



MEMORANDUM

TO: Kent Nelson, Acting General Counsel
University of Idaho

FROM: Hawley Troxell Ennis & Hawley LLP

DATE: June 7, 2023

RE: Powers of Regents to Form Nonprofit Corporation

We previously provided you a memorandum dated June 2, 2023 addressing several legal issues relevant to the powers of the University (the “University”) and its Board of Regents (the “Regents”), one of which was the power for the University to form a nonprofit corporation. This Memorandum further expands on that issue and outlines the manner in which a nonprofit corporation can access tax-exempt financing.

A. Regents’ Power to Form Nonprofit Corporation

1. General Powers

Our initial memorandum referred to the general Idaho constitutional authority of the Regents, and our conclusion that it encompasses the formation of a nonprofit corporation. The Regents are possessed with the general supervision of the University and of all powers that are necessary and convenient to accomplish the “objects and duties” prescribed to it by law.¹ In turn, the “object of the University of Idaho, shall be to provide the means of acquiring a thorough knowledge of the various branches of learning connected with scientific, industrial and professional pursuits . . .”² The Regents likely possess broad powers for its objects and purposes as prescribed in the act to establish the University at the 15th Session of the Territorial Legislature (and incorporated into the Idaho Constitution via Article IX, Section 10).

In addition, this power can be negatively inferred from the prohibition on the State of Idaho (the “State”) or certain other public entities from being a stockholder in any association or corporation.³ Neither of these provisions apply to the Regents and the University. As to Article VIII, Section 2, the Regents are a legally distinct constitutional corporation without the power to obligate the State, and as such it cannot be said that the University being the sole member of a nonprofit corporation would be the “State” being a stockholder of a corporation in violation of the

¹ Sec. 3, 15th Territorial Sess. Laws.

² Sec. 9, 15th Territorial Sess. Laws.

³ See Idaho Const. Art. VIII, sec. 2, Art. XII, sec. 4.

prohibition.⁴ The Regents do not fall under the definition of a “county, town, city, or other municipal corporation” that would equally be prohibited from being a stockholder in a corporation.⁵ Although in other contexts “corporation” includes nonprofit corporations, the Constitution should be read literally, and the obvious intent was to limit state involvement with for profit enterprises for the benefit of private interests.

2. Indirectly vs. Directly

It is often said an entity may not do indirectly what it cannot do directly. Here the converse is occurring: Acting under its general powers the University probably has the power to acquire the Phoenix assets under the purchase agreement in its own name. However, in the exercise of their fiduciary duties the Regents have chosen to acquire these assets indirectly to limit the risk to the University itself.

3. Interpretation of “Stockholder” Clause of Article VIII, Section 2 of the Idaho Constitution

Article VIII, Section 2 provides “nor shall the state directly or indirectly, become a *stockholder* in any *association or corporation*.”⁶ Little guidance exists to interpret Article VIII, Section 2, especially with respect to its second element, the stockholder in a corporation prohibition, and especially with regard to the status of a nonprofit corporation. Nonetheless, there are three insights for interpretation that lead us to believe Article VIII, Section 2 does not prohibit the Regents from acting as the member of an Idaho nonprofit corporation.

i. Separateness of the Regents

In light of the treatment of the Regents in cases under Article VIII Section 1, and other cases confirming the Constitutional separateness of the Regents, it is arguable that the “State” within Article VIII, Section 2 does not include the Regents. Similarly, in light of the public purpose qualifier to the lending of credit portion of Article VIII Section 2, where the Phoenix integration will further the educational public purposes of the University, there should be no prohibition.

ii. Case Law

Our memorandum discussed *Engelking v. Investment Bd.*, which held that there was no lending of credit where there was no imposition of a new financial liability on the State.⁷ It also reiterated that the “credit clause” of Article VIII, Section 2 is intended to preclude State action which primarily aims to aid private schemes and is not violated when there is a primary public

⁴ See *State v. State Bd. of Educ.*, 33 Idaho 415, 196 P. 201, 205 (1921).

⁵ See Idaho Const. Art XII, sec. 4.

⁶ Idaho Const. art. VIII, § 2. (emphasis added).

⁷ *Engelking v. Inv. Bd.*, 93 Idaho 217, 222, 458 P.2d 213, 218 (1969).

purpose.⁸ The Court avoided the “stockholder” clause of Article VIII, but in doing so its reasoning clearly would distinguish an investment in a for profit corporation from membership in a nonprofit corporation; the key distinguishing factor being the difference between a public and private for profit purpose.

The purpose of the nonprofit formed to acquire Phoenix is for the clearly public purposes of education. Additionally, there is no liability imposed on the State as no State funds can or will be obligated for the nonprofit’s activities or by virtue of the University’s membership in the nonprofit.

iii. General

The minutes of the constitutional convention adopting the Constitution show no debate over Article VIII, Section 2. It was adopted without comment. As such, it should be narrowly construed to its specific language.

iv. Private Corporations at Time of Enactment of Constitution

Although the term “corporation” could contemplate any private corporation, it is instructive to examine the corporate law at the time Article VIII, Section 2 was officially adopted and ratified with the Constitution of the State of Idaho in 1890.⁹ Preceding statehood, the territory of Idaho was governed by its territorial session laws. Revised Statutes of the Idaho Territory enacted at the Fourteenth Session of the Legislative Assembly, Chapter I, Title IV governing private corporations.¹⁰ Section 2586 therein specifically states “The owners of shares in a corporation which has a capital stock, are called stockholders. If a corporation has no capital stock, the incorporators and their successors are called members.”¹¹ It is fair to conclude that if the drafters of the Constitution had intended to preclude the being a “member” in a nonstock corporation, they clearly had the opportunity to do so. Thus, the plain language of Article VIII, Section 2, should be read to prohibit only ownership of capital stock in a private corporation based on the definition of “stockholder” as such term appears in the laws of the Territory of Idaho around the time of adoption and ratification of the Idaho Constitution.

B. Debt Incurring Powers of Nonprofit Corporation

Nonprofit corporations under Idaho law have broad powers, some of which are specifically enumerated, such as the power to borrow money. Idaho Code Section 30-30-302(7) provides that a nonprofit has power to “make contracts and guaranties, incur liabilities, borrow money, issue

⁸ *Id.*

⁹ *See* Idaho Const. art. VIII, § 2; Idaho Admission Bill § 1.

¹⁰ Revised Statutes of Idaho Territory, 14th Sess., June 1, 1887.

¹¹ *Id.* at § 2586.

notes, bonds and other obligations, and secure any of its obligations by mortgage or pledge of any of its property, franchises or income.”¹²

The power to incur indebtedness the interest on which is exempt from income taxes is a matter of Federal tax law. It is not inherent in being a nonprofit corporation under state law. Federal tax law has three requirements. First, the nonprofit must receive a designation as organized for charitable purposes under Section 501(c)(3) of the Code. Education is such a purpose as demonstrated by the numerous education institutions that have this designation. Second, to be tax exempt, the debt must be issued by a governmental or quasi-governmental body that has been empower under its state law—a so-called “constituted authority” -- to issue bonds on behalf of nonprofits. Internal Revenue Code Section 145 is entitled: “Qualified 501(c)(3) Bonds.” Third, Section 145 itself has limitations, for example on financing working capital and debt that extends beyond a useful life; thus some indebtedness of the nonprofit, even if issued on its behalf by a constituted authority, will not qualify for tax exempt financing.

In Idaho, one constituted authority issues bonds for healthcare 501(c)(3)’s, and another, the Idaho Housing and Finance Association, issues bonds for all other 501(c)(3)’s.¹³ Similar agencies exist in other states, some of which have been engaged by Idaho nonprofit schools.

The issuing agency pledges neither the credit of the state, nor any of its own funds or credit, but “passes through” to the nonprofit the obligation to pay payments that will equal what the agency owes on the bonds it issues. Investors understand they are lending against the credit, resources and cash flow of the nonprofit, not of anyone else.

¹² Idaho Code § 30-30-302(7).

¹³ See Idaho Code Section 67-6206(cc).