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OFFICE OF THE ATTORNEY GENERAL

CHARLES MOLONY CONDON
ATTORNEY GENERAL

December 3, 1996

Kenneth D'Vant Long, Director
State Reorganization Commission
1105 Pendleton Street, Suite 228
Columbia, South Carolina 29201

Dear Mr. Long:

You have referenced an Informal Opinion, authored by me, dated September 6, 1996. You further state that

> [u]nder the authority of Section 41-43-240, JEDA (Jobs Economic Development Authority] has established a not-for-profit corporation called Carolina Capital Investment Corporation. In at least one instance, this corporation took an equity interest in a company in exchange for an investment of capital. The source of these funds was not state appropriations. The Legislative Audit Council has found that this transaction may be in violation of Article X, Section 11 of the South Carolina Constitution. The Committee's original question concerned the legality of ownership investments by a not-for-profit corporation established by JEDA. Mr. Cook's informal opinion was that such investments by Carolina Capital Investment Corporation are legal with some qualifications.

You now seek additional advice on the following question:

> [t]he Compliance Review Committee is requesting a formal opinion regarding any potential liability which may accrue to the State of South Carolina as a result of equity investments

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by a non profit corporation established by an authority of the State.

Law / Analysis

In the Informal Opinion issued by me on September 6, 1996, I addressed the question of whether an equity investment by the Carolina Capital Investment Corporation violated Article X, Section 11 of the South Carolina Constitution, which forbids a state or its political subdivisions from becoming "a joint owner of or a stockholder in any company, association or corporation." I concluded that the key issue in resolving this question was whether CCIC was a "state agency" or not for purposes of Article X, Section 11. I deemed the question extremely close, and still do, but on balance guardedly concluded as follows:

> [o]f course, this Office, in a legal opinion cannot make factual determinations. Op.Atty.Gen., December 12, 1983. Ultimately, the conclusion of whether or not CCIC is a State agency is a factual question, applying all the criteria referenced above. Based upon the facts at hand, it appears that CCIC is a separate legal entity incorporated as a non-profit corporation, and is not a State agency. As noted above, this Office, in its previous opinions, has generally presumed that an entity incorporated as a separate non-profit corporation is not a State agency. This is consistent with Section 41-43-240 which refers to the authority of JEDA to create either "profit or non-profit corporations as the authority considers necessary to carry out the purposes of this act." Likewise, it would not appear that CCIC is such "an integral part of State government as to come within regular patterns of administrative organization and structure." I am advised that there are interlocking directors serving on both the JEDA Board and the CCIC Board and that CCIC is deemed a "public procurement unit" pursuant to the State Procurement Board. See, Section 11-35-4610(5). Notwithstanding these attributes of a State agency, however, I am of the opinion, based upon the facts presented, and previous opinions of this Office, that CCIC is probably not a State agency for purposes of Article X, § 11. I must caution that you should review the various criteria contained in the authorities referenced herein, applying

> these criteria to all the facts, for any final resolution of this matter.

You have now inquired whether the State can be held liable for the nonprofit corporation's equity investment. I have reviewed several cases in this area and will attempt to summarize them for you here.

First, is Utah Technology Finance Corp. v. Wilkinson, 723 P.2d 406 (Utah 1986). There, the Supreme Court of Utah addressed the constitutionality of the actions of the Utah Finance Corporation, a nonprofit corporation created by the Utah Legislature. The Corporation was empowered to provide capital for equity investments and to make direct loans to assist and encourage emerging and developing small businesses.

First, it was argued that the statute authorizing the Utah Finance Corporation violated the State's constitutional prohibition against lending the State's credit to a private corporation. The Utah Supreme Court rejected that argument because it could find nothing in the enabling legislation "which would authorize a lending of credit" as such term had been defined in its earlier cases or cases in other jurisdictions. The State, said the Court "is not empowered to become a surety or guarantor of another's debts." 723 P.2d at 412. Said the Court,

> [t]he Act authorizes UTFC to provide capital for equity investment or to make direct loans to assist and encourage emerging and developing small businesses. In addition, research grants are authorized. These powers are to be exercised with private funds and with funds appropriated to UTFC by the legislature. The Act does not empower UTFC to become a surety or guarantor of the debts of the fledgling businesses it assists. Indeed, the Act does not even permit UTFC to incur any debt of its own.

Id.

However, the Court found that a portion of the Act violated the State Constitution's bar against subscriptions by the state or its political subdivisions to stocks or bonds in aid of any private enterprise. In contrast to other legislation which had been upheld, the Court deemed that

> ... the Act before us authorizes UTFC to use funds appropriated to it by the legislature as matching sources of capital for equity investment in emerging and developing technological and innovative small businesses. Accordingly, UTFC has committed $1 million of public funds to purchase a limited partnership interest in Venture Fund I, which proposes to use that amount, together with private funds, to subscribe to stock in selected small high-tech businesses. This is clearly the subscription to stock in aid of private enterprise which section 29 [of the Utah Constitution] prohibits. UTFC seeks judicial approbation on the ground that the subscription to stock in fledgling businesses has been found by the legislature to have a public purpose. See § 63-60-3 of the Act as amended in 1985. However, the legislature's findings of a public purpose are of no avail in this instance .... Whether the public benefits thereby is of no consequence. This means of assistance is forbidden by section 29.

In Arkansas Uniform and Linen Supply v. Institutional Services, 287 Ark. 370, 700 S.W.2d 358 (1985), the Court addressed the situation where Conway Memorial Hospital. a nonprofit corporation, leased land and improvements from the City of Conway for the operation of a hospital. Directors of the corporation were nominated by the Board subject to confirmation by the Conway City Council. Upon dissolution of the Hospital Corporation, all corporation assets reverted to the City of Conway.

The Hospital Corporation formed Institutional Services Corporation to supply laundry to the Hospital and other hospitals nearby. All of the stock in ISC was owned by the Hospital and the Hospital Board served as the governing board of ISC. ISC leased vehicles from the Hospital as well as the land and equipment used for the laundry. The Hospital set the rental payments from ISC in amounts equal to its own payments for the land and vehicles which the laundry corporation leased.

The issue before the Court was whether the relationship between the City Council and the Hospital Corporation was of such closeness that the investment by the corporation in ISC was in essence, that of the City. If so, the result would be that such would constitute a violation of the State Constitution for becoming a stockholder in or lending credit to a private corporation.

The Arkansas Supreme Court concluded that no constitutional violation had occurred. The facts, said the Court, simply did not warrant the conclusion that the City of Conway was sufficiently involved in the transactions between the Hospital and ISC. The Court viewed the facts as follows:

> [a]ppellants rely heavily on that section of the articles of incorporation of CMH pertaining to the selection of directors and, to a lesser extent, on that section dealing with the disposition of its assets should dissolution occur. Neither governs the outcome here. The provision on dissolution which directs that all assets revert to the City of Conway is there to meet the requirements for charitable tax exempt status ... . It simply insures that assets acquired for charitable use will never be put to private use. It does not strengthen the premise that CMH is simply an extension of the city council.
>
> Nor does the provision pertaining to the replacement of board members give us reason to pause. ... The fact is the hospital board selects its own members, the council merely confirms the board's nominees. Moreover, it is undisputed that over the nearly fifty years of the hospital's existence the council has never failed to confirm a nomination, an unlikely record if the hospital's autonomy were threatened.
>
> Of greater significance is the fact the hospital itself belongs to the City of Conway and is leased to the hospital corporation. But that arrangement is expressly sanctioned ... [by statutes]. The rationale behind these provisions is the obvious benefits which accrue to a community from the availability of hospital services. We conclude that the leasing of a hospital by municipal government to be operated by a nonprofit corporation is not a violation of Article 12, Section 5.

In addition, it was argued that since the Hospital Corporation was supplying financial aid to ISC, if the Hospital Corporation were dissolved, the assets reverting to the City would be reduced by the balance owed by ISC. To that contention, the Court responded:

> [b]ut the answer, as with the first argument, lies in the fact that CMH is not the arm of the city council and Conway is not granting financial aid to ISC either directly or indirectly. The reversion of assets to the City of Conway in the event of a dissolution is not an expectancy, but a mere possibility, and one which may never occur. Besides, as appellees point out, the reverter clause applies only to assets belonging to CMH at the time of dissolution and has no effect on assets prior to that uncertain event.

700 S.W.2d at 360-361 (emphasis added).

Foster-Wheeler Energy Corp. v. Metropolitan Knox Solid Waste Authority, 970 F.2d 199 (6th Cir. 1992) is another instructive decision which was discussed at length in the September 6 Informal Opinion. There, the Court refused to attach liability to the City of Knoxville and County of Knox for the actions of the Metropolitan Knox Solid Waste Authority, a nonprofit corporation created by the City and County. The purpose of the Authority was to construct and operate a waste incinerator for the area. Members of the Authority's Board of Directors were appointed by the City and County. The Authority, not the City and County, issued revenue bonds to support the project and no public monies were used to pay the bonds.

Foster-Wheeler contracted with the Authority to operate and manage the Facility, but the City subsequently withdrew its support and Foster-Wheeler sought to hold the City and County liable for breach of the agreement even though they were not parties thereto. The plaintiffs theory of the case was that the Authority constituted little more than the "alter ego" of the City and County.

The Court rejected the argument, however. Noting that "[i]n the present case ... the city and county were not equity owners in the Waste Authority ...", the Court stated that it was "reluctant to extend the corporate veil theory to the present set of facts absent more specific guidance from the Tennessee Courts." Concluded the Court,

> [s]imply because the city and county placed directors on the Waste Authority's board, and agreed to cooperate and use their best efforts to make the Waste Authority succeed, does not, in our view, create a sufficient nexus between the city, the County and the Waste Authority on which to predicate liability.

970 F.2d at 202.

As an alternative theory, plaintiffs sought to hold the city and county liable on the basis that the Waste Authority served a public purpose and was a public instrumentality. However, the Court found that "[n]either the district court, nor the plaintiffs, cite to any case law which has specifically held a municipality or county to answer for the contractual obligations of a separately incorporated non-profit corporation like the Waste Authority." Concluding, the Court stated:

> ... [P]laintiffs have completely failed to identify any theory or cause of action by which the municipality and county are liable in this case. We therefore believe that the Waste Authority's corporate status must be respected.
>
> It is clear that the plaintiffs contracted only with the Waste Authority and they knew that the city and county were not parties to the contract. Given the circumstances of this case, we see no reason to rewrite the contract allowing plaintiffs to recover from the city or county. Absent any allegations of fraud or other tortious wrongdoing, we hold that the plaintiffs may look no further than the Waste Authority itself for recovery ... .

Likewise, in Andres v. First Arkansas Development Finance Corp., 230 Ark. 594, 324 S.W.2d 97 (1959), the Arkansas Supreme Court held that an Act authorizing the creation of corporations to finance industrial development corporations did not authorize governmental liability. Summarized the Court,

> [i]n Halbert v. Helena, etc. Industrial Development Corporation, 226 Ark. 620, 291 S.W.2d 802, we had before us Act No. 404 of 1955, and we held that a corporation organized under that Act was a private corporation and that the Cities of Helena and West Helena were in no sense liable for the obligations of the Industrial Development Corporation. That case points to the holding here. The finance corporations authorized by the Act No. 567 are, as we have heretofore said, corporations set up to provide finances that may be loaned to development corporations organized under the Act No. 404 of 1955. The finance corporations are non-profit corporations,

> but their actions do not make liable the State or any of its subdivisions for the obligations of such corporations.

324 S.W.2d at 100.

Other decisions reach the same basic conclusion in a variety of contexts. In Greco v. Orange Memorial Hospital Corporation, 513 F.2d 873 (5th Cir. 1975), the Court found that there was no "symbiotic" relationship between a county and a hospital corporation which leased the county hospital from the county. Thus, there was no "state action" for purposes of 42 U.S.C. § 1983 (civil rights statute). Likewise, in Albright v. Longview Police Dept., 884 F.2d 835 (5th Cir. 1989) no "state action" was found in the fact the County leased the Hospital to a nonprofit corporation for its operation; thus, the § 1983 section for termination of two employees was thrown out for want of the requisite "state action".

Similarly, in Thompson v. Chas. Area Med. Center, 539 F.Supp. 671 (S.D.W.Va. 1982), the Court refused to hold the State liable for the actions of a private corporation which ran the health care programs of West Virginia University's school of anesthesia. The plaintiff sought liability against the State for her dismissal as a teaching nurse, but the Court found that the plaintiff was hired and fired by the corporation; the Court also noted that she acknowledged she was a corporation employee, that there was no proof of direct connection between the firing and polices or practices of WVU, that no county or state monies were used to satisfy the bond obligations of the corporation, and that neither WVU nor the corporation exercised control over the other. Other cases are in accord. See, Nat. Med. Enterprises, 324 S.E.2d 268 (N.C. Ct. App. 1985) [lease arrangement with private corporation removed hospital's status as "public hospital"]; Willis v. Univ. Health Services, Inc., 993 F.2d 837 (11th Cir. 1993); Gotsis v. Lorain Comm. Hosp., 46 Ohio App.2d 8, 345 N.E.2d 641 (1974) [no "state action"]; Gilbert v. Bath, 267 S.C. 171, 227 S.E.2d 177 (1976) [lease by hospital district to nonprofit corporation does not make the corporation and district "joint owners" in violation of Article X, § 11]; Prescott Newspapers v. Yavapai Com. Hosp. (Ariz. App. 1989) [leasing of hospital by hospital district to nonprofit corporation, such corporation was not made an "instrumentality" or "institution" of the State for purposes of Freedom of Information Act]; State v. Smith, 357 So.2d 505 (La. 1978) [private nonprofit corporation not a state or parish "agency"]; Bush v. Aiken Electric Coop., 226 S.C. 442, 85 S.E.2d 716, 717 (1955) [cooperative nonprofit association not an agency of State because the "State has not undertaken to name its governing board or control its affairs ..." and upon dissolution the State "receives none of its property."]

And, in Williams v. Richmond County, Georgia, 804 F.Supp. 1561 (S.D.Ga. 1992), the Court held that a public hospital authority could not be liable under § 1983 for the acts of an ambulance driver and attendant employed by a private, nonprofit corporation pursuant to a lease agreement with the authority. Opined the Court,

> [t]here is no sufficient nexus between RCHA and the actions of UHS ambulance service personnel in this case to create § 1983 liability for UHS as a state actor. Furthermore, the state in the form of RCHA cannot be said to have coerced or encouraged UHS regarding UHS operation of the ambulance service. Finally, UHS as a private hospital corporation does not exercise powers traditionally reserved exclusively to the State ... . Therefore, there is no state action present with regard to Defendant UHS.

See also, Wright v. U.S., 428 F.Supp. 782 (D. Mont. 1977) [nonprofit community corporation which developed rural recreational complex which was financed by federal government was not the alter ego of the federal government and thus the United States was not liable].

There is authority to the contrary, however. In Colorado Assoc. of Pub. Employees v. Board of Regents of Univ. of Colorado, 804 P.2d 138 (Col. 1990), for example, the Court held that a university hospital which was reorganized to a private, nonprofit corporation continued as a state entity for purposes of a constitutional provision relating to a state personnel system. There, the corporation was governed by a Board of Directors appointed by the University Board of Regents and confirmed by the Senate. Pursuant to statute, the University's Regents could borrow money and issue bonds on behalf of the corporation. The Court noted, additionally, the strong role which the Colorado Legislature continued to play in the corporation's operation:

> [e]ven though the reorganized hospital is not governed by provisions of law affecting only government or public entities, § 23-21-403(1)(a), the General Assembly has a continuing role in the reorganized hospital's activities under the articles of incorporation. Any change in the mission of the reorganized hospital or in certain articles of incorporation must be approved by the General Assembly. Should the reorganized hospital wish to transfer the corporation to "any person or entity except the regents" or to exceed the sixty million dollar

> indebtedness limit after two years, it can only do so with the approval of the General Assembly. §§ 23-21-404(1)(f), (i). The General Assembly is further involved in the operation of the corporation to the extent that the Legislative Audit Committee and four other members appointed by the Governor compose the Board of Visitors, which reviews every two years the corporation's use of state funds for the medically indigent, § 23-21-405. It then reports its findings to the General Assembly, the Governor, the Regents, and the Directors. Id.

804 P.2d at 141. The court also was persuaded by the Regents' control over the corporation. Among these were that the Regents appointed and removed members of the corporate board. Power to arrange the corporation's billing, collection and disbursement rested with the Regents. Fees collected supported the professional, research and educational activities of the faculty. Budget and spending of the hospital were controlled by the Regents. Therefore, "[i]n view of the Regents creation of the corporate hospital and their continuing control over the internal operations of the reorganized hospital, it is evident that the Regents have not sufficiently divested themselves of power over the hospital to enable the new corporation to operate independently as a private corporation. Thus, we find that the reorganized hospital is still a public entity." Id. at 143.

Likewise in Arkansas Uniform and Supply Company, supra, there was a strong dissenting opinion. The dissenting justice concluded that the hospital was "an arm of the city and is, therefore, prohibited from these activities in which the city may not engage." 700 S.W.2d at 361. The dissenting justice's analysis was as follows:

> What then is the purpose of the corporation -- to run someone else's hospital? It is still a public hospital -- Conway's public hospital. The city owns the hospital, that is not denied. The hospital owns all the stock in the laundry. The board members of the hospital are the board members of the laundry. It does not take a large step in logic to realize that the city, in fact, owns the laundry. But the majority prefers to ignore such logic.

700 S.W.2d at 362.

The South Carolina Tort Claims Act, Section 15-78-10 et seq., governs a state agency's liability. The Tort Claims Act does not create causes of action; rather, it removes the common law bar of sovereign immunity in certain circumstances, but only to the extent provided by the Act. Thus, any liability depends in part upon whether sovereign immunity has been waived by the Tort Claims Act. Such a determination would depend upon the particular facts giving rise to the claim. Op. Atty. Gen., July 28, 1978; Summers v. Harrison Const., 298 S.C. 451, 381 S.E.2d 493 (Ct. App. 1989). The Act makes the State, an agency, a political subdivision and a governmental entity liable for torts "in the same manner and to the same extent as a private individual under like circumstances, subject to the limitations upon liability and damages, and exemptions from liability and damages", contained therein.

Section 15-78-30(c) defines the "State" as

> the State of South Carolina and any of its offices, agencies, authorities, departments, commissions, boards, divisions, instrumentalities, including the South Carolina Protection and Advocacy System for the Handicapped, Inc., and institutions, including state-supported governmental health care facilities, schools, colleges, universities and technical colleges.

As indicated above, the bulk of the cases in this area conclude that a State or a political subdivision which creates a nonprofit corporation to perform a public purpose are not liable for that corporation's acts and omissions or for that corporation's failure to perform a duty required under the law. Using the same reasons outlined in the September 6 Informal Opinion -- that the acts of a separate corporation do not generally constitute the acts of the State -- the courts have analyzed the question of a State or political subdivision's liability in much the same way. The courts do not find liability on behalf of the State or a political subdivision unless it is concluded that the State is, in reality, in control of the acts and decisions of the corporation. This has generally not been found unless the state or governmental agency is required to approve the major corporate decisions or is funding the corporation in large part.

Of course, no one can guarantee that the State will not be sued, nor can I absolutely assure you that liability will not be found against the State for the acts of a nonprofit corporation established by an authority of the State. However, the general body of case law draws a reasonably clear line between liability and non-liability. If the nonprofit corporation is not under the direction and control of the State or its political subdivisions, but instead independently stands on its own there is almost universal agreement in the

cases that no liability to the government will ensue. On the other hand, if the nonprofit corporation is deemed, based upon all the facts and circumstances, to be the State's "alter ego", then there is the possibility of liability. The less state control, the less likely is liability. Courts look at the degree of financial aid being given by the government to the corporation and particularly to the degree of control by the State over the corporation's internal decisions to make this determination. The facts of the particular cases, which I have discussed herein, provide a road map to determining whether or not there is sufficient state control or financial assistance to make the nonprofit corporation an arm or alter ego of the State. Thus, if the nonprofit corporation is not deemed to be under the direction and control of the State, and is not the alter ego thereof, the likelihood of State liability is remote.

With kind regards, I am

Very truly yours,

Robert D. Cook
Assistant Deputy Attorney General

RDC/an