

**MEMORANDUM OF LAW
CONSTITUTIONALITY OF PROPOSED HB530
LIFE SCIENCES DEVELOPMENT ACT (“LSD ACT”)**

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The following is a legal analysis of proposed House Bill 580, entitled Life Sciences Development Act (the “LSD Act”), specifically pertaining to its constitutional validity under the North Carolina Constitution.

Upon careful review of the LSD Act, the North Carolina Constitution, and cases that have been decided in North Carolina courts with provisions analogous to the LSD Act, I conclude that the LSD Act contains a number of controversial and unconstitutional provisions.

Below is a summary of three of the controversial constitutional problems I identified, each of which point to the probable illegality of the LSD Act under the Constitution of North Carolina. Other legal and constitutional problems exist, but these three may threaten the stability of proposed investments under the LSD Act, which may be invalidated at a later time by the courts.

The LSD Act

The LSD Act appears to create a somewhat tortured corporate structure to facilitate the State’s novel proposal to participate as a venture capital firm in the biotech market. Under the most recent version of the bill, the proposed system would essentially function as follows.

The LSD Act creates a for-profit limited liability company which functions as a venture capital firm to provide funding to biotech start-up companies. The LSD Act also creates a Nonprofit Company, which in turn, manages the for-profit LLC (the “Investment Company”). One of the members of the Nonprofit Company board would be the North Carolina Secretary of Commerce.

The Investment Company would solicit investment funds from private investors, invest those funds in the biotech market, and contractually agree to give a return on the investment. It would promise, like a mortgage with a bank, to give regular re-payments of the principal and interest to the investors.

If market conditions arose that prevented the Investment Company from making good on its promise to make re-payment with interest, rather than undergo bankruptcy or debt restructuring, it would issue, on behalf of the State of North Carolina, North Carolina State tax credits to its investors instead of the normal contractual payments.

Once the Investment Company determines to pay North Carolina Tax Credits, the Secretary of Commerce is then compelled to issue those State tax credits, thereby making payment to the investors on behalf of the Investment Company.

The Constitutional Areas of Concern

Several provisions of the North Carolina Constitution are at issue. I cite the text of those provisions below, followed by brief application of those constitutional principles to the relevant provisions of the LSD Act.

1. Article V, Section 2(1) of the North Carolina Constitution states that **“The power of taxation shall be exercised in a just and equitable manner, for public purposes only, and shall never be surrendered, suspended, or contracted away.”**

The LSD Act allows the private, for-profit Investment Company to exercise the taxing power of the state by issuing reductions in the taxes that investors would otherwise be required to pay under North Carolina tax law. The government has thus sub-contracted the decision-making function of providing special tax breaks to certain North Carolina taxpayers. The Investment Company, as opposed to the State, would decide that the generally applicable tax law would apply differently to LSD Act investors versus non-LSD Act investors.

2. Article V, Section 3(2) and Section 3(3) of the North Carolina Constitution state:

(2) Gift or loan of credit regulated. The General Assembly shall have no power to give or lend the credit of the State in aid of any person, association, or corporation, except a corporation in which the State has a controlling interest, unless the subject is submitted to a direct vote of the people of the State, and is approved by a majority of the qualified voters who vote thereon.

(3) Definitions. A debt is incurred within the meaning of this Section when the State borrows money. A pledge of the faith and credit within the meaning of this Section is a pledge of the taxing power. A loan of credit within the meaning of this Section occurs when the State exchanges its obligations with or in any way guarantees the debts of an individual, association, or private corporation.

The LSD Act creates an arrangement that is similar to that of a parent co-signing for a child’s car note. Here, the parent is the State and the child is the Investment Company, LLC.

The crux of the LSD Act empowers the Investment Company to offer tax credits to back the debt incurred to its investors. If the Investment Company determines that it is unable to pay its contract obligations to investors, it deems that investors are eligible for State tax-credit payments and then obligates the government to provide payment in lieu of the Investment Company.

A “debt” occurs when one person gives money in return for a contractual agreement to be repaid over time with varying amounts of interest. If the Investment Company cannot pay its debt, it would be empowered to give the investors tax credits instead. These tax credits can be redeemed for tax reductions or – in the event that the credit is more than the investor’s tax bill – for a tax refund. In either case, the government is backing the debt with public funds. This requires a vote of the people.

The LSD Act does contain a statement that the Investment Company is not pledging that the State will back the Investment Company's debts to investors, but this language appears to be boiler plate language that was added to the LSD Act in an attempt to resolve the problem outlined above.

Nevertheless, the LSD Act is specifically designed to, and is predicated upon, the concept of government-backed debt. Thus, the attempt to rescue the LSD Act from this aspect of its unconstitutionality is likely to be met with judicial skepticism.

3. **Article I, Section 6 and Article II, Section 1 of the North Carolina Constitution state in effect that the legislature cannot delegate its power to make laws.** A recognized exception allows legislature to delegate this power to other governmental branches, thus enabling them to make rules with the force of law, only when it issues adequate guiding standards so the other body of government clearly knows that it cannot exercise the legislative power inconsistent with the directives of the legislature.

Under the State's system of constitutional government, which parallels the federal system, there are three separate, coordinate, and coequal branches of government: legislative, executive, and judicial. As a baseline matter of constitutional law, one branch may not delegate this power to another branch of government. Courts have endorsed certain delegations of power to other branches of government when there are clearly expressed limitations on that delegation and effectively defined procedures by which the delegation can be challenged when the exercise of that authority (as it sometimes does) spills outside the clearly articulated bounds of the delegation.

However, courts have had numerous opportunities to pass upon the subject and have uniformly held that if the legislature delegates its law-making power to a private entity (as opposed to another branch of government), the delegation is flatly prohibited.

This principle follows good constitutional sense. Individual citizens can only exercise governmental power when they are part of the government. For any branch of government to give its power to private entities turns the principles of representative democracy on their head: it gives government power to the favored few, who are not elected by or accountable to the people.

Such a delegation occurs in the LSD Act. The Investment Company (a private, for-profit entity) is empowered to exercise its discretion to determine who may receive a tax credit and when that credit must be issued. The Investment Company's decision is binding on the Secretary of Commerce, who must then issue the tax credit. Thus, the Investment Company has the authority to lower the taxes of certain citizens. Such an action is legislative in nature and may only be accomplished through a proper act of the General Assembly. It cannot be performed by or delegated to private entities.