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The State of South Carolina
OFFICE OF THE ATTORNEY GENERAL

HENRY MCMASTER
ATTORNEY GENERAL

December 8, 2004

The Honorable Grady L. Patterson, Jr.
Treasurer, State of South Carolina
Post Office Drawer 11778
Columbia, South Carolina 29211

Dear Mr. Patterson:

You note that your Office has "been apprised that an agency of a Florida Municipality (Agency) is seeking to issue private activity bonds to finance a project in the State of South Carolina (State) in a South Carolina County (County)." You further indicate that "[t]he County has posted notice of a public hearing related to the issuance of the bonds." By way of background, you further state that

> [t]o the best of our knowledge, this is the first time that an out-of-state governmental agency has attempted to issue bonds to provide financing for a project located wholly within the State with which the issuing Agency has no other connection. For this reason we are seeking your opinion as to whether or not there are South Carolina laws that regulate the issuance of bonds in a foreign jurisdiction to make a loan to a non-governmental entity; in this case to make a loan to finance a housing facility in South Carolina.

Thus, you have raised the following questions:

1. Is the Agency permitted to undertake the proposed financing without State approval?

2. Under State law, can the proposed bonds be issued without the approval of the State Budget and Control Board?

3. Will the proposed transaction impinge on the sovereignty of the State?

Law / Analysis

Typically, in a private activity bond setting "a municipality lends the proceeds of the bond issue to a private obligor that is a nongovernmental commercial enterprise or builds a facility for its

benefit and then sells the facility on an installment sale basis or leases it to the obligor. The loan payments, sale proceeds, or rentals are set at levels necessary to pay the issuing municipality's expenses and debt service." Funk and Poe, "Applicability of State Securities Laws to Securities Issued By Governmental Entities," 43 Bus. Law. 433, 437 (1987). Common examples of the use of private activity bonds are pollution control revenue bonds or bonds issued to build docks and wharves. Id. Tax-exempt private activity bonds "may be issued only to finance such public purpose property as low-income housing, small manufacturing plants, sewage and solid waste disposal facilities, mass transportation facilities, water supply facilities, hazardous waste facilities and similarly needed public purpose property. Practicing Law Institute, "Working with the New Municipal Continuing Disclosure Regulations and Avoiding Issuer Catastrophes," 898 PLJ/Corp. 359, 442 (June 1995).

Federal law defines and regulates the issuance of and expenditure of the proceeds of private activity bonds. As part of the Tax Reform Act of 1986, "stringent requirements" were imposed "on municipal obligations in order for bonds to qualify for tax exemption." Trujillo, "Municipal Bond Financing after South Carolina v. Baker and the Tax Reform Act of 1986: Can State Sovereignty Reemerge?" 42 Tax Law., 147 (1988). Pursuant to 26 U.S.C. § 141, a private activity bond is any bond which meets the "private loan financing test" set forth in 26 U.S.C. § 141. See, 26 U.S.C. § 141(c)(1). Federal law requires that in order for the interest on private activity bonds to be exempt from federal taxation,

> ... the private activity bonds must also be qualified under 26 U.S.C. § 141(e) (1994). There are three criteria that a bond issuance must meet under this section. First, the bond must fall within one of the enumerated categories: "(A) an exempt facility bond, (B) a qualified mortgage bond, (C) a qualified veterans mortgage bond, (D) a qualified small issue bond, (E) a qualified student loan bond, (F) a qualified redevelopment bond, or (G) a qualified 501(c)(3) bond." 26 U.S.C. § 141(e)(1) (1994); Second, the bond issue must meet the volume cap requirements of section 146 .... 26 U.S.C. (e)(1) (1994); see also 26 U.S.C. § 146 (1994). Finally, the bond issue approval requirement of section 147(f), in order to be a qualified bond a private activity bond must be approved by both the governmental unit issuing the bond and the governmental unit that has jurisdiction over the area in which the facility receiving financing through the bond proceeds is located. (emphasis added)

Steele v. Industrial Development Bd. of the Metropolitan Govt. of Nashville and Davidson Co., 117 F.Supp.2d 693, 697 (M.D. Tenn. Nashville Div. 2000). As will be seen below, this approval requirement is quite detailed.

Congress has also imposed a limit on the tax-exempt non-general obligation debt or private activity bonds which may be issued in any one year by a state, its political subdivisions and nonprofit corporations. See, 26 U.S.C. § 146. Certain exemptions are provided for in the volume cap provisions, see, 26 U.S.C. § 146(g). Amendments were recently made to 26 U.S.C. § 146 which

apply to bonds issued after December 31, 2004. See, § 701(c) of PJ 108-357, October 22, 2004, 118 Stat. 1418.

As noted above, 26 U.S.C. § 147(f)(A)(ii) requires approval by the governmental unit having jurisdiction over the location of the project where the bond revenues are to be used as well as approval by the jurisdiction which issued the bonds. While this provision does not speak directly to the situation in which the issuing jurisdiction and the host jurisdiction are in different states, we assume that the statute and the IRS regulation cover this situation. See, Example 7 of 5 C.F.R. § 5f.103-2 (either State or city in the host State must give host approval). Such provision states that approval is necessary by

> ... each governmental unit having jurisdiction over the area in which any facility, with respect to which financing is to be provided from the net proceeds of such issue is located (except that if more than 1 governmental unit within a State has jurisdiction over the entire area within such State in which such facility is located, only 1 such unit need approve such issue).

In addition, 26 U.S.C. § 147(f)(B) defines public approval for purposes of the Act as follows:

> (B) Approval by a governmental unit – For purposes of subparagraph (A), an issue shall be treated as having been approved by any governmental unit if such issue is approved –
>
> (i) by the applicable elected representative of such governmental unit after a public hearing following reasonable public notice, or
>
> (ii) by voter referendum of such governmental unit.

Section 147(f)(E) further defines what is meant by "applicable elected representative" for purposes of approval. Such provision reads:

> (E) Applicable elected representative. – For purposes of this paragraph –
>
> (i) In general. – The term "applicable elected representative" means with respect to any governmental unit –
>
> (I) an elected legislative body of such unit, or
>
> (II) the chief elected executive officer, the chief elected State legal officer of the executive branch, or any other elected official of such unit designated for purposes of this paragraph by such chief elected executive officer or by State law.

The Internal Revenue Service has promulgated regulations implementing 26 U.S.C. § 147, further defining the Congressional requirements for approval by the jurisdiction in which the facility utilizing private activity bonds will be utilized. See, Steele v. Industrial Devel. Bd., 301 F.3d 401, 405, n. 2 [26 C.F.R. § 5f.103-2 provides the scope of approval necessary for private activity bonds]. 26 C.F.R. § 5f.103-2(c)(3) sets forth federal requirements for so-called "host approval" as follows:

> (3) Host approval. Each governmental unit the geographic jurisdiction (as defined in paragraph (g)(4)) of which contains the site of a facility to be financed by the issue must approve the issue ("host approval"). However, if the entire site of a facility to be financed by the issue is within the geographic jurisdiction of more than one governmental unit within a State (counting the State as a governmental unit within such State), then any one of such units may provide host approval for the issue with respect to that facility. For purposes of this paragraph (c)(3), if property to be financed by the issue is located within two or more governmental units but not entirely within either of such units, each portion of the property which is located entirely within the smallest respective governmental units may be treated as a separate facility. The issuer approval (as described in paragraph (c)(2)) may be treated as a host approval if the governmental unit giving the issuer approval is also a governmental unit described in this paragraph (c)(3). See paragraph (e)(2) with respect to host approval by a governmental unit with no applicable elected representative.
>
> (d) Method of public approval. For purposes of this section, an issue is approved by a governmental unit only if–
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> (1) An applicable elected representative (as defined in paragraph (e)) of such unit approves the issue following a public hearing (as defined in paragraph (g)(2)) held in a location which, under the facts and circumstances, is convenient for residents of the unit, and for which there was reasonable public notice (as defined in paragraph (g)(3)), or
>
> (2) A referendum of the voters of the unit (as defined in paragraph (g)(5)) approves the issue.
>
> An approval may satisfy the requirements of this section without regard to the authority under State or local law for the acts constituting such approval. The location of hearing will be presumed convenient for residents of the unit if it is located in the approving governmental unit's capital or seat of government. If more than one governmental unit is required to provide a public hearing, such hearings may be combined as long as the combined hearing is a joint undertaking that provides all of the residents of the participating governmental units (i.e., those relying on such hearing as an element of public approval) a reasonable opportunity to be

heard. The location of any combined hearing is presumed to provide a reasonable opportunity to be heard provided it is no farther than 100 miles from the seat of government of each participating governmental unit beyond whose geographic jurisdiction the hearing is conducted.

(e) Applicable elected representative–(1) In general. The applicable elected representative of a governmental unit means–

(i) Its elected legislative body,

(ii) Its chief elected executive officer,

(iii) In the case of a State, the chief elected legal officer of the State's executive branch of government, or

(iv) Any official elected by the voters of the unit and designated for purposes of this section by the unit's chief elected executive officer or by State or local law to approve issues for the unit.

For purposes of subdivisions (ii), (iii), and (iv) of this paragraph (e)(1), an official shall be considered elected by the voters of the unit only if he is popularly elected at-large by the voters of the governmental unit. If an official popularly elected at-large by the voters of a governmental unit is appointed or selected pursuant to State or local law to be the chief executive officer of the unit, such official is deemed to be an elected chief executive officer for purposes of this section but for no longer than his tenure as an official elected at-large. In the case of a bicameral legislature which is popularly elected, but chambers together constitute an applicable elected representative, but neither chamber does independently, unless so designated under paragraph (e)(1)(iv). If multiple elected legislative bodies of a governmental unit have independent legislative authority, however, the body with the more specific authority relating to the issue is the only legislative body described in paragraph (e)(1)(i) of this section. See paragraph (h), Example (7) of this section. (emphasis added).

We turn now to South Carolina statutory provisions which govern private activity bonds. The regulation and approval of private activity bonds is generally provided for in S.C. Code Ann. Section 1-11-510 et seq. The General Assembly has delegated the task of approval of private activity bonds to the State Budget and Control Board. Section 1-11-510 (A) states, for example, that the Board must allocate "[t]he private activity bond limit for all issuing authorities ... in response to authorized requests as described in § 1-11-530 by the issuing authorities." Section 1-11-520 further establishes the "state government pool" and the "local pool" within the state ceiling allocated by

Congress, and empowers the Board "with review and comment by the Joint Bond Review Committee" to "shift unallocated amounts from one pool to the other at any time."

Section 1-11-530 establishes the procedure for a "state government issuing authority "as well as issuing authorities "other than state government issuing authorities" to obtain approval from the Budget and Control Board for the issuance of private activity bonds. Such provision states in pertinent part:

> (A) For private activity bonds proposed for issue by other than state government issuing authorities, an authorized request is a request included in a petition to the board that a specific amount of the state ceiling be allocated to the bonds for which the petition is filed. The petition must be accompanied by a copy of the Inducement Contract, Inducement Resolution, or other comparable preliminary approval entered into or adopted by the issuing authority, if any, relating to the bonds. The board shall forward promptly to the committee a copy of each petition received.
>
> ....
>
> (C) Each authorized request must demonstrate that the allocation amount requested constitutes all of the private activity bond financing contemplated at the time for the project and any other facilities located at or used as a part of the integrated operation with the project.

Section 1-11-540(A) authorizes the Board, with review and comment by the Joint Bond Review Committee, to "disapprove, reduce or defer any authorized request," but the "board and the committee shall take into account the public interest in promoting economic growth and job creation" as part of its exercise of discretion. Moreover, among other provisions, § 1-11-570 empowers the Board "after review and comment by the committee, ... [to] adopt the policies and procedures it considers necessary for the equitable and effective administration of §§ 1-11-500 through 1-11-570." See also, § 1-11-370 [Budget and Control Board and the Joint Bond Review Committee "shall develop a plan pursuant to which the Board shall determine which issue of indebtedness, or portions of indebtedness, issued by the State of South Carolina or any agency or political subdivision of the State must be included within any limitation on 'private activity bonds' or any similar indebtedness, proposed or imposed by any federal legislation or regulations."]

The foregoing state statutory provisions appear to relate only to the issuance of private activity bonds. We are aware of no state law which provides for the necessity of or authority for approval by the Budget and Control Board of expenditures of private activity bond proceeds in so-called "host" jurisdictions – i.e. areas in South Carolina where facilities will be constructed with private activity bond proceeds from bonds issued in other states. While such requirements for Board approval might arguably be "implied" as part of § 1-11-510 et seq.'s requirement that the Board

approve private activity bond issuances, we do not think a court would so construe these provisions. It is well recognized that a state administrative agency such as the Budget and Control Board "... has only such powers as have been conferred upon it by law and must act within the granted authority for an authorized purpose ...." South Carolina Tax Commission v. South Carolina Tax Board of Review, 278 S.C. 556, 559, 299 S.E. 489, 491 (1983). Thus, we doubt whether a court would conclude that state law authorizes the Budget and Control Board to approve the expenditure of private activity bond proceeds resulting from the issuance of such bonds by a municipality in another State. In our opinion, the General Assembly has not yet anticipated such situation arising.

With respect to governing provisions in federal law, approval by a State administrative agency, such as the Budget and Control Board, of "host" facility construction does not appear to have been envisioned. As noted, 26 CFR § 5f.103-2(C)(3) states that "... if the entire site of a facility to be financed by the issue is within the geographic jurisdiction of more than one governmental unit within a state (counting the State as a government unit within such State), then any one of such units may provide host approval for the issue with respect to that facility." (emphasis added). Moreover, while an approval may satisfy federal requirements "without regard to the authority under State or local law for the acts constituting such approval", elected officials by the voters of the unit which are expressly authorized by federal law to give approval must be "popularly elected at-large by the voters of the governmental unit." Thus, based upon federal law, it would appear that the following officials are recognized as being authorized to approve "host" facilities:

a. the South Carolina General Assembly;
b. the Governor;
c. the Attorney General;
d. any statewide elected official designated by the Governor or state law;
e. the governing council of the political subdivision (county or municipal, depending upon the location of the facility);
f. the mayor or chief elected executive officer of the county, (depending upon the location of the facility);
g. any countywide or citywide elected official (depending upon the location of the facility) designated by the chief elected executive officer of the political subdivision (county or municipal, depending upon the location of the facility).

In view of the federal law requirement that, except for the unit's elected legislative body, those elected officials designated as authorized to approve a "host" facility, must be "popularly elected at-large by the voters of the governmental unit,"it does not appear that the Budget and Control falls within this group. While certain members of the Board are elected at-large by the voters of the State, and thus might be designated by the Governor to give such approval, other members are not. Thus, the Board as an entity does not appear to qualify pursuant to federal law to give such approval.

Therefore, with respect to your first question, the Agency would, pursuant to federal law, be permitted to undertake the proposed financing without necessarily having State approval. As noted above, the controlling federal Regulation provides that any one of the applicable governmental units (in this case county or State) "may provide host approval for the issue with respect to that facility." See, Steele v. Peterson, 301 F.3d 401, 405 (6th Cir. 2002) ["In this case, the bond issue was approved by the Industrial Development Board (of Nashville) as the governmental unit that issued the bonds and by Mayor Bill Boner as the chief elected executive officer of Metropolitan Government of Nashville and Davidson County, the governmental unit in which the facilities of Lipscomb University are located."].

With respect to your second question – under State law, can the proposed bonds be issued without the approval of the State Budget and Control Board – the answer is that state law does not speak directly to the issue, but, under federal law, they can. Indeed, as discussed above, federal law apparently does not permit the full Board to provide so-called "host approval."

This now brings us to your third question – will the proposed transaction impinge on the sovereignty of the State? This obviously raises the issue of the Tenth Amendment. The Tenth Amendment of the United States Constitution states that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." We have located no decision which addresses the Tenth Amendment question in the context of governing federal law concerning private activity bonds.

However, South Carolina v. Baker, 485 U.S. 505 (1988) does provide certain guidance. In Baker, the United States Supreme Court concluded that a federal tax code provision which denied a federal income tax exemption for unregistered state and local bonds did not violate the Tenth Amendment. The federal statute in question, 26 U.S.C. § 310, sought "to address the tax evasion concerns posed generally by unregistered bonds ... ." Covered by the statute were "not only state bonds but also bonds issued by the United States and private corporations." 485 U.S. at 510. Federal law mandated that various tax exemptions were deemed inapplicable with respect to bonds issued in unregistered form.

The Court described South Carolina's argument that § 310(b) violated the Tenth Amendment as follows:

> ... South Carolina and the NGA contend, and the Master found, that § 310 effectively requires States to issue bonds in registered form, noting that if States issued bonds in unregistered form, competition from other nonexempt bonds would force States to increase the interest paid on state bonds by 28-35%, and that all state bonds were issued in bearer form before § 310 became effective, since then no State had issued a bearer bond. ... South Carolina and the NGA thus argued that that, for purposes of Tenth Amendment analysis, we must treat § 310 as if it simply banned bearer bonds altogether without giving States the option to issue nonexempt bearer bonds. The

> Secretary does not dispute the finding that § 310 effectively requires registration ... preferring to argue that § 310 survives Tenth Amendment scrutiny because a blanket prohibition by Congress on the issuance of bearer bonds can apply to States without violating the Tenth Amendment. For the purposes of Tenth Amendment analysis, then, we treat § 310 as if it directly regulated states by prohibiting outright the issuance of bearer bonds.

The Supreme Court noted that its earlier decision in Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528 (1985) had held that the limits of the Tenth Amendment "are structural, not substantive" and that there are no "judicially defined spheres of unregulable state activity." 485 U.S. at 512. In other words, "states must find their protection from congressional regulation through the national political process ... ." Id. The Court was satisfied that "South Carolina has not even alleged that it was deprived of any right to participate in the national political process or that it was singled out in a way that left it politically isolated and powerless." Id. at 512-513. Instead, according to the Court, South Carolina argued that Congress was "uninformed ...."

A second argument, made by the NGA, was that § 310 "... commandeers the state legislative and administrative process by coercing states into enacting legislation authorizing bond registration and into administering the registration schemes." Id. NGA relied upon FERC v. Mississippi, 456 U.S. 742 (1982). However, the Supreme Court distinguished the FERC case simply by saying that "Section 310 regulates state activities; it does not, as did the statute in FERC, seek to control or influence the manner in which States regulate private parties." Id. at 514. Likewise, the Baker Court rejected the NGA's "commandeering" argument in the following passage from the Court's opinion:

> [t]he NGA nonetheless contends that § 310 has commandeered the state legislative and administrative process because many state legislatures had to amend a substantial number of statutes in order to issue bonds in registered form and because many state legislatures had to amend a substantial number of statutes in order to issue bonds in registered form and because state officials had to devote substantial effort to determine how best to implement a registered bond system. Such "commandeering" is, however, an inevitable consequence of regulating a state activity. Any federal regulation demands compliance. That a State wishing to engage in certain activity must take administrative and sometimes legislative action to comply with federal standards regulating that activity is a commonplace that presents no constitutional defect. After Garcia, for example, several States and municipalities had to take administrative and legislative action to alter the employment practices or raise the funds necessary to comply with the wage and overtime provisions of the Federal Labor Standards Act. Indeed, even the pre-Garcia line of Tenth Amendment cases recognized that Congress could constitutionally impose federal requirements on States that States could meet only by amending their statutes. See EEOC v. Wyoming, 460 U.S. 226, 253-254, and n.2, 103 S.Ct. 1054, 1069-1070, and n. 2, 75 L.Ed.2d 18 (1983) (Burger, C.J., dissenting) (citing state statutes form over half the

> States that did not comply with the federal statute upheld by the Court). Under the NGA's theory, moreover, any State could immunize its activities from federal regulation by simply codifying the manner in which it engages in those activities. In short, the NGA's theory of "commandeering" would not only render Garcia a nullity, but would also restrict congressional regulation of state activities even more tightly than it was restricted under the now overruled National League of Cities [v. Usery, 426 U.S. 833 (1976)] line of cases. We find the theory foreclosed by precedent, and uphold the constitutionality of § 310 under the Tenth Amendment.

Id. at 514-515.

The Court also rejected South Carolina's argument that even if a statute banning state bearer bonds entirely did not contravene the Tenth Amendment, "§ 310 unconstitutionally violates the doctrine of intergovernmental tax immunity because it imposes a tax on the interest earned on a state bond." 485 U.S. at 516. With respect to this contention, the Court overruled Pollock v. Farmers Loan & Trust Co., 157 U.S. 429 (1895) which had held that any interest earned on a state bond was immune from federal taxation. The Baker Court concluded that "subsequent case law has overruled the holding in Pollock that state bond interest is immune from a federal regulatory tax. We see no constitutional reason for treating persons who receive interest from government bonds differently than persons who receive income from other types of contracts with the government, and no tenable rationale for distinguishing the costs imposed on States by a tax on state bond interest from the costs imposed by a tax on the income from any other state contract." 485 U.S. at 524-525.

Thus, employing the test enunciated in Baker, the issue which a court would necessarily confront in any Tenth Amendment attack upon the federal regulation of private activity bonds is whether 26 U.S.C. § 141 et seq. and its governing regulations regulates State activities or seeks "'to control or influence the manner in which States regulate private parties.'" Compare, Printz v. United States, 521 U.S. 898 (1997) [provision of Brady Act which commanded "state and local enforcement to conduct background checks on prospective handgun purchasers" violates the Tenth Amendment] and New York v. United States, 505 U.S. 144, 162 (1992) ["the Constitution has never been understood to confer upon Congress the ability to require the States to govern according to Congress' instructions."] with Reno v. Condon, 528 U.S. 141 (2002) [relying upon South Carolina v. Baker, court held that Driver's Privacy Protection Act does not violate the Tenth Amendment because Act does not require the States in their sovereign capacity to regulate their own citizens," but, instead, "(t)he DPPA regulates the States as the owners of (driver's license) data bases."]. See also, U.S. v. Lopez, 514 U.S. 549 (1995) [Congress exceeded its powers under the Commerce Clause by enacting the Gun-Free School Zones Act of 1990, which prohibited the knowing possession of a firearm at a school.]

As indicated, we have found no case which challenges the above-referenced federal private activity bond statute and regulations on Tenth Amendment grounds. Of course, it could be argued that the Baker and Reno cases are controlling because Congress is, pursuant to its Taxing Power,

regulating the State's authority to control private activity bonds rather dictating how the State may govern private activity. Baker would appear to mandate that "a State wishing to engage in certain activity must take administrative and sometime legislative action to comply with federal standards ...." 485 U.S. at 514-515.

On the other hand, at least one commentator views the Baker decision as "flawed" and that the restrictions imposed by Congress on private activity bonds as well as other requirements, present "major constitutional problems" under the Tenth Amendment. Trujillo, supra at 147. Thus, it could be argued that federal laws relative to private activity bonds could be seen by a court as "commandeering" state officials and processes for purposes of legislative and administrative regulation, and thus violative of the Tenth Amendment, as the Supreme Court has held in the New York and Printz cases. Clearly, Congress has sought here to dictate to the State how it regulates private activity in a certain sense – particularly, those private parties interested in investing in the particular project funded by the municipal private activity bonds. Moreover, a fundamental sovereign power of the state and its political subdivisions – its ability to borrow money – has arguably been intruded upon by Congress. One commentator has presented the case for a Tenth Amendment challenge to the federal restrictions on private activity bonds this way:

> [t]he Tax Reform Act of 1986 restricts private activity bonds in three primary ways. First, the determination of what constitutes a private purpose is shifted from the states to Congress and the Service. .... In Code section 141(a), Congress limits private utilization of a project to 10% of the proceeds. Since private and public purposes are often inextricably interwoven, the 10% limitation constitutes a substantial interference in the state's power to borrow. .... While Congress may be justified in precluding purely private projects from a tax exemption, ... the Supreme Court has announced in Union Line Co. v. Chicago & Northwestern Ry. Co. .... that the determination of what a public project should remain the hands of the state or local government. ....
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> The Supreme Court in Union Lime found that the states were the proper authorities to determine whether a particular use was public or private. .... In spite of the Court's decision in Union Lime, Congress stripped the states of this power by dictating the activities that are entitled to tax exemption .... and by permitting the Service to determine whether a particular project constitutes a public or private use. .... The Court's failure to prevent Congress' usurpation of this power to determine the public or private nature of a proposed use may be an implicit rejection on the Union Lime holding, particularly in light of the Court's virtual abdication of its role in monitoring Congress' rule-making powers in commerce clause cases. ....
>
> Even though the Court has given Congress almost complete control in the commerce area, ... the Court noted it would intervene when the political process fails to protect state sovereignty. .... An argument could be fashioned that the political

> process failed to protect a particular state's interests. In order to sustain the argument, the state must show that (1) it relies heavily on bond financing, (2) it must interact with private developers to complete certain necessary projects and (3) its peculiar circumstances were ignored in the national political process. .... Thus, any future challenge to Congress' authority to determine unilaterally whether a particular project is for a private use or a public use must focus on both the Court's decision in Union Lime and the 'breakdown in the political process' analysis in Garcia.
>
> A second restriction placed on industrial development bonds by the Tax Reform Act of 1986 is that a volume cap is imposed on qualified private activity bonds. .... By imposing these volume limitations on permissible bond issues, the states suffer a severe impact on the sale and purchase of tax-exempt obligations because of the uncertainty that is created in the bond market. .... This uncertainty translates into substantial burdens on the states to finance certain projects because of the higher issuance costs and the reduced pool of investors willing to risk an investment in unstable securities. ....
>
> The third disruption of the state's power to borrow is the requirement that all private activity bonds receive public approval prior to issuance to qualify for tax-exempt treatment. .... The public approval requirement creates a significant hurdle to a state's borrowing power because a negative reception by the public to the proposed bond issue would preclude the project. Furthermore, the costs incurred for the public hearing or the voter referendum add to the issuance costs and create additional economic burdens on the state. Not only does this requirement violate the state's power to borrow, but it also infringes on the state's power to set elections and public hearings, which are at the heart of self-government. ....

Trujillo, "Municipal Bond Financing After South Carolina v. Baker and the Tax Reform Act of 1986: Can State Sovereignty Reemerge?" 42 Tax Law. 147, 167-168 (1988).

In addition, it could be argued that the Congress has dictated to the State that it may not use the Budget and Control Board – the agency which has traditionally approved municipal bond issuances – as the agency to render "host approvals." This may be seen as an intrusion upon fundamental state sovereignty as well.

Certain other commentators have criticized the Baker decision as "weakly reasoned and will not stand if the tax exemption for state and local bonds is put squarely before the Court." Miller and Glick, "The Resurgence of Federalism: The Case For Tax-Exempt Bonds," 1 Tax.Rev.L.&Pol. 25, 58 (Spring, 1997). In the view of these commentators, Baker "ignores prior case law and effectively nullifies constitutional federalism by limiting it to state participation in the political process." Id. These authorities contend, based upon cases such as New York v. United States, supra and United States v. Lopez, supra, which were decided after Baker, that Congress may not repeal the tax

exemption for state and local bonds, nor dictate the conditions for qualifying for such exemption, consistent with the Tenth Amendment. They argue that, notwithstanding Baker, "states have substantive rights under principles of federalism reserved to them by the Tenth Amendment to the United States Constitution, and that Congress, in the exercise of its powers, may not infringe upon a state's sovereign powers, specifically its right to borrow money." Id.

Of course, only a court could address the fundamental state sovereignty issues which would lie at the heart of any constitutional challenge under the Tenth Amendment to the federal private activity bonds statutes and their accompanying regulations. After Reno v. Condon, however, it is not clear how a court would resolve the Tenth Amendment question. Clearly, the Court is of the opinion that South Carolina v. Baker remains a controlling precedent. As one scholar has noted, in this area of constitutional law, "[t]here is no reason to believe that an effective judicially manageable standard can be developed." Choper, "Taming Congress's Power Under The Commerce Clause: What Does The Near Future Portend," 55 Ark.L.Rev. 731, 792 (2003). Unless and until the federal statutes and regulations governing private activity bonds are successfully challenged, however, they must be followed in order to qualify for federal tax exemptions as to the interest thereupon.

Conclusion

In terms of your specific questions, we would answer them as follows:

1. Is the Agency permitted to undertake the proposed financing without State approval? As we read current federal law, the answer is yes. State law does not appear to address this issue.

2. Under State law, can the proposed bonds be issued without the approval of the State Budget and Control Board? State law does not address these circumstances. Thus, without express statutory authority, we doubt that the Board possesses the authority to approve under the circumstances which you reference. Moreover, under current federal law, it appears the Board is not an authorized approving authority because all members are not elected at large by the voters of the State.

3. Will the proposed transaction impinge on the sovereignty of the State? Current federal law relative to private activity bonds does raise serious Tenth Amendment questions. Only a court could resolve these questions with certainty, however.

Very truly yours,

Robert D. Cook
Assistant Deputy Attorney General

RDC/an