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October 2, 2001

COPY

Jay Holmquist, General Manager
Nebraska Rural Electric Association
800 South 13th Street
P.O. Box 82048
Lincoln, NE 68501

Dear Jay:

QUESTION

You have asked whether public power districts ("District or Districts") may purchase voting membership unit shares in ethanol plants?

ANSWER

Probably not.

ANALYSIS

1. Statutory authority. The Legislature has made a determination that the experience of public power districts within the state in the production and transmission of electrical power could be used in the production and distribution of ethanol and the economic well being of the state. *Neb. Rev. Stat.* § 70-601(6) & (7). The Legislature in implementing this determination granted Districts the statutory authority to "own, construct, purchase, lease, or otherwise acquire, improve, extend, manage, use, or operate . . .ethanol production or distribution systems, either within or beyond . . .the boundaries of the district . . ." *Neb. Rev. Stat.* § 70-626.

It is clear that a District has broad statutory authority regarding the development of ethanol production or distribution systems, either within or outside the boundaries of a District. Nevertheless, if a District desires to make an investment in a private ethanol venture, other legal concerns must be examined.

2. Constitutional prohibition.

Article XI, Section 1 of the Nebraska Constitution provides:

"No city, county, town, precinct, municipality, or other sub-division of the state, shall ever become a subscriber to the capital stock, or owner of such stock, or any portion or interest therein of any railroad, or private corporation, or association."

The constitutional prohibition has been interpreted by the Nebraska Supreme Court in *Nebraska League of Savings and Loan Assn. v. Mathes,* 201 Neb. 122, 268 N.W. 2d 720 (1978) to prohibit political subdivisions from depositing funds in a mutual savings and loan associations ("Association or Associations"). The Court's rationale was based on the fact that depositors had (1) an ownership interest in the Association, and (2) a voice in the management of the Association by voting for the board of directors at an annual meeting. The Supreme Court reached this conclusion even though the Association had no capital stock.

The Nebraska Supreme Court ruled that an ownership interest in the Association violated the constitutional provision, so that political subdivisions could not deposit funds in Associations.

In reaching this conclusion, the Court in *Mathes* stated:

"The historical background warrants the conclusion that the constitutional provision was directed against the acquisition by a subdivision of the state of any ownership or proprietary interest in a private corporation or association. A multitude of cases hold that the owner of an account in a mutual savings and loan association has a proprietary interest therein. (Citations omitted.)

In *Family Savings & Loan Assn. v. Steward,* 232 Md. 424, 194 A. 2d 118, the court said: 'Every member or shareholder is entitled to the same rights and privileges, and must bear the same burdens as every other member or shareholder holding the same class of investment security. The shareholders have the same rights as stockholders in ordinary corporations for profit, except in so far as they may be enlarged or restricted by special legislation, the Statute under which the corporation is incorporated, its charter or its by-laws. * * * In other words, the members or shareholders own the association and are entitled to conduct its affairs through their officers and Board of Directors.'

In historical context the language used in the constitutional provision impels the conclusion that it was intended to prohibit any state subdivision from acquiring any proprietary or ownership interest in any private corporation or association, whether that interest was represented by a stock certificate or by some other from of representation of ownership. <u>The constitutionally prohibited acquisition of any interest applies to any interest in private associations, which ordinarily issue no capital stock, to the same extent as it does to corporations which issue capital stock." (Emphasis added.)</u>

Id. at 126-27.

The Supreme Court of Nebraska essentially reached the same conclusion in *Nebraska League of Savings and Loan Assns. v. Johnson,* 215 Neb.19, 337 N.W. 2d 114 (1983), notwithstanding the fact that the Savings and Loan had the political subdivisions sign waiver of all rights and incidents of ownership when they made deposits. The Savings and Loan argued that the waiver eliminated the ownership problem, but the Court rejected the argument, finding that neither the Savings and Loan nor the political subdivisions had the statutory authority to agree to the waiver.

It is difficult to predict what a Court may do today, some twenty years after *Mathes*. It may be that a Court would interpret the constitutional prohibition in the same broad fashion so as to find that any participation in a private corporation or association creates an ownership interest in its members. On the other hand, a Court may take a narrower view finding that the prohibition only applies to the subscription in capital stock.

3. Investment statutes. Although Districts have broad investment authority under *Neb. Rev. Stat.* § 77-2341 and §§ 77-2353 to 77-2367 there is no specific statutory authority to invest in businesses engaged in ethanol production and distribution. Even if there were such specific authority, it could not override the constitutional prohibition in Article XI, Section 1 of the Nebraska Constitution. See, *i.e., Abel v. Conover*, 170 Neb. 926; 104 N.W.2d 684 (1960) (A statute cannot authorize what is prohibited by the Constitution); *Jaksha v. State*, 241 Neb. 106, 486 N.W.2d 858 (1992) (An act of the legislature that is forbidden by the state Constitution at the time of its passage is absolutely null and void); *Haman v. Marsh*, 237 Neb. 699, 467 N.W.2d 836 (1991) (Legislature cannot circumvent express provision of Constitution by doing indirectly, what it may not do directly); *In re Joshua M.,* 256 Neb. 596, 591 N.W.2d 557 (1999) (Statutory provisions cannot abrogate constitutional rights).

4. Interlocal Cooperation Act. It should be noted that a District may under the Interlocal Cooperation Act, *Neb. Rev. Stat.* §§ 13-801 to 13-827, join with other public agencies (including counties and cities) to own or otherwise acquire ethanol production or distribution systems. *Neb. Rev. Stat* § 13-804(1) provides that "any power or powers, privileges, or authority exercised or capable of exercise by a public agency of this state may be exercised and enjoyed jointly with any other public agency of this state ..." *Neb. Rev. Stat.* § 13-807 provides "any one or more public agencies may contract with any one or more other public agencies to perform any governmental service, activity, or undertaking which at least one of the public agencies entering into the contract is authorized by law to perform."

5. Transfer of District property and expenditure of funds. A District is prohibited from transferring its property or placing it under the control of a private person, firm or corporation engaged in the business of generating, transmitting, or distributing electricity for profit. *Neb. Rev. Stat.* § 70-646.01. However, this prohibition does not apply to the sale of ethanol production or distribution facilities to private parties. *Neb. Rev. Stat.* § 70-646.01(2). Accordingly, a District may sell ethanol production or distribution facilities to a private person, corporation or association. It may also sell District land to a private person, corporation or association engaged in the ethanol business. *Neb. Rev. Stat.* § 70-625(1). In addition, it seems reasonable to conclude that a District may, incidental to the expressed authority to "own, construct, purchase, lease, or otherwise acquire, improve, extend, manage, use, or operate . . .

ethanol production or distribution systems, expend funds to determine the feasibility of an ethanol production or distribution system.

5. Ethanol Development Act. The Ethanol Development Act, *Neb. Rev. Stat.* §§ 66-1330 to 66-1348, encourages processing, market development, promotion, distribution, and research on products derived from grain, ethanol, or ethanol components, coproducts, or byproducts. The Legislature, as part of its findings, indicates an intent to cooperate with private industry. *Neb. Rev. Stat.* § 66-1331 (5) states "cooperation with private industry to establish ethanol-related production facilities in Nebraska to create demand for agricultural products; and (6) states "promotion and market development, in cooperation with private industry, of ethanol or products derived from ethanol or ethanol components, coproducts, or byproducts." Although the legislation provides for cooperation with private industry, it does not authorize political subdivisions, such as public power districts to invest in private corporations or associations. Even if it did, it cannot override the constitutional prohibition in Article XI, Section 1 of the Nebraska Constitution. See authorities cited in Paragraph 2 above.

7. Joint Venture. It may be possible that other organizational structures would provide less risk for a District. For example, a contractual joint venture arrangement, where each participant is involved in its own right rather than collectively through a distinct private corporation or association. Under this structure, a District may be able to contribute land or invest district funds in ethanol production and distribution systems or facilities. In *Lackman v. Rousselle,* 7 Neb. App. 698, 690-91, 585 N.W.2d 469 (1998) the Court of Appeals discussed the legal attributes of a joint venture:

> "A joint venture can exist only by voluntary agreement of the parties and cannot arise by operation of law. . . . There must be an agreement to enter into an undertaking; the parties must have a community of interest in the object of the undertaking and a common purpose in performance; each of the parties must have an equal voice in the manner of performance and control over the agencies used . . . .The mere pooling of property, money, assets, skill, or knowledge does not create the relationship . . .And there must be something more than mere sharing of profits; there must be some active participation in the enterprise and some control of the subject matter thereof or property engaged therein. . . The absence of mutual interest in the profits or benefits is conclusive that a partnership or joint venture does not exist . . . The primary criterion is that the parties enter into an agreement as owners or principals in the endeavor . . . . Therefore, even a close relationship between two parties does not create an implied joint venture."

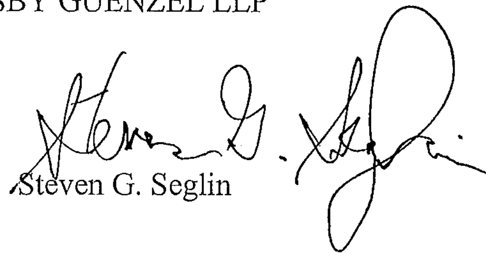
If a District is interested in exploring the feasibility of structuring a joint venture, it should contact its own attorney since this is a complex issue and is only mentioned here for illustrative purposes.

CONCLUSION

Based on the rational in the cases referred to in Paragraph 2 above it appears that the Constitutional prohibition in Article XI, Section 1, against subscribing to the capital stock of a private corporation or association, precludes the investment by a District in voting membership unit shares in an ethanol plant. However, a District is authorized to sell ethanol production and distribution facilities or land to private parties engaged in the ethanol business, expend funds on feasibility studies, and may be able to participate in a joint venture arrangement to develop ethanol production or distribution systems.

Very truly yours,

CROSBY GUENZEL LLP

By 
Steven G. Seglin

SGS:tlh