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The State of South Carolina
OFFICE OF THE ATTORNEY GENERAL

CHARLIE CONDON
ATTORNEY GENERAL

November 13, 2000

The Honorable James H. Harrison
Chairman, Judiciary Committee
House of Representatives
P.O. Box 11867
Columbia, South Carolina 29211

Dear Representative Harrison:

By your letter of September 27, 2000, you have requested an opinion of this Office with respect to a proposed agreement between the Greenville County School District and a private business, Institutional Resources, to construct and improve numerous facilities for use by the School District. Specifically you ask whether such an arrangement would violate South Carolina Code Section 11-27-110, which subjects lease purchase or financing agreements to a governmental entity's constitutional debt limit.

Law / Analysis

It is helpful to review this statute's history in some detail. Pursuant to Article X, Section 15 of the South Carolina Constitution, a school district may incur general obligation debt in an amount up to 8% of the assessed value of all taxable property of the school district. To incur debt over 8%, the school district must obtain voter approval in a referendum. In an effort to obtain funding for the construction of new school facilities, school districts attempted to finance the large costs of the projects without running afoul of the constitutional limit on general obligation debt.

In Caddell v. Lexington County School District, 296 S.C. 397, 373 S.E.2d 598 (1988), one such plan tested the limits of Article X, Section 15. A school district leased to a non-profit corporation for a term of thirty years all the land and school buildings requiring renovation. The corporation would sell certificates of participation to obtain funding for the project. With the funding, the schools could be renovated and then leased back to the school district on a yearly basis. The rent payments were in an amount sufficient to pay both the interest and principal due on the certificates. Also, the agreement contained a non-appropriation clause, under which the school district could decline to renew the lease without penalty.

Request Letter

The Court held in Caddell that the lease purchase agreement did not constitute "debt" under Article X, Section 15 of the Constitution. The Court noted that liability of the school district under the agreement was contingent: the district could terminate the lease at any time without penalty. At worst, the school district would lose the use of the facilities for a limited time, but the ownership of the land and buildings would not be impaired. Id. at 400, 373 S.E.2d at 599. Furthermore, the Court rejected the argument that the school district's agreement was a "subterfuge" to maneuver around the constitutional debt limit. Concluding that the debt limit was inapplicable, the Court suggested either legislative action or a constitutional amendment to address such arrangements. See id. at 402, 373 S.E.2d at 600.

In 1994, the Court once again upheld a lease purchase agreement involving a school district's efforts to obtain funding following the defeat of a bond referendum. See Redmond v. Lexington County School District, 314 S.C. 431, 445 S.E.2d 441. The Court once more rejected the argument that the spirit of the constitutional debt limit was being circumvented by a lease purchase approach. Instead, the Court pointed to the absence of legislation designating lease purchase agreements as general obligation debt. Should such a bill pass the General Assembly, the Court suggested, similar litigation would reach a very different result. Id. at 435, 445 S.E.2d at 444.

In 1995, the General Assembly enacted Act No. 55, 1995 Acts and Joint Resolutions, presently codified at §11-27-110. This statute provides that payments pursuant to a lease purchase or financing agreement are subject to the constitutional debt limit of a governmental entity. The Act effectively prohibits school districts from entering into lease purchase agreements similar to those in Caddell and Redmond. Thus, §11-27-110 represents the General Assembly's response to the Court's holdings in these cases and § 11-27-110 must be interpreted in light of this historical context. While it is clear that the General Assembly could not declare which agreements are constitutional or unconstitutional, it could, without question, limit the types of agreements into which a school district may enter. Significantly, and relevant to your inquiry, is the definition of "financing agreement" now found in §11-27-110 (A)(6):

> "financing agreement" means any contract entered into after December 31, 1995, under the terms of which a governmental entity acquires the use of an asset which provides:
>
> (a) for payments to be made in more than one fiscal year, whether by the stated term of the contract or under any renewal provisions, optional or otherwise;
>
> (b) that the payments thereunder are divided into principal and interest components or which contain any reference to any portion of any payment under the agreement being treated as interest; and
>
> (c) that title to the asset will be in the name of or be transferred to the governmental entity if all payments scheduled or provided for in the financing agreement are made, but the term excludes any refinancing agreement and contracts entered into in

> connection with issues of general obligation bonds or revenue bonds issued pursuant to authorization provided in Article X of the Constitution.

This definition of "financing agreement" determines whether the scope of §11-27-110's prohibition reaches the proposed agreement contemplated by the Greenville County School District.

The proposed financing arrangement under the Greenville County School District's plan includes the creation of a nonprofit corporation which serves as an intermediary between the school district and those responsible for the actual building and renovations. The school district plans to enter into a base lease with the nonprofit corporation in which the corporation will have occupancy rights of all the facilities to be renovated for a term exceeding the term of financing. In consideration for the lease, the corporation agrees to arrange for the construction and renovation of certain facilities for the district. The district, the corporation, and the building contractors will enter into an agreement in which the builders agree to perform the necessary construction of the facilities owned by the corporation. So long as the school district makes payments to the corporation, the school district has the right to occupy the premises. Significantly, as the school district makes payments to the corporation, the corporation will convey an undivided interest in all the improvements to the school district. In other words, if the school district pays an amount equal to 1/20 of the total cost of the project, the school district has purchased 1/20 of the improvements. As distinguished from the agreements in Caddell and Redmond, the school district does not pay "rent" comprised of a payment of the interest and principal due under the certificates. Instead, the school district pays a lump sum to purchase an undivided interest in the improved property. Should the school district decide to terminate the agreement before the full amount of the improvements is purchased, the facilities will be immediately divided according to the ownership interest of the parties. For example, if the school district chooses to terminate the arrangement after purchasing an undivided 25% interest in the improvements, the school district will own 1/4 of the facilities, with the intended goal of the agreement to transfer whole facilities as opposed to parts thereof.

The differences between the Greenville County School District's plan and the Caddell and Redmond plans are critical to determining the application of §11-27-110. To apply, the agreement must fall within the statute's definition of "financing agreement." The statute requires that in the financing agreement, (a) the payments must be made in more than one year, (b) the payments are divided into principal and interest, **and** (c) title is transferred if all payments are made. All three elements are necessary. In the Greenville County School District plan, the payments are not divided into principal and interest, but one payment which purchases an undivided interest. To illustrate the difference: as with any loan, payments are typically comprised of both interest any principal. In the early stages of repayment, the payment is applied mostly to the interest. At some point, as the interest is paid down, the portion of the payment applied to the principal increases. If a debtor defaults on the loan in the early stages of repayment, little equity has accumulated in the underlying collateral. In the Greenville County School District plan, each payment purchases a distinct undivided interest

in the improvements. If the school district defaults, or chooses not to renew the lease, the school district owns the value of the entire amount paid on the improvements. In fact, with each payment, the interest is conveyed to the school district, arguably defeating the third requirement of the statute. Although separate title to a particular facility would not be transferred until the school chooses not to renew the lease, the school is not required to make all payments under the agreement before any title is transferred. These two differences–the purchase of an interest and the immediate transfer of title–distinguish the Greenville County School District's plan from those in Caddell and Redmond.

In addition to the distinguishing characteristics of this plan as compared to traditional lease-purchase or financing agreements, the inapplicability of §11-27-110 is further suggested by the attempted passage of an amended version of §11-27-110. The amendments would have rewritten the definition of "financing agreement" to replace the current (A)(6)(b) and (c) with:

> (b) *for payments by the governmental entity which will be utilized, directly or through any intermediary, to service all or a portion of indebtedness of such governmental entity, intermediary or any other entity issued for the purpose of acquiring or improving the asset; and*
>
> (c) that title to *all or a portion of* the asset will be in the name of *the governmental entity* or will be transferred to the governmental entity if all *or a portion of* the payments scheduled or provided for in the financing agreement are made, but the term excludes any refinancing agreement and contracts entered into in connection with issues of general obligation bonds or revenue bonds issued pursuant to authorization provided in Article X of the Constitution;

(Emphasis added to show amendments). This broader definition of "financing agreement" appears to encompass the type of proposal contemplated by the Greenville County School District. However, it is our understanding that these proposed amendments failed to pass. In effect, the General Assembly could have included amendments of the kind seen in the Greenville County School District plan within the scope of §11-27-110, but has thus far affirmatively rejected such inclusion.

In short, it is clear that there are major distinctions between the proposed transaction in Greenville and the circumstances which § 11-27-110 literally, on its face encompasses. We have no doubt that the proposed transaction is not a "financing agreement" as expressly defined by the statute. Thus, if the statute is literally applied, it does not address this situation.

However, there are other factors which a court may consider which could lead it to reach a contrary conclusion. It is well settled that the language used in a statute must be construed in light of the intended purpose of the statute. Bohlen v. Allen, 228 S.C. 135, 89 S.E.2d 99 (1955). Courts are not always confined to the literal meaning of an enactment and the real purpose and intent of the lawmakers will prevail over the literal import of the words used. Ashley v. Ware Shoals Mfg. Co.,

210 S.C. 273, 42 S.E.2d 390 (1947). A statute must be construed in the light of the evil which it seeks to remedy and in the light of the conditions obtaining at the time of its becoming law. Judson Mills v. S.C. Unemployment Comp. Comm., 204 S.C. 37, 28 S.E.2d 535 (1944). The statute should be construed to carry out the legislative purpose. Bannister v. Shepherd, 191 S.C. 165, 4 S.E.2d 7 (1939).

Furthermore, a remedial statute should be liberally construed to effectuate its purpose. S.C. Dept. of Mental Health v. Hanna, 270 S.C. 210, 241 S.E.2d 563 (1978). What cannot be done directly cannot then be done indirectly, either. Op. Atty. Gen., 1990 WL 599265 (July 31, 1990), citing State ex rel. Edwards v. Osborne, 193 S.C. 158, 7 S.E.2d 526 (1940); Lurey v. City of Laurens, 265 S.C. 217, 217 S.E.2d 226 (1975); Westbrook v. Hayes, 253 S.C. 244, 169 S.E.2d 775 (1969).

While the body of § 11-27-110 only deals with "financing agreements" as defined therein, the title of Act No. 55 of 1995 appears broader in scope. Such title states that the Legislature's purpose was to add

> SECTION 11-27-110 SO AS TO PROVIDE THAT THE PRINCIPAL AMOUNT OF A LEASE PURCHASE OR FINANCING AGREEMENT IS SUBJECT TO THE CONSTITUTIONAL DEBT LIMIT FOR POLITICAL SUBDIVISIONS ... . (emphasis added).

Thus, the Act's title indicates the General Assembly's intent may have been to reach all "lease purchase" agreements, as well as those "financing agreements" as defined in the statute.

This broader reach is consistent with accounts of the legislation as it wound its way toward passage. The Bill was described after passage by the House and Senate as one to "stop local governments from using lease-purchase plans without voter approval ... ." One Representative stated that when the Bill arrived on the Governor's desk for signature "Lease-purchase is dead." The Representative added that with the legislation, "It's a new day in financing government programs and school buildings. It means people will have a chance to vote on any expenditure that requires payments from their taxes." See, The State, May 10, 1995, p. B4.

In summary, it is conceivable that, despite the literal language of § 11-27-110 and the express definition of "financing agreement" contained therein, a court could conclude that the statute is applicable to the transaction in Greenville. Of necessity, the court would have to find that the statute's reach is broader than the literal language thereof. The court would have to determine that the agreement in question was in substance prohibited by the "anti lease purchase law" even if not in form. Only a court, with the ability to take testimony, admit evidence and find facts, etc. could make that determination.

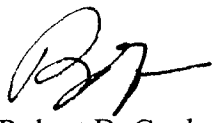
Conclusion

It is our opinion that the Greenville agreement in question is not covered by the literal language of the "anti-lease purchase law" [§ 11-27-110]. The basis for our conclusion is that, from the information provided, it does not appear that the proposed agreement is a "financing agreement" as expressly defined by the statute. Thus, on its face the anti-lease purchase law does not apply here.

However, we would caution that there are other factors which a court could consider which could cause it to reach a contrary conclusion. Based upon the Legislature's intent to ban all lease purchase agreements, if a court should determine that the agreement's factual differences with the express prohibitions of the anti-lease purchase statute simply represent mere "form over substance," then the court could still find the prohibition applicable. Only a court could make such a factual determination, however.

Accordingly, while we are of the opinion that on its face the anti-lease purchase prohibition contained in § 11-27-110 is not applicable, there is sufficient doubt to advise that a prudent course of action would be to obtain court approval of the Greenville agreement.

Very truly yours,



Robert D. Cook
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