that we do not challenge the wisdom of the legislative and executive decision to induce this plant to locate in Kentucky, it is necessary for the validity and security of the bonds to insure that proper financial safeguards are enunciated clearly in the initial transaction. In order to do that, in my view, it is absolutely necessary that the deed of conveyance must contain an appropriate security interest, encumbrance, vendor's lien or other safeguard up to the amount of the property acquisition and site improvements, or approximately \$35 million. I cannot envision any prudent private financial institution providing money to a borrower without appropriate safeguards. In a sense, the state of Kentucky

is extending funds to a new enterprise and appropriate safeguards must be maintained. As soon as the revenue benefits are received, the lien or other restraint can be released and the property becomes that of the company.

I am persuaded by the reasoning set out in Almond v. Day, Va. 91 S.E.2d 660, when the Virginia Supreme Court in interpreting the use of certain funds of the Virginia Retirement System, noted that Section 185 of the Virginia Constitution is very similar in its import to Section 177 of the Kentucky Constitution. The Virginia court stated that when the underlying purpose of the transaction and the financial obligation incurred are for the benefit of the State, there is no lending of credit even though it may have expended its funds or incurred an obligation that benefits another. Merely because the state incurs an indebtedness for its benefit and others may incidentally profit does not bring the action within the letter or the spirit of the prohibition of lending of state credit. Industrial Development Authority v. Eastern Kentucky Regional Planning Commission, Ky. 332 S.W.2d 274 (1960) provides that it is clearly established in Kentucky that the relief of unemployment is a public purpose that would justify the outlay of public funds. As noted in the dissent by Justice Palmore in Industrial Development Authority, supra, there is no reason why outright loans or grants of tax money to private manufacturing corporations cannot be made for the purpose of relieving unemployment

and thereby serve a public purpose. In my view such activities must be properly secured. The real question is whether the tax funds involved as the ultimate protection to the bondholders are a gamble or an investment. Certainly one is legitimate and the other is not. The legislature attempted to provide safeguards to make it clear that this was an investment and not a speculative gamble. In my opinion the evidence presented in this case does not support the argument that this is a fully secured investment because there is no guarantee to safeguard the state in the event of default by the company. Such a guarantee can be obtained by the simple revision of the deed language so as to include an appropriate encumbrance vendor's lien or other mechanism to protect the citizens of this state as well as protect the bondholders.

It should be noted that the two year financing agreement otherwise provided in Section of this Constitution is totally subject to the actions of future legislatures in appropriating funds for the renewal of the agreement. This requirement complies in every respect with the previous case rulings by this Court. The credit provisions of Section 177 attempt to prevent transactions which might result in future liabilities against the general tax revenues of this state and thereby encroach on the freedom of future generations to utilize those resources as they deem appropriate.

It is the assurance that the legislature would provide

for funding in future appropriations which is most offensive to this Court. See McGuffey v. Hall, Ky. 557 S.W.2d 401 (1977); Greer v. Kentucky Health and Geriatrics Authority, Ky. 467 S.W.2d 340 (1971). This legislation does not commit any future funds to the Toyota project. It is significant to note that in Greer, supra, the transfer of title to the real estate occurs when the revenue bonds have been discharged. In that case this Court found that such transaction was not a lending or giving of the credit of the Commonwealth to a private corporation within the meaning of Section 177. The difference here is that the transfer of title can occur initially but that provisions must be included in the financing transaction to assure receipt of fair market value by the State for the property in the event of premature disposition by the company.

Section 177 prohibits the Commonwealth from lending or pledging its credit or donating its property.

Sections 3 and 171

SB 361 expressly declares that the authority granted and the purposes to be served are public in nature and the preamble indicates that it is the policy and purpose of the Commonwealth to encourage, promote and support economic development in order to alleviate and prevent unemployment and that these goals constitute an essential public purpose.

We must first consider that Section 3 of the Kentucky Constitution refers to public services while Section 171 speaks

of taxes to be collected for public purposes only. The exact meaning of these two different words should not be unduly troubling. There appears to be an absence of exact general definition or definition in the context of the Constitution.

This Court has recognized on a number of occasions that Sections 3 and 171 are closely related. See Nichols v. Henry, Ky. 191 S.W.2d 930 (1946).

The relief of unemployment is a public purpose within the taxing power. The important point is whether the purpose is public and that it does not matter whether the agency through which it is dispensed is public or not. The appropriation is not made for the agency or company but for the object which is served. See Hager v. Kentucky Children's Home Society, Ky. 83 S.W. 604 (1904).

Industrial Development Authority, supra, provides that an act creating the Industrial Development Authority was constitutional. That law authorized the use of general fund money to make loans to local development agencies which in turn use such funds for particular industrial building projects. In upholding the validity of the act, this Court noted that the Constitution restricts the use of tax money to public purposes and noted that the determination of what constitutes a public purpose when made by the legislature will be upheld by the courts so long as it has some reasonable basis.

Section 171 provides that the tax money shall be levied and collected for public purposes. Section 3 is clearly related to Section 171 and provides that no grant of exclusive, separate public emoluments or privileges shall be made to any man or group of men except in consideration of public services. Both sections are directly related to public purpose. Here the financing of an industrial development project accomplishes a public purpose of alleviating unemployment and public money may be used.

The record indicates that the inducement to Toyota to build a plant of approximately \$800 million will provide incremental taxes estimated to be \$13 million per annum. This is an increase from approximately \$17,000 per annum now realized on the same location. Clearly the projections which seem to be generally agreed upon by all the financial experts produced by all the contesting parties are sufficient to provide part of the fair market value consideration needed in this transaction and required by the Constitution. The record indicates that the average unemployment rate in Kentucky for the period in question was 9.5 percent as contrasted to a national unemployment rate of 7.2 percent. The average unemployment rate in Scott County in 1985 was 4.8 percent and in seven contiguous counties, it was 6.4. The issue here is what is the overall state unemployment rate because this is a state industrial revenue bond issue and not a local or county revenue

issue. Therefore it is the state unemployment rate that is significant.

Section 49 and 50

Sections 49 and 50 of the Constitution strictly limit the power of the legislature to financially obligate future legislatures without the permission of the people by means of a direct vote. These constitutional provisions were also part of the Constitution of 1850 and were enacted at the time when the Commonwealth was heavily in debt and the requirement of fiscal restraint on the legislature was considered to be in the best interests of the people. It is difficult to say that the same conditions do not exist in 1985. The Federal Constitution contains no such debt limitations and we are clearly aware of the fact that deficit spending is one of our largest national and international problems. The State can incur debt by issuing either general obligation bonds or revenue bonds. General obligation bonds are backed by the full faith and credit of the Commonwealth and are payable out of the general revenues of the state. They are voted on by the people. Revenue bonds are not backed by the state but are secured by the revenues of the project which is being financed. Generally the security for the payment of the bonds is taken the form of rentals in building projects or tolls on certain highway projects. In order not to run afoul of the debt limitations found in Sections 49 and 50 of the Constitu-

tion, the so-called "serial" leases have been devised. Under such a plan, revenue bonds are issued to finance the construction of a public improvement which is then leased by the state and the bonds are retired by lease payments made by the state. Each lease period runs for two years and the lease automatically renews for another two years unless notice of cancellation is given. Generally these two-year lease renewals run until the bonds are retired. Such a program was endorsed in Turnpike Authority of Ky. v. Wall, Ky. 336 S.W.2d 551 (1960) and later confirmed by Blythe v. Transportation Cabinet, Ky. 660 S.W.2d 668 (1983).

The trial judge was correct in holding SB 361 does not violate Sections 49 and 50 of the Kentucky Constitution. As the trial judge observed in his opinion, beginning with the case of Waller v. Georgetown Board of Education, Ky. 273 S.W.2d 498 (1925) Kentucky courts have consistently held that financing projects like the one here does not constitute a debt within the meaning of Sections 49 and 50. The reason that no debt has been created is because the financial obligations of the Commonwealth are confined to a particular two-year period and the General Assembly appropriates general fund revenue for debt service accruing during that two-year period only. Blythe, supra, upheld a similar plan to issue revenue bonds financing toll road projects. SB 361 provides that the obligation of the Revenue Cabinet to pay debt service

on the Toyota bonds is specifically incurred for only the current biennium during which the initial agreement is in effect and which funds have been appropriated for debt service by the legislature. No debt is created and consequently no vote of the people is required under Section 50. Guthrie v. Curlin, Ky. 263 S.W.2d 240 (1953). All such financing plans are within the scope of Sections 49 and 50 and insofar as they involve the two-year fiscal period of the Commonwealth as created by the Constitution. To the extent that there is any duty to pay debt service on special obligations issued by various agencies of the State, that duty is confined to a particular two-year period and the legislature during such time may make a valid appropriation of general fund money to pay debt service accruing during that particular two-year period only. Such financing plans have always been held to be constitutional by this Court. Efforts to impose any financial obligation on state units of government beyond the current two-year period have invariably been held as unconstitutional. See Curlin v. Weatherby, Ky. 275 S.W.2d 934 (1955).

An examination of the testimony offered by the executive director of the office of investment and debt management of the Finance and Administration Cabinet indicates that very few of the State Property and Buildings Commission's financing plans provide for revenue bonds secured by a lien or security interest on anything except the revenues derived from the

two-year leases. In that regard, the Toyota bonds have basically the same security as all other bond issues of this State. That is, there is no lien or security interest on a financed project, it is secured only by the revenues from the biennial financing agreement and subject to the decision of future legislatures to appropriate any debt service.

Section 51

The trial court was correct in holding that SB 361 does not violate Section 51 of the Kentucky Constitution which prohibits legislation involving more than one subject in the title. Commonwealth of Kentucky, ex rel Armstrong, Attorney General v. Collins, Governor, Ky. 709 S.W.2d 437 (1986) holds that the title of legislation need only furnish general notification of the general subject in the act. The act in question here is not at variance with Section 51 when judged by that standard.

Section 59

The trial court was correct in holding that SB 361 does not violate Section 59 of the Kentucky Constitution which prohibits special legislation. The purpose of this section is to prevent special privileges, favoritism and discrimination in order to ensure equality under the law. This statute authorizes the financing of industrial development projects by the state for the use of industrial entities in order to provide for valid public purposes such as the elimination of unemploy-

ment. The law is not directed to the Toyota project although the availability of such a project obviously ignited interest in this method of financing. However, the language of the law is very general and its availability for uses in connection with any valid industrial development project now or in the future. The classification of industrial development projects is reasonable and the provisions of the act apply equally to any potential industrial development project.

There is a reasonable basis to justify the classification established by the legislature and it should be upheld. Meredith v. Ray, Ky. 166 S.W.2d 437 (1942).

The law is available to any industrial entity which agrees to construct and install a facility which satisfies the standards provided by the Buildings Commission and otherwise meets the requirements of the act. Consequently it would be available to every industrial concern even those now operating within the Commonwealth of Kentucky in connection with any expansion of existing enterprises. The public purpose for which all industrial development legislation has been founded has been the inducement of the location of a project which performs the public purpose of providing employment to Kentucky citizens and alleviating any conditions of unemployment.

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to the various standards. The national unemployment rate at the time the Toyota resolution was adopted by the Buildings Commission was 6.8 percent while the unemployment rate in the state was more than 10 percent and was well above 11 percent during January 1986, the month immediately following public announcement of the project. The decision of the trial court to deny the intervening defendant's motion to amend their answer in certain respects so as to raise additional constitutional questions did not amount to reversible error. The trial court's decision to refuse to compel production of the work product of counsel for the commission was not reversible error.

Miscellaneous

In regard to the \$500,000 debt limit provided in Section 49 of the Kentucky Constitution, this matter could technically be remanded to the circuit court for the purpose of taking proof to determine whether the proposed bond issue will create an indebtedness in excess of the limitation contained in that Section. Any such consideration must apply the so-called "rubber dollar" rule of construction as established in Matthew v. Allen, Ky. 360 S.W.2d 135 (1962) and Commonwealth v. Hesch, Ky. 395 S.W.2d 362 (1965) and KRS 64.480, et seq. The \$500,000 debt limitation contained in Section 49 of the 1892 Constitution equals 36.8 percent of general fund revenues for the fiscal year 1893 through 1894. Computed by present

day standards, the available general fund revenues for the present biennium are approximately \$3 billion. The constitutional debt limitation of \$500,000 should be interpreted as a percentage of the general revenues available at the time of the adoption of the constitution. If such a construction of Section 49 of the Constitution were adopted, the Toyota issue could be approved without nullifying the express or literal provisions of Section 50. This Court could also limit future revenue bonds to those strictly conforming the definition of "revenue bonds" in Dalton, supra, to those which are payable only from a revenue-producing public project. All other bond issues would have to be general obligation bonds subject to the provisions of Sections 49 and 50.

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Your comments and suggestions will be appreciated.