

CONSTITUTION OF VIRGINIA: TAXATION AND FINANCE (COLLECTION AND DISPOSITION OF STATE REVENUES).

ADMINISTRATION OF GOVERNMENT GENERALLY: DEPARTMENT OF GENERAL SERVICES.

Legislation to implement Governor's Innovative Progress plan to securitize tobacco settlement revenues will not violate Constitution. Tobacco payments owed Commonwealth qualify as assets. Transfer of Commonwealth's rights to tobacco settlement revenue stream is characterized as true sale which is nonrecourse to Commonwealth. Corporate public body involved in securitization activities is organized and operated independently from Commonwealth.

The Honorable Charles R. Hawkins
Member, Senate of Virginia

The Honorable Whittington W. Clement
Member, House of Delegates
February 25, 2000

You ask whether the General Assembly may create an entity to which certain revenues that are due the Commonwealth may be deposited rather than depositing such revenues into the State treasury.

While your inquiry is general in nature, I shall assume for the purposes of this opinion that your inquiry arises from the recent settlement of tobacco litigation. A plan is proposed¹ to "securitize"² the stream of payments due under a settlement agreement filed by the Commonwealth in the Circuit Court of the City of Richmond against major cigarette manufacturers.³ "Securitized" are commercial transactions that routinely occur in private business dealings.⁴ Securitization typically is used by financial institutions and involves the sale of illiquid financial assets, such as mortgages, automobile loan receivables, or credit card receivables, to a special purpose, independent corporation ("SPC"). SPCs sell securities in public financial markets in order to obtain the funds to pay the purchase price of the financial assets. The SPC securities are payable solely from the pool of financial assets purchased for that purpose. In addition, SPC securities are nonrecourse⁵ to the seller. It is my understanding that, under general accounting principles, such transactions are characterized as "sales."

Under the Innovative Progress plan, the Governor may sell up to forty percent of the tobacco settlement payments to a public body corporate organized and operated independently from the Commonwealth (the "nonstock corporation").⁶ The nonstock corporation would issue bonds to raise the monies necessary to buy the Commonwealth's right and title to the authorized portion of the stream of revenue contemplated by the settlement. Bondholders would be paid from the revenue stream the nonstock corporation purchases from the Commonwealth. All bonds issued by the nonstock corporation would

be nonrecourse to the Commonwealth and would expressly indicate that they were not backed by the Commonwealth's full faith and credit. The purchase price received by the Commonwealth from such sale would be deposited into the general fund to be spent only pursuant to the ordinary appropriations process. As discussed below, it is my opinion that the Innovative Progress plan is distinguishable from the type of fact situation contemplated by your opinion request.⁷

To avoid potential constitutional issues raised by your question, I believe that any proposal to securitize the tobacco settlement revenues must meet three concerns: (1) the rights to the revenue stream must constitute an asset of the Commonwealth, (2) the transfer must be a true sale, and (3) the purchasing entity must be independent of the Commonwealth. I believe those requirements can be met in a plan such as that proposed by the Governor.

First, the payments the tobacco companies owe the Commonwealth under the settlement must qualify as assets of the Commonwealth. Indeed, while Article X, § 7 of the Constitution of Virginia (1971) requires that "[a]ll ... revenues of the Commonwealth shall be ... paid into the State treasury," the Commonwealth has broad authority to sell its assets.⁸ The term "asset" generally is defined to mean "entries on a balance sheet showing the items of property owned, including ... accounts receivable."⁹ The payments the tobacco companies owe the Commonwealth are analogous to accounts receivable and clearly are intangible rights of the type that qualify as assets.

Second, the nonstock corporation's acquisition of the Commonwealth's right to receive payments from the tobacco companies can be structured as a true sale. A "sale" is the transfer of property, the title to property or the rights to property for a valuable consideration.¹⁰ Under common securitization principles, the Commonwealth will transfer to the nonstock corporation its rights to the settlement revenue stream for its present cash value. Moreover, under such a plan neither the nonstock corporation nor the bondholders will have recourse against the Commonwealth should the tobacco companies fail to make the required payments. Under general accounting principles, a nonrecourse feature of the transfer supports its characterization as a true sale.

Finally, the plan contemplates that the nonstock corporation will be an independent entity distinct from the Commonwealth. A determination of whether an organization is truly an entity separate and independent of the Commonwealth rests upon the peculiar features and characteristics of the body being considered and, ultimately, depends upon the statutory provisions creating the entity in question.¹¹ In the context of civil rights lawsuits,¹² whether a private corporation's actions are fairly attributable to a state depends on four factors:

- 1) the extent and nature of public funding to the institution, 2) the extent and nature of regulation on the institution, 3) whether the institution's activity constitutes a public function in the "exclusive prerogative" of the state, and 4) whether there is a "symbiotic relationship" between the institution and the state.^[13]

These criteria can easily be addressed under a plan such as the Innovative Progress plan. Presumably, there will be no public funding or regulation of the nonstock corporation. Moreover, the corporate activities—selling private bonds and purchasing financial assets as investments—are not exclusively governmental undertakings. Indeed, as mentioned above, private businesses regularly securitize assets. Nor does the Innovative Progress plan appear to contemplate a symbiotic relationship. Indeed, the sale will be arm's length, independent, and without recourse. Thus, I find no reason to believe that the nonstock corporation cannot be organized and operated independent of the Commonwealth.¹⁴

The General Assembly's powers are broad and plenary.¹⁵ It may enact any law not prohibited by the United States or Virginia Constitution.¹⁶ "Moreover, an act of the General Assembly is presumed to be constitutional, and every reasonable doubt must be resolved in favor of the act's constitutionality."¹⁷ Accordingly, I see no reason why legislation could not be fashioned to implement the Innovative Progress plan without violating Article X, § 7 of the Virginia Constitution.

¹See "Innovative Progress: Improving Transportation in Virginia" (Aug. 31, 1999) [hereinafter Innovative Progress plan].

²"Securitize" means "[t]o convert (assets) into negotiable securities for resale in the financial market, allowing the issuing financial institution to remove assets from its books, to improve its capital ratio and liquidity while making new loans with the security proceeds." Black's Law Dictionary 1358 (7th ed. 1999).

³Commonwealth *ex rel.* Earley v. Brown & Williamson Tobacco Corp., No. HJ-2241-4 (Richmond Cir. Ct. Feb. 23, 1998).

⁴See 1 Jason H.P. Kravitt, *Securitization of Financial Assets* §§ 1.01-1.02 (Aspen Law & Business 2d ed. Supp. 2000). The statements in this opinion concerning the process of securitization are derived from this treatise.

⁵The term "nonrecourse" relates to "an obligation that can be satisfied only out of the collateral securing the obligation and not out of the debtor's other assets." Black's Law Dictionary, *supra*, at 1080.

⁶See Innovative Progress plan, *supra* note 1, at 3, 5, 12, 13; *see also* 1999 Va. Acts: chs. 963, 880, cl. 2, at 2507, 2514, 1665, 1673, respectively (requiring that 40% of funds received by Commonwealth from Master Settlement Agreement be deposited in general fund).

⁷Because your request does not refer to any specific proposed legislation and because all proposed legislation is subject to modification, I offer no comments on any bills proposed during the 2000 Session of the General Assembly.

⁸*See, e.g.*, §§ 2.1-457.2, 2.1-457.3 (disposition of surplus materials and proceeds from sale or recycling of such materials); § 2.1-504.3 (conveyance and transfers of real property by state agencies); § 2.1-512 (sale or lease of surplus property).

⁹Black's Law Dictionary, *supra*, at 112.

¹⁰*See* Faulkner v. Town of So. Boston, 141 Va. 517, 520, 127 S.E. 380, 381 (1925); *see also* Black's Law Dictionary, *supra*, at 1337.

¹¹Hope Natural Gas Co. v. West Virginia Turn. Com'n, 143 W. Va. 913, 105 S.E.2d 630 (1958).

¹²*See* 42 U.S.C.A. § 1983 (West Supp. 1999).

¹³Hicks v. Southern Md. Health Systems Agency, 737 F.2d 399, 402 (4th Cir. 1984).

¹⁴*See* 1996 Op. Va. Att'y Gen. 1.

¹⁵Harrison v. Day, 200 Va. 764, 770, 107 S.E.2d 594, 598 (1959) (unless forbidden by state or federal constitution, powers of General Assembly are plenary).

¹⁶Trucking Corporation v. Commonwealth, 207 Va. 23, 29, 147 S.E.2d 747, 751 (1966); Railway Express v. Commonwealth, 199 Va. 589, 593, 100 S.E.2d 785, 788 (1957), *aff'd*, 358 U.S. 434 (1959); Lipscomb v. Nuckols, 161 Va. 936, 944, 172 S.E. 886, 889 (1934); Supervisors Cumberland County v. Randolph, 89 Va. 614, 619, 16 S.E. 722, 723 (1893); *see also* Portsmouth v. Chesapeake, 205 Va. 259, 264, 136 S.E.2d 817, 822 (1964).

¹⁷Terry v. Mazur, 234 Va. 442, 449, 362 S.E.2d 904, 908 (1987).