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# PUBLIC INDUCEMENT OF LOCAL ECONOMIC DEVELOPMENT: LEGAL CONSTRAINTS ON GOVERNMENT EQUITY FUNDING PROGRAMS

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Over the past ten years, state and local governments have become increasingly involved with efforts to promote economic development within their boundaries.<sup>1</sup> These efforts have been prompted by heightened economic insecurity resulting from a decline in the traditional in-

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1. The popular press has recently reported on the significant increase in these efforts. See *Tax-Cuts-and-More to Woo Business*, U.S. NEWS & WORLD REP., Feb. 8, 1982, at 31. See also *The Second War Between the States*, BUS. WEEK, May 17, 1976, at 92; Lancaster, *Competition by States to Lure Firms Turns into a Fierce Struggle*, Wall St. J., Dec. 28, 1983, at 1, col. 6.

dustrial base of many regions<sup>2</sup> and an accelerated pace of capital mobility.<sup>3</sup> The public policy response has been largely market-oriented, with state legislatures and city councils promoting the virtues of their respective realms as sites for economic activity. Public officials have attempted to provide a smorgasbord of public inducements aimed at inspiring industry to locate in their particular area.<sup>4</sup>

A new and unfamiliar creature to emerge from this recent flurry of economic development legislation is the publicly owned and operated equity capital fund. Though government has long been in the business of providing or subsidizing debt to private firms in the United States,<sup>5</sup> public equity financing has appeared only recently. Since 1975 state governments have instituted no fewer than twenty-one equity financing programs,<sup>6</sup> in the form of venture capital funds and royalty financing programs, and at least six programs now exist at the local level.<sup>7</sup> It has

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2. See generally Rafuse, *The State-Local Sector and the Economy: Overall Performance and Regional Disparities*, in *ESSAYS IN PUBLIC FINANCE AND FINANCIAL MANAGEMENT: STATE AND LOCAL PERSPECTIVES* 127 (Peterson & Spain eds. 1980). Rafuse noted the:

[A]larm attached to evidence adduced by a number of studies of trends since 1970. These data appear to show a dramatic acceleration in migration of people and jobs from the Northeast in particular—and the Frostbelt in general—to the Sunbelt, coupled with seriously lagging economic growth in the former region and a continuing boom in the latter. One of the most important consequences of these trends, it was argued, is the increasingly desperate fiscal condition of state and local government.

*Id.* at 133.

3. B. BLUESTONE & B. HARRISON, *THE DEINDUSTRIALIZATION OF AMERICA*, 47 (1982). See generally Millsbaugh, *The Campaign for Plant Closing Laws in the U.S.: An Assessment*, 5 *CORP. L. REV.* 291 (1982).

4. For an excellent description of the types of programs being offered, see generally Note, *Problems With State Aid to New or Expanding Businesses*, 58 *S. CAL. L. REV.* 1019 (1985).

5. "Industrial development authorities are not new, the first such authority having been set up in Mississippi in 1936." *Basehore v. Hampden Indus. Dev. Auth.*, 433 Pa. 40, 46, 248 A.2d 212, 216 (1968).

6. In 1985, the authors, with Michael Sheehan, undertook an empirical study of the structure of "public/private partnerships" in economic development programs for the Economic Development Administration, U.S. Department of Commerce. See Fisher, Sheehan & Colton, *Public/Private Enterprise as an Economic Development Strategy for States and Cities* (1986) (unpublished study) [hereinafter Fisher, Sheehan & Colton].

7. The six local programs, and the years in which they were created, include: Erie County, New York (1970); St. Paul, Minnesota (no new legislation); New Haven, Connecticut (1983); North Greenbush, New York (1984); Baltimore, Maryland (1985); and Providence, Rhode Island (1980). Fisher, Sheehan & Colton, *supra* note 6, at 5-5.

suddenly become acceptable for states and localities to own stock in private firms.

Public sector promotion of business enterprise<sup>8</sup> must be undertaken within a complex web of statutory and constitutional constraints. Equity funding programs entail a grant of financial aid to the target industry. This offer of government money, however, raises significant state constitutional questions concerning the use of public funds.<sup>9</sup> Moreover, the federal antitrust implications of government involvement in private enterprise are particularly unclear in light of a series of recent United States Supreme Court decisions.<sup>10</sup>

The complexity of legal regulation becomes even greater when public sector assistance flows from the local level. Because local governments are not sovereign,<sup>11</sup> courts do not accord their decisions the deference given to state actions. Furthermore, local governments do not have the inherent authority that resides in state governmental bodies.<sup>12</sup>

The purpose of this article is three-fold. First, it will develop a taxonomy of venture capital programs that local governments use. Second, it will examine those programs in light of state constitutional restrictions on the use of the public's finances.<sup>13</sup> Finally, it will examine whether the federal antitrust immunity traditionally accorded state actions<sup>14</sup> is likely to extend to these programs.

## I. PUBLIC INVESTMENT: ALTERNATIVE INSTITUTIONAL ARRANGEMENTS

A number of mechanisms exist through which local governments can invest in and promote business enterprises. At one extreme is the most laissez-faire policy, whereby the government's role is limited to

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8. For purposes of this article a "business enterprise" is defined as an entity that produces a marketable good as opposed to providing traditional governmental services such as social services, police and fire protection, roads, and education.

9. For a discussion of these constitutional restrictions in the area of publicly-owned utilities, see Colton, *Utility Financing of Energy Conservation: Can Loans Only Be Made Through an Investor-Owned Utility?*, 64 NEB. L. REV. 189 (1985).

10. See *infra* notes 138-77 and accompanying text.

11. See *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 412 (1978).

12. W. VALENTE, *LOCAL GOVERNMENT LAW* 55 (2d ed. 1980).

13. See generally Comment, *State Constitutional Limitations on a Municipality's Power to Appropriate Funds or Extend Credit to Individuals and Associations*, 108 U. PA. L. REV. 95, 97 (1959).

14. See *Parker v. Brown*, 317 U.S. 341 (1943).

the provision of subsidies.<sup>15</sup> At the other end of the continuum is outright public enterprise.<sup>16</sup> In between these two extremes lies a variety of other types of institutional arrangements.<sup>17</sup>

### A. *Publicly Funded Equity Funding Institutions*

The first government owned and operated equity financing institution created in the United States was the Connecticut Product Development Corporation (CPDC), established in 1972.<sup>18</sup> Three years later, the Massachusetts legislature created the Massachusetts Community Development Finance Corporation (CDFC)<sup>19</sup> and followed in 1978 with the Massachusetts Technology Development Corporation (MTDC).<sup>20</sup> The State of Maine, meanwhile, created the Maine Capital Corporation in 1977, a for-profit privately managed venture capital

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15. State and local governments occasionally provide direct grants of aid to private firms. More often, however, subsidies are provided via the tax code or via the underpricing of governmental services. "Tax expenditures" are provisions in state or local tax law that deviate from some standard, uniform, comprehensive tax and grant an exemption or tax preference resulting in a lower tax bill to some subset of taxpayers. There are usually no preconditions for this type of subsidy beyond the eligibility criteria set forth in the tax code. The public invests in the private sector, but claims no ownership share, no voice in business decisions, and no financial return on its investment. Investment tax credits under a state corporate income tax and local property tax abatements on new industrial construction are examples of such a subsidy. The free or below cost provision of infrastructure such as water or sewer extensions is another means of subsidizing economic activity. In this case, however, the public sector does have ownership and control over the capital facilities themselves.

16. See generally A. WALSH, *THE PUBLIC'S BUSINESS* (1978); SHEPHERD, *PUBLIC ENTERPRISE: ECONOMIC ANALYSIS OF THEORY AND PRACTICE* (1976).

17. Governments may also invest in productive economic activity by actual ownership of physical assets rather than financial claims upon assets. Governments sometimes own land or facilities such as industrial parks, world trade centers, sports stadiums, or business incubation centers that are in turn leased to private firms. In many cases, facilities are built "on spec," with the public assuming any risk associated with the uncertainty that the facility will stay fully rented. In these situations, the government may take a much more proactive and entrepreneurial role than is typically the case with mere financial investments. The government is also in a position to exercise at least some control over the private firm in negotiations over the terms of the lease. The leasing of public facilities may entail subsidies, to the extent that the government fails to cover costs or to earn a rate of return on its investment comparable to the market rate. On the other hand, a lease could also have equity features if the lease payments are tied to the firm's sales or profits.

18. CONN. GEN. STAT. §§ 32-32 to -47 (1983).

19. MASS. GEN. LAWS ANN. ch. 40F, §§ 1-5 (West 1983).

20. *Id.* ch. 40G, §§ 1-10.

fund using state tax credits as an inducement to private investors.<sup>21</sup> These four entities have served as models for most of the equity funding institutions created since that time.<sup>22</sup>

Two general types of publicly funded and managed equity funding institutions exist: (1) state product development corporations, which entail royalty financing, and (2) venture capital funds, which involve the purchase of stock or an option to buy stock. As of January 1986 there were six state product development corporations,<sup>23</sup> nine venture capital funds at the state level (not including six privately managed funds with some state financial participation),<sup>24</sup> and six venture capital funds at the local level.<sup>25</sup> Both types of endeavors are generally organized as quasi-public not-for-profit corporations.<sup>26</sup> The primary objective of these organizations is the provision of risk capital to new or growing businesses that have significant job-creation potential.<sup>27</sup> They

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21. ME. REV. STAT. ANN. tit. 10, §§ 950-54 (1964).

22. For a general discussion of state equity funding activities see U.S. SMALL BUSINESS ADMIN., STATE ACTIVITIES IN VENTURE CAPITAL, EARLY-STAGE FINANCING AND SECONDARY MARKETS (1984) [hereinafter STATE ACTIVITIES]; see also U.S. SMALL BUSINESS ADMIN., STATE ACTIVITIES IN CAPITAL FORMATION: VENTURE CAPITAL, WORKING CAPITAL, AND PUBLIC PENSION FUND INVESTMENTS (1985).

23. The states in which product development corporations exist, and the years in which these corporations were created, include: Connecticut (1972); Iowa (1983); New Mexico (1981); Ohio (1983); North Carolina (1983); and Louisiana (1984). Fisher, Sheehan & Colton, *supra* note 6, at 5-5.

24. The existing venture capital funds that are both publicly funded and publicly managed, and the years in which they were created, include: the Massachusetts Community Development Finance Corporation (1975); the Massachusetts Technology Development Corporation (1978); the Alaska Resources Corporation (no longer in operation) (1978); the Corporation for Innovation Development, New York Science and Technology Foundation (1982); the Utah Technology Finance Corporation (1983); the Louisiana Renewable Resources Foundation (1984); the Illinois Venture Investment Fund (1985); the Wisconsin Community Development Finance Authority (1982); and the New Hampshire Community Development Finance Authority (1983). Fisher, Sheehan & Colton, *supra* note 6, at 5-4.

25. See *supra* note 7 and accompanying text.

26. Only the New Mexico, Ohio, and North Carolina efforts are state agencies. The remaining endeavors are public or quasi-public corporations. Fisher, Sheehan & Colton, *supra* note 6, at 5-4.

27. Compare the private sector analog in California, the Business and Industrial Development Corporation (BIDCO). See generally Hansen, *The Business and Industrial Development Corporation: A Source of Capital for Small Solar Businesses*, 2 SOLAR L. REP. 941 (1981):

Unlike most traditional energy enterprises, solar energy and conservation businesses are likely to be small. As small businesses, they are likely to encounter difficulties in their efforts to raise capital, a situation that frustrates the develop-

are usually capitalized with federal grants and state or local government appropriations.<sup>28</sup> In a few instances, general obligation bond issues have provided the funds.<sup>29</sup>

The initial financing for venture capital programs may, but need not, come directly from government sources.<sup>30</sup> Illinois and Pennsylvania, for example, provide state appropriations to privately managed funds established by the state,<sup>31</sup> while the Port Authority of New York contributes Authority revenues to a privately managed venture fund that it established.<sup>32</sup> Some publicly established venture capital funds, however, receive capital from private investors or from public employee pension funds. Three states provide tax credits for contributions to privately owned and managed venture capital funds initially set up by the state.<sup>33</sup> Finally, a number of states permit public employee pension funds to invest in venture capital funds, while other states require similar investment.<sup>34</sup> This pension fund participation occurs either by purchasing stock in the venture capital endeavor or by becoming a limited partner.<sup>35</sup>

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ment and expansion of this important sector of the energy industry. Despite the rapid growth of the industry, the ability of these small firms to market their products successfully is impeded by the inability of present financial institutions to meet their capital needs.

*Id.* at 941-42.

28. For a list of the endeavors first capitalized with public appropriations, see Fisher, Sheehan & Colton, *supra* note 6, at 5-4.

29. The endeavors that have been capitalized with general obligations bonds include the Massachusetts Community Development Finance Corporation, the Baltimore Enterprise Development Fund (Baltimore Economic Development Corporation), and the Connecticut Product Development Corporation. Fisher, Sheehan & Colton, *supra* note 6, at 5-4.

30. Notwithstanding this public funding, these endeavors are generally privately owned and operated. The government plays a role only in chartering them, in providing state tax credits for contributions, or in making an investment or becoming a limited partner. The states that have publicly funded and privately managed endeavors include Illinois, Pennsylvania, Indiana, Maine, Montana, New York, and New Jersey. Fisher, Sheehan & Colton, *supra* note 6, at 5-4; note 24.

31. Fisher, Sheehan & Colton, *supra* note 6, at 5-4.

32. *Id.*

33. These states are Indiana, Maine, and Montana. *Id.*

34. For a general discussion of the role that state employee pension funds play in providing venture capital, see STATE ACTIVITIES, *supra* note 22, at 6-7. The U.S. Small Business Administration (SBA) reports that pension funds with particular venture capital activity exist in Michigan, New Jersey, New York, Ohio, Oregon, Pennsylvania, Utah, and Washington.

35. The SBA reports that most pension funds limit their venture investment activity

Venture capital funds provide financing for both new and small businesses<sup>36</sup> in either start-up or early growth stages.<sup>37</sup> The investment generally takes the form of either a stock purchase or a warrant for the future purchase of stock. A fund may also provide convertible debt.<sup>38</sup> In addition to the two Massachusetts programs, state financed and managed venture capital funds have existed in Alaska,<sup>39</sup> Louisiana,<sup>40</sup> New York,<sup>41</sup> and Utah.<sup>42</sup> Local venture funds exist in New Haven, Connecticut; St. Paul, Minnesota; Baltimore, Maryland; Providence, Rhode Island; and North Greenbush, New York.<sup>43</sup>

### B. *Government as Financial Intermediary*

Local venture capital funds are a form of financial intermediary.<sup>44</sup> A financial intermediary is an institution that pools the savings of many

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to 5% of assets. Many funds typically invest in 10-year limited-partner venture capital pools. STATE ACTIVITIES, *supra* note 22, at 6.

36. In contrast, product development corporations invest in the development and marketing of new products. The return on the public's investment comes in the form of product royalties, such as a percentage of product sales. Between 1981 and 1984, New Mexico, Iowa, Ohio, North Carolina, and Louisiana set up product development corporations, modeled to some extent after the Connecticut Product Development Commission (CPDC).

37. Again, the California BIDCO proves to be a useful comparison:

Alcohol plants are an excellent example. Few lenders have the technical capacity to make intelligent loan decisions to an applicant in this business. The technology is simply too new and involves markets, economics, and government programs that are changing too rapidly. . . . The next few decades may see small businesses in a number of fields that, like alcohol fuels, will involve replicable loans. Solar powered irrigation systems, wind-powered pumping systems, and solar water heater conversions are solar applications that can spawn thousands of small businesses and energy facilities needing essentially similar financing.

Hansen, *supra* note 27, at 947.

38. Convertible debt is debt that is subject to conversion into shares of stock at a rate specified in the loan agreement. It is not to be confused with a "warrant." See *infra* notes 55-56 and accompanying text.

39. ALASKA STAT. §§ 30.13.010-900 (1984).

40. LA. REV. STAT. ANN. §§ 33:9081-9093 (West Supp. 1986).

41. N.Y. PUB. AUTH. LAW §§ 3100-3109 (McKinney Supp. 1986).

42. UTAH CODE ANN. §§ 63-60-1 to -6 (1953).

43. Fisher, Sheehan & Colton, *supra* note 6, at 5-4.

44. For a detailed discussion of public financial intermediaries, see generally AMERICAN PLANNING ASS'N, FINANCING STATE AND LOCAL DEVELOPMENTS 63-68, 91-117 (Barker ed. 1983) [hereinafter FINANCING DEVELOPMENT]. When a public equity investment results in majority ownership and control, an outright public enterprise, rather than a public financial intermediary, exists.

individuals or businesses. The intermediary then invests those savings, usually in some type of security. Local governments can create publicly owned financial intermediaries by establishing a public corporation or public authority that is capitalized with federal grants, state or local appropriations, bond sales, or private investments subsidized via a state tax credit.<sup>45</sup> The authority thus serves to pool the savings of the general public<sup>46</sup> or the savings of higher-income individuals who either purchase tax exempt bonds or acquire shares in the authority. The authority then invests the pooled savings in businesses through loans, stock purchases, or other forms of debt or "near equity."<sup>47</sup>

The form of local government financing will dictate both how the government may participate in private sector decisionmaking and how it will recoup its financial commitment. With pure debt financing the public financial intermediary has no ownership or control. In contrast, with straight equity financing the investor may or may not have rights of ownership and control, depending upon the type of stock purchased.<sup>48</sup> With debt, the public recoups its investment from the assisted industry through the firm's contractual obligation to repay the principal and a fixed rate of interest according to a predetermined timetable. The loan may be unsecured or it may be a mortgage. The distinguishing feature of equity, however, is that the investor does not have a right to a predetermined return in the form of interest, but has only a claim on a portion of profits.

Debt instruments can be made more like equity by incorporating several features. The debt may be subordinated, thereby placing the lender lower in line among creditors in the event of bankruptcy.<sup>49</sup> The debt may include a moratorium on payment of principal or interest or

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45. North Greenbush, New York; Erie County, New York; and New Haven, Connecticut used federal grants to capitalize their local venture capital funds. Baltimore, Maryland sold general obligation bonds. Local appropriations were made by St. Paul, Minnesota, and New Haven. Fisher, Sheehan & Colton, *supra* note 6, at 5-4.

46. This is done by pooling a portion of their tax payments.

47. For a discussion of the ways in which a public financial intermediary can make assistance available to private developers, see generally Fisher, *The Role of the Public Sector in Local Development Finance: Evaluating Alternative Institutional Arrangements*, 17 J. ECON. ISSUES 133 (1983).

48. Some state constitutional and statutory provisions, however, require that all shares be voting shares. See, e.g., Comment, *Non-Voting Shares—The Code and the Constitution*, 16 S.C.L. REV. 657 (1964); see also Note, *Status of Nonvoting Stock in Nebraska*, 33 NEB. L. REV. 646 (1954).

49. See generally Calligar, *Purposes and Uses of Subordination Agreements*, 23 BUS. LAW 33 (1967); Everett, *Subordinated Debt—Nature, Objectives and Enforcement*, 44



both during the early years of the loan so that the firm is not burdened with debt service during start-up and growth phases when it is unlikely to be profitable.<sup>50</sup> The debt may involve an actual forgiveness of interest payments at first, perhaps contingent on profitability.<sup>51</sup> Finally, the rate of interest on the debt may not be fixed, but may instead be tied to the profitability of the firm.<sup>52</sup>

Frequently, public investments are a combination of both debt and equity. In these instances, the investor provides a loan containing warrants.<sup>53</sup> The warrant gives the lender a right to purchase a certain number of equity shares at a specified price.<sup>54</sup> Similarly, the debt may be "convertible."<sup>55</sup> In this situation, it is subject to conversion into shares of stock at a rate specified in the loan agreement. The advantage of warrants, as opposed to convertible debt, is that warrants generally are "detachable." They can be exercised or sold separately while the debt obligation remains.<sup>56</sup> If the market value of the firm's stock rises above the warrant price, the investor may either exercise the warrant price and then sell the stock, or he may sell the warrant itself, in either case for a capital gain.

A final form of combining debt and equity is purchasing stock with a "put option,"<sup>57</sup> whereby the investor can sell the stock back to the

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B.U.L. REV. 487 (1964). Even in this case, the lender is still guaranteed payment ahead of stockholders.

50. In a similar fashion, a company in such a case is not likely to be burdened with dividend payments.

51. Interest rates that are conditioned in whole or in part upon corporate earnings are often called "income obligations." See generally Comment, *Bonds—Income Bonds—Rights of Bondholders and Deductability of Interest for Federal Income Tax Purposes*, 56 MICH. L. REV. 1334 (1958).

52. This may be done through a combination of a fixed base rate and a higher rate or rates that become effective when and if the firm achieves certain profit targets.

53. A warrant is, in effect, a "reverse tender option." Compare *infra* note 57 and accompanying text.

54. In some instances, a warrant provides that rather than purchasing equity, the holder may purchase additional bonds at the same price and coupon rate as the warrant. J. PETERSEN & W. HOUGH, *CREATIVE CAPITAL FINANCING FOR STATE AND LOCAL GOVERNMENTS* 73 (1983).

55. For general discussions of convertible debt, see Lewellen & Facette, *Convertible Debt Financing*, 8 J. FIN. & QUANTITATIVE ANALYSIS 777 (1973); Brigham, *An Analysis of Convertible Debentures: Theory and Some Empirical Evidence*, 21 J. FIN. 35 (1966).

56. J. PETERSEN & W. HOUGH, *supra* note 54, at 73-76.

57. A "put option" is also sometimes referred to as a "tender option."

company for a specified price.<sup>58</sup> Such a purchase gives the investor "downside protection with upside potential."<sup>59</sup> Even if the firm is not doing well, this option guarantees the investor a minimum return either in the form of interest or in the "put price" of the stock.<sup>60</sup> If the firm becomes highly profitable, the investor shares in those profits through either ownership of the stock or warrants to purchase the stock.

Given the variety of potential investment forms, it is difficult to determine whether a local government has made an equity investment or provided debt-financing to a private industry. An investment that gives the investor unlimited opportunity for realizing gains through appreciation in the price of a firm's stock might be considered an equity investment.<sup>61</sup> On the other hand, if the investor does not actually hold stock at the time of the initial investment, the investment is, in reality, debt that is often termed "near equity."<sup>62</sup> Convertible debt and warrants, therefore, both represent "near equity." Loans with interest forgiveness or interest rates tied to profitability could also be considered "near equity" because the investor's return increases with profits. All other forms of debt, even if unsecured, subordinated, or with deferred interest or principal payments, are best defined simply as debt.<sup>63</sup>

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58. There are two primary types of "put options:" (1) the "window put" (also known as the European option); and (2) the "anniversary put" (also known as the American option). A window put can be exercised only during a specified time in the future; an anniversary put can be exercised periodically, for example once per year. J. PETERSEN & W. HOUGH, *supra* note 54, at 41.

59. Because this protection is provided, the investor can expect to receive a lower rate of return. *Id.*

60. This option guarantee is effective only in the event the firm does not fail.

61. Two additional forms of equity investment exist. First, the public entity may enter into a royalty agreement with a private firm, in which case the public is entitled to a fixed percentage of the sales of the firm's product. Royalty agreements are probably best defined as equity positions. There is little or no "downside protection" because the investor receives no return if there are no sales. On the other hand, there is unlimited "upside potential" because royalties will increase in proportion to sales. Second, a public entity may become a limited partner, usually in a real estate venture. As a limited partner, the public does not exercise control over operations. Because the return on the public's investment is a share of the profits, however, the investment is considered equity.

62. These types of securities are also sometimes referred to as "equity securities." For a discussion of "near equity" or "equity securities," see generally Loiseaux, *Loans or Capital Contributions to the Close Corporation*, 38 REF. J. 4 (1964); FINANCING DEVELOPMENT, *supra* note 44, at 132.

63. See generally Johnson, *Subordinated Debentures: Debt That Serves as Equity*, 10 J. FIN. 1 (1955).

A local government's financial investment in private industries may take many forms, even when the local government chooses to act through a government organized financial intermediary. Six local governments have chosen to develop venture capital funds to provide financial assistance to new and small businesses. The aid made available through these funds may take the form of debt, equity, or "near equity," with different rights and responsibilities appertaining to each.

## II. LIMITATIONS ON THE USE OF PUBLIC FINANCES

Fundamental precepts of state constitutional law place several restrictions on the use of public finances to participate in private enterprise. The grant of public funds for anything other than a "public purpose" is prohibited.<sup>64</sup> To avoid this restriction, the expenditure of money must be used to address a social problem within the competence of the legislature.<sup>65</sup> If the grant meets the "public purpose" test, incidental benefits to private entities are permissible,<sup>66</sup> even if substantial.<sup>67</sup> In contrast, lending the state's credit to private parties is forbidden in all circumstances.<sup>68</sup> The state's credit is implicated when the general

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64. The "public purpose" constitutional restriction came as a result of the overextension of public commitments in the mid-nineteenth century. Public inducements to private railroads were made in the form of government loans, bond issuances, and guarantees of credit. See *City of Clovis v. Southwestern Pub. Serv. Co.*, 49 N.M. 270, 276, 161 P.2d 878, 881-82 (1945) (quoting *Murphy v. Dever*, 320 Ill. 186, 188-89, 150 N.E. 663, 663-64 (1926)); cf. *Carruthers v. Port of Astoria*, 249 Or. 329, 334, 438 P.2d 725, 727 (1968); *Bailey v. City of Tampa*, 92 Fla. 1030, 111 So. 119 (1926).

65. C.D. SANDS & M. LIBONATI, *LOCAL GOVERNMENT LAW* § 25.07 (1981) (citations omitted).

66. See, e.g., *Anderson v. McCann*, 124 N.H. 249, 251, 469 A.2d 1311, 1313 (1983); *contra Price v. Philadelphia Parking Auth.* 422 Pa. 317, 338, 221 A.2d 138, 150 (1966) ("This net increment to the public, in light of the magnitude of the garage project and the substantial benefits accruing to [the public] therefrom, is not sufficient to warrant the public involvement here proposed.").

67. *How substantial is a fluid concept at best: A slide rule definition to determine public purpose for all time cannot be formulated; the concept expands with the population, economy, scientific knowledge, and changing conditions. As people are brought closer together in congested areas, the public welfare requires governmental operation of facilities which were once considered exclusively private enterprises . . . , and necessitates the expenditure of tax funds for purposes which, in an earlier day, were not classified as public. Often public and private interests are so commingled that it is difficult to determine which predominates.* *Mitchell v. North Carolina Indus. Dev. Fin. Auth.*, 273 N.C. 137, 144, 159 S.E.2d 745, 750 (1968).

68. See e.g., *State ex rel. Ryan v. City Council*, 9 Ohio St. 3d 126, 128, 459 N.E.2d

taxing power is used as bond security<sup>69</sup> or when the state acts as a guarantor or surety for privately incurred debt.<sup>70</sup> The intent of this constitutional restriction is to proscribe lending the state's credit to private parties, whether or not for a "public purpose."<sup>71</sup>

The various means by which local governments participate in promoting business enterprise involve the grant of public funds or the loan of public credit. This article will examine those means; it will not examine the use of eminent domain. The analysis will evaluate the historic development of industrial inducement programs to gain insight into the probable treatment of contemporary equity investment programs.

### A. *The Expenditure of Public Funds*

Financial participation in private industry<sup>72</sup> is generally undertaken to alleviate economic dislocation. The relief of unemployment and related economic ills quite easily satisfy judicial inquiry into whether the expenditures serve a "public purpose." Courts look to the economic impact of a government supported industrial project to determine whether or not a "public purpose" exists to sustain it.<sup>73</sup> Typical of judicial approval of these programs is the statement that the purpose of the public investment is "to relieve an economic condition affecting the welfare of the people of the entire parish."<sup>74</sup>

Lawsuits challenging local industrial development projects sup-

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208, 209-210 (1984). (section 6, art. VIII of the Ohio Constitution "forbids the union of public and private capital or credit in any enterprise whatever").

69. The constitutional restriction serves largely to protect the state treasuries from bond defaults by private corporations. See Colton, *supra* note 9, at 194 nn.34-35.

70. See e.g., *State ex rel. Thomson v. Giessel*, 271 Wis. 15, 29, 72 N.W.2d 577, 584 (1955); *Button v. Day*, 203 Va. 687, 127 S.E.2d 122 (1962); *State ex rel. O'Connell v. Public Util. Dist. No. 1*, 2 Wash. App. 366, 469 P.2d 922 (1970) *rev'd*, 79 Wash. 2d 237, 484 P.2d 393 (1971).

71. Comment, *State Constitutional Provisions Prohibiting the Loaning of Credit to Private Enterprise—A Suggested Analysis*, 41 U. COLO. L. REV. 135, 139-40 (1969); but see Note, *The "Public Purpose" of Municipal Financing for Industrial Development*, 70 YALE L.J. 789, 794 (1961).

72. This public participation will sometimes be referred to as a public inducement within this article. These programs, however, are in contrast to inducement programs such as tax abatements.

73. *DeArmond v. Alaska State Dev. Corp.*, 376 P.2d 717 (Alaska 1962); *Roan v. Connecticut Indus. Bldg. Comm'n*, 150 Conn. 333, 189 A.2d 399 (1963).

74. *Miller v. Police Jury*, 226 La. 8, 19, 74 So. 2d 394, 398 (1954).

ported with public funds generally fail.<sup>75</sup> The prevailing judicial attitude is reflected in the Mississippi Supreme Court decision in *Albritton v. City of Winona*.<sup>76</sup> That 1938 decision dismissed a "public purpose" challenge and held that "the relief of unemployment, and the promotion of agriculture and industry are undoubtedly proper governmental purposes, [and] are so recognized everywhere and by all."<sup>77</sup> The two most common rationales used to justify industrial assistance are the creation of jobs, known as the "multiplier effect," and the diversification of a community's economic base.<sup>78</sup> Several courts upholding public inducement programs have expressly referred to the multiplier effect of industrial jobs.<sup>79</sup>

The propriety of spending public funds on private enterprise, however, is not settled. One commentator criticized the quick approval often given industrial financing plans.<sup>80</sup> The general judicially-noticed belief that "industrialization usually results in economic betterment," the commentator said, is perhaps "based too much on supposition." A more rationale inquiry, he continued, would be "to examine each possible consequence of the project in detail." Such an inquiry would allow an opportunity to show in specific cases that the court's intimation was wrong.

This criticism is well-based. For industrial incentive packages to cure local economic ills, the multiplier effect upon income and property values must increase the tax base in order to adequately finance the infrastructure required to support the new industry.<sup>81</sup> The community's responsibility to provide municipal services such as sewers,

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75. Note, *supra* note 71, at 791 n.14; see also *Wright v. City of Palmer*, 468 P.2d 326 (Alaska 1970); *Basehore v. Hampden Ind. Dev. Auth.*, 433 Pa. 40, 67, 248 A.2d 212, 225 (1968). See generally Mumford, *The Past, Present and Future of Industrial Development Bonds*, 1 URB. LAW. 147 (1969). One leading treatise on local government law notes that "courts are increasingly inclined to sustain a wide variety of borrowing arrangements that further public objectives." C.D. SANDS & M. LIBONATI, *supra* note 65, § 25.07.

76. 181 Miss. 75, 178 So. 799, *appeal dismissed*, 303 U.S. 627 (1938).

77. 181 Miss. at 97-98, 178 So. at 804.

78. *DeArmond v. Alaska State Dev. Corp.*, 376 P.2d 717 (Alaska 1962); *Roan v. Connecticut Indus. Bldg. Comm'n*, 150 Conn. 333, 189 A.2d 399 (1963).

79. See, e.g., *City of Gaylord v. Gaylord City Clerk*, 378 Mich. 273, 144 N.W. 2d 460 (1966); *City of Pipestone v. Madsen*, 287 Minn. 357, 178 N.W. 2d 594 (1970); *State ex rel. Hammermill Paper Co. v. LaPlante*, 58 Wis. 2d 32, 205 N.W. 2d 784 (1973).

80. Note, *supra* note 71, at 798.

81. Local decisionmakers are beginning to recognize the costs of providing additional infrastructure. For an excellent discussion of innovative methods of financing

water, streets, and public buildings must still be met, especially with the increased demand for these services from the new industry. Because the city will often forego the opportunity to tax the new industry, the funds for maintaining public services must instead be collected from property taxes and other local option taxes on pre-existing residents and businesses.

It is not clear that these additional burdens can be met through multiplier effect benefits. The use of multiplier analysis has been severely criticized on a technical basis, particularly at the local level where local policymakers run into considerable difficulty utilizing the various multiplier models to address specific local situations.<sup>82</sup> One group of economists, attempting to develop a more reliable multiplier model, noted:

Efforts to estimate accurately the income multipliers, employment multipliers, or both for small areas, (counties, municipalities, or multicounty planning and development districts), have been constrained for a number of reasons. Particular difficulty has been encountered in utilizing sophisticated techniques such as input-output and economic models because of data limitations, computing facility requirements, and the like.<sup>83</sup>

Another group of economists concluded that the degree of confidence that can be placed on the results of many impact assessments is questionable, "since there are many areas of uncertainty that may affect the quality of the results."<sup>84</sup> In addition, the economists found that "technical sophistication is no guarantee of the reliability of results . . ."<sup>85</sup>

Contemporary courts are split as to whether a factual analysis into these criticized areas is a proper subject for judicial inquiry. Some courts specifically eschew any examination of the factual foundation underlying claims of a public purpose. The Connecticut Supreme Court, for example, said it would not hold an industrial inducement program unconstitutional "simply because the petitioners' economic

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such development, see Zorn, *Financing Infrastructure to Promote Economic Development in the East North Central Region*, GOV'T FIN. REV. Apr. 1986, at 29.

82. Policymakers have also often failed to realize that "usual applications of base theory involve rather heroic assumptions." Smith, Heckbart & Van Veen, *A Modified Regression Base Multiplier Model*, GROWTH & CHANGE, July 1981, at 18.

83. *Id.* at 17.

84. Bartels, Nichols & Dunn, *Estimating the Impact of Regional Policy*, 3 REGIONAL SCI. & URB. ECON. 35 (1982).

85. *Id.*

forecasts differ from those of the legislature.”<sup>86</sup> The Maine Supreme Court agreed,<sup>87</sup> rejecting the use of any analysis that depends on an examination of whether a particular project would actually result in added income or employment.<sup>88</sup> Constitutional limitations are satisfied, the Maine court held, if the legislative *purpose* is appropriate.<sup>89</sup> Testimony, it continued, that might prove an incorrect calculation of benefits does not detract from an expressed legislative intent.<sup>90</sup>

In contrast, a number of state courts have engaged in a specific inquiry into the propriety of spending public funds on private enterprise. In 1954 the New Hampshire Supreme Court was called upon to review an urban redevelopment project.<sup>91</sup> The court said that though the legislative findings of a public purpose were “entitled to weight,” they had “no magical quality to make valid that which is invalid.”<sup>92</sup> Moreover, several courts have rejected the notion that new or expanding business *per se* fulfills the dictates of the “public purpose” doctrine. The Tennessee Supreme Court, for example, upheld a municipal financing scheme for one industrial plant, finding that it addressed the public need for new jobs.<sup>93</sup> The same court, however, had previously held a financing scheme unconstitutional because the need for additional economic development in the area was not demonstrated.<sup>94</sup> Similarly, an early Mississippi Supreme Court decision found a municipal financing scheme lacking a public purpose because the economic and social justi-

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86. *Wilson v. Connecticut Prod. Dev. Corp.*, 167 Conn. 111, 118, 355 A.2d 72, 76 (1974).

87. *Common Cause v. State*, 455 A.2d 1, 17 (Me. 1983).

88. *Id.*

89. *Id.* at 24-26.

90. In general, all other things equal, an industrial development program supported by appropriate legislative findings of a “public purpose” tends to be immune from successful judicial attack. The “emerging trend of decision” is to accord a legislative enactment authorizing borrowing “virtually dispositive weight” on whether the public benefit involved is sufficient to meet the public purpose requirement. C.D. SANDS & M. LIBONATI, *supra* note 65, § 25.06. Even critics of the use of public monies for industrial development note that although what constitutes a public purpose “is primarily a judicial question . . . the courts have been disposed to give great weight to the legislative determination.” Comment, *supra* note 71, at 150 (quoting *Milheim v. Moffat Tunnel Improvement Dist.*, 262 U.S. 710 (1922)).

91. *Valishka v. City of Nashua*, 99 N.H. 161, 106 A.2d 571 (1954).

92. *Id.* at 165, 106 A. 2d at 573.

93. *McConnell v. City of Lebanon*, 203 Tenn. 498, 314 S.W.2d 12 (1958).

94. *Ferrell v. Doak*, 152 Tenn. 88, 275 S.W. 29 (1925); *see also* *Manning v. Fiscal Court*, 405 S.W.2d 755 (Ky. 1966).

fications for the challenged plan were missing.<sup>95</sup> A later decision by that same court found the justifications for a different project adequately established.<sup>96</sup>

Courts that are willing to examine the factual foundation of a proposed project specifically evaluate the economic impacts of these projects to determine whether or not a public purpose exists to sustain them.<sup>97</sup> A South Carolina Supreme Court decision typifies this inquiry. The court held, in *State ex rel. McLeod v. Riley*,<sup>98</sup> that authorization of public bonds for the promotion of certain computer and office facilities and shopping centers was unconstitutional.<sup>99</sup> Commercial projects, the court said, do not provide many new jobs. The claim of a "public purpose" based on economic factors, the court concluded, thus had no basis.<sup>100</sup>

The Florida Supreme Court first explicitly rejected, on legal principle, the notion that a "public purpose" is established by showing general economic benefits.<sup>101</sup> In 1983 the Florida court invalidated industrial obligation bonds that were issued to support a new 45,000 square foot facility for two broadcast studios and related offices.<sup>102</sup> The proposed project, the court found, would create a total of twenty-five jobs. The court reiterated the standard test for whether a "public purpose" exists, holding that municipal financing was appropriate "where the private benefit was strictly incidental to a paramount public purpose."<sup>103</sup> It continued, however, by placing an important caveat on this doctrine. A "broad general public purpose," the court said, "will not constitutionally sustain a project that in terms of direct, actual use,

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95. *Carothers v. Town of Booneville*, 169 Miss. 511, 153 So. 670 (1934).

96. *Albritton v. City of Winona*, 181 Miss. 75, 109, 178 So. 799, 809, *appeal dismissed*, 303 U.S. 627 (1938).

97. *See supra* notes 78-79, 93-96 and accompanying texts.

98. 276 S.C. 323, 278 S.E.2d 612 (1981).

99. *Id.* at 332, 278 S.E.2d at 617; *but see* *Marshall Field & Co. v. Village of South Barrington*, 92 Ill. App. 3d 360, 415 N.E.2d 1277 (1981); *State ex rel. Ohio County Comm'n v. Samol*, 165 W. Va. 714, 720, 275 S.E.2d, 2, 5 (1980).

100. 276 S.C. at 332, 278 S.E.2d at 617. According to one justice of the West Virginia Supreme Court, a clear distinction exists between industrial projects and commercial endeavors in this regard. 165 W. Va. at 721, 275 S.E.2d at 6.

101. *Orange County Indus. Dev. Auth. v. State*, 427 So.2d 174, 179 (Fla. 1983); *but see* *State v. Housing Fin. Auth.*, 376 So.2d 1158 (Fla. 1979); *Jordan v. Woodward*, 40 Maine 317, 323-24 (1855).

102. 427 So.2d at 179.

103. *Id.* at 176.



is purely a private enterprise.”<sup>104</sup> The court found:

Every new business, manufacturing plant, or industrial plant which may be established in a municipality will be of some benefit to the municipality. Incidental benefits accruing to the public from the establishment of some private enterprise [are] not sufficient to make the establishment of such enterprise a public purpose.<sup>105</sup>

In a subsequent Florida case the court adhered to the same general principle, though the outcome was different on the facts: “[E]conomic stimulation is not a sufficient public benefit to justify using public bond proceeds primarily to aid a private business.”<sup>106</sup>

The State of Washington has been particularly adverse to the notion that general economic benefits will justify the use of public funds. In *Port of Longview v. Taxpayers of the Port of Longview*<sup>107</sup> the Washington Supreme Court considered the constitutionality of legislation that sought to give port districts authority to make pollution control facilities available to nonpublic entities.<sup>108</sup> The port districts issued bonds “sufficient to cover the cost of acquisition, construction, and installation of the pollution control facility on property of the private corporation.”<sup>109</sup> Supporters of the bond argued that “ultimately the local governments are actually aided by virtue of an increased ad valorem tax base and increased local payroll through increased local employment.”<sup>110</sup> The Washington court rejected this argument, stating that its function “is not to weigh the economic impact of the transactions. The loan of money or credit by a municipality to a private corporation is a violation of our state constitution regardless of whether or not it serves a laudable public purpose.”<sup>111</sup>

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104. *Id.* at 179.

105. *Id.* (quoting *State v. Town of North Miami*, 59 So.2d 779, 784 (Fla. 1952); *Adams v. Housing Auth.*, 60 So.2d 663, 669 (Fla. 1952)).

106. *Linscott v. Orange County Indus. Dev. Auth.*, 443 So.2d 97, 103 (Fla. 1983) (Boyd J., dissenting).

107. *Port of Longview v. Taxpayers of the Port of Longview*, 85 Wash. 2d 216, 527 P.2d 263 (1974), *amended*, 533 P.2d 128 (1975).

108. *Id.* at 218, 527 P.2d at 264.

109. *Id.* at 220, 527 P.2d at 265. Though not general obligation bonds, the bonds in controversy were issued in the name of the city, and the face of the bond declared that it was the obligation of the issuing municipality. *Id.* at 221, 527 P.2d at 265.

110. *Id.* at 230, 527 P.2d at 270.

111. *Id.* at 231, 527 P.2d at 271; *see also Lassila v. City of Wenatchee*, 89 Wash. 2d 804, 576 P.2d 54 (1978) (“[T]he expected receipt of future public benefits cannot serve to validate an otherwise unconstitutional loan of credit.”).

Substantial academic commentary argues that to accept general economic benefits as sufficient to establish a public purpose "ignores the lessons of the railroads."<sup>112</sup> One commentator queried whether public officials could politically forego assistance to an industry that is not economically sound.<sup>113</sup> All types of officials can get carried away with the prospects of gain:

We know the history of these municipal and county bonds—how the legislature, yielding to popular excitement about railroads, authorized their issue; how grand juries, and county commissioners, and city officers, were molded to the purposes of speculators; how recklessly railroad officers abused the overwrought confidence of the public, and what burdens of debt and taxation have resulted to the people.<sup>114</sup>

The same situation may currently be developing. One commentator recently noted, for example, that "even though the recession and Reagan's 'new Federalism' shift of programs to the state level have put more of a burden on state treasuries than ever before, states continue to increase business tax breaks."<sup>115</sup> It is difficult to assess the financial consequences of these public inducement programs.<sup>116</sup> States and cities seldom know precisely what their incentives cost the public. In New York City, for example, a public official discovered that "no reliable estimates of annual [property tax] exemption commitments are available."<sup>117</sup>

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112. Lawrence, *Constitutional Limitations on Governmental Participation in Downtown Development Projects*, 35 VAND. L. REV. 277, 310 (1982).

113. Tilden, *Public Inducements for Industrial Location: A Lesson From Massachusetts*, 18 ME. L. REV. 1, 46-47 (1966).

114. *Id.* (quoting *Diamond v. Lawrence County*, 37 Pa. 353, 358 (1860); see also *People ex rel. Detroit & Howell R.R. v. Township Bd.*, 20 Mich. 452, 487 (1870).

115. Rosenberg, *States at War*, NEW REPUBLIC, Oct. 3, 1983, at 20.

116. The cost of venture capital funds is tied to their success in assisting the creation of new firms. There is, however, a sharp contrast in the ability of the different venture capital endeavors to do this. The Massachusetts Community Development Finance Corporation (CDFC) made loans and equity investments in 23 firms from July 1978 to July 1982. These loans and equity investments reached 5.1 million dollars. By 1985 only six of those firms survived and the CDFC lost 4 million dollars in loans or stock investment. In contrast, the Massachusetts Technology Development Corporation (MTDC) invested 6.7 million dollars in 33 corporations from June 1979 to June 1985. Only two of those firms have failed. Through 1984 the MTDC investments of 5.7 million dollars leveraged 51 million dollars of private capital, a ratio of about 9:1. Fisher, Sheehan & Colton, *supra* note 6, at 5-7 to 5-13.

117. Cho & Schuermann, *A Decision Model for Regional Industrial Recruitment and Development*, 10 REGIONAL SCI. & URB. ECON. 259, 260 (1980).

Public industrial inducement programs are causing an expanding amount of state resources to be poured into new or expanding businesses.<sup>118</sup> As more states provide financial assistance and inducements to businesses, each state discovers that it must increase the amount it provides in its own programs to remain competitive.<sup>119</sup> The Minnesota Supreme Court has held that a publicly financed industrial inducement program met the "public purpose" test because that state would lose its competitiveness with surrounding states without the assistance.<sup>120</sup>

State and local programs providing public assistance to new or expanding industries generally entail the provision of various types of financial aid. The expenditure of public funds for private endeavors, however, is constitutionally permissible only if the endeavor is for a "public purpose." The trend of courts today is to uphold the notion that projects resulting in economic development for an area constitute a "public purpose." Many courts, in better reasoned decisions, have inquired into the factual basis for a declaration of whether a "public purpose" exists. Policymakers who support efforts involving public investment in business enterprises must, therefore, be prepared to present a convincing demonstration of the public benefits to be gained from those programs.

### B. *Lending the Public Credit*

State constitutional provisions proscribe lending the state's credit to private parties for any purpose.<sup>121</sup> Unlike the expenditure of public funds, the constitutional lending ban does not turn on whether a "public purpose" is implicated in the financing scheme.<sup>122</sup> The purpose of the ban is to protect the public treasury from the types of credit over-

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118. Note, *Problems With State Aid to New or Expanding Businesses*, 58 S. CAL. L. REV. 1019, 1025 (1985).

119. This observation was made as early as 1938: "[T]he economic implications of the Mississippi Industrial Plan are of considerable moment. For this statute is the latest weapon in a new War between the States,—a bitter competition for the attraction and establishment of industry." Note, *Municipal Subsidies and the Industrialization of the South*, 47 YALE L.J. 1412, 1415 (1938).

120. *City of Pipestone v. Madsen*, 287 Minn. 357, 368, 178 N.W.2d 594, 601 (1970).

121. See generally J. HEINS, *CONSTITUTIONAL RESTRICTIONS AGAINST STATE DEBT* (1963); Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265 (1963).

122. See *supra* note 71 and accompanying text; but see E. MCQUILLAN, *THE LAW OF MUNICIPAL CORPORATIONS* § 39.30 (3d ed. 1983). *Dyche v. City of London*, 288 S.W.2d 648 (Ky. 1956).

extensions that plagued state and local governments during the expansion of railroads in the mid- and late-nineteenth century.<sup>123</sup>

Several indices guide whether the credit of the state has been given or loaned in aid of a private interest. First, there must be some evidence of indebtedness incurred on the part of the public body.<sup>124</sup> Bonds are generally issued in the name of the governmental entity for the ultimate use of a private developer. Second, the indebtedness must be a legal obligation of the government, whereby the governmental entity is held to be a payer of the indebtedness.<sup>125</sup>

Recently developed legal inventions have served to eliminate most of the efficacy of this constitutional restriction. The revenue bond is perhaps the primary mechanism through which governments may raise funds to make available to private developers.<sup>126</sup> The issuance of revenue bonds pledges the proceeds of a designated stream of funds other than tax dollars as security for debt repayment.<sup>127</sup> The bondholder bears the risk that funds dedicated to the repayment of revenue bonds will be insufficient to pay principal and interest.<sup>128</sup> In the event of such an insufficiency governmental taxing powers are not implicated. Indeed, revenue bonds often expressly disclaim the obligation of the issuing government to ensure prompt and complete payment.<sup>129</sup> In industrial assistance programs, revenue bonds are frequently secured through pledges of the revenue generated by the assisted project. Revenue bonds issued to raise capital for these programs do not constitute a

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123. See *supra* note 64 and accompanying text; but see *Wright v. City of Palmer*, 468 P.2d 326, 330 n.11 (Alaska 1970). The court in *Wright* found: "Long-run economic and social changes are ever present sources of financial risk. Population shifts or widespread economic recession may render unworkable fiscal policies that were once considered sound. These risks, however, are inevitable concomitants of public decisionmaking." *Id.*

124. *State ex rel. Beck v. City of York*, 164 Neb. 223, 226, 82 N.W.2d 269, 272 (1957).

125. *Id.*

126. By 1979 revenue bonds accounted for 72% of all new long-term municipal bond issues. PUBLIC SECURITIES ASS'N, *FUNDAMENTALS OF MUNICIPAL BONDS* 16 (1981) [hereinafter *BOND FUNDAMENTALS*].

127. Sources of funds may include user fees, tolls, concessions, municipal lease-back payments, or industrial lease payments. *Id.* at 19-20.

128. Fisher, Forbes & Petersen, *Risk and Return in the Choice of Revenue Bond Financing*, in J. PETERSEN & W. HOUGH, *supra* note 4, at 139, 140-41.

129. See, e.g., *Miles v. City of Eugene*, 252 Or. 528, 531-32, 451 P.2d 59, 61 (1969); *State ex rel. Ohio County Comm'n v. Samol*, 165 W. Va. 714, 720, 275 S.E.2d 2, 5 (1980).

debt, liability, or general obligation of the state, and thus do not run afoul of constitutional prohibitions.<sup>130</sup>

Another means of bypassing constitutional restrictions involves the credit of a public or quasi-public corporation, which is considered distinct from the credit of the state.<sup>131</sup> These corporations often take the form of "public authorities," and are therefore considered independent instrumentalities and not political subdivisions.<sup>132</sup> There are, however, a number of legal prerequisites to the formation of a public authority. The primary requirement is that independence must be maintained from the originating governmental entity. A public authority must function independently and be distinct from its creator.<sup>133</sup> An authority must meaningfully be regarded as an additional and separate unit of government and not as a mere appendage of the creating government.<sup>134</sup> Moreover, public authorities are generally not supported by general taxing revenues, but instead derive their support from user fees and compensation paid for the provision of their services.<sup>135</sup> As a result of these attributes, debt incurred by a public authority is not considered public credit. In the event that financing is made available to private developers, it is not considered to be "credit of the state" that might conflict with constitutional provisions.

Finally, public assistance to industrial developers can be structured so that the assistance does not constitute a loan or gift of the public credit. In the instance in which mutual consideration is exchanged, no

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130. "[T]he rule is well established that the issuance of revenue bonds to finance a public project . . . does not constitute a lending of credit . . ." *Miller v. City of Owensboro*, 343 S.W.2d 398, 402 (Ky. Ct. App. 1961).

131. *People v. Chicago Transit Auth.*, 392 Ill. 77, 64 N.E.2d 4 (1945); *Cleveland v. City of Detroit*, 322 Mich. 172, 33 N.W.2d 747 (1948).

132. *See Thompson v. Municipal Elec. Auth.*, 238 Ga. 19, 231 S.E.2d 720 (1976); *Opinion of the Justices*, 294 Ala. 571, 319 So.2d 699 (1975).

133. *Bloomfield Village Drain Dist. v. Keefe*, 119 F.2d 157 (6th Cir. 1941), *cert. denied*, 314 U.S. 649 (1941); *Water Works Bd. v. City of Mobile*, 253 Ala. 158, 43 So.2d 409 (1949); *Kennelly v. Kent County Water Auth.*, 79 R.I. 376, 89 A.2d 188 (1952).

134. *North Miami Beach Water Bd. v. Gollin*, 171 So.2d 584 (Fla. Dist. Ct. App. 1965); *Broadway Nat'l Bank v. Parking Auth.*, 40 N.J. 227, 191 A.2d 169 (1963); *Opinion of the Justices*, 254 Ala. 506, 49 So.2d 175 (1950).

135. Fetner, *Public Power and Professional Responsibility: Julius Henry Cohen and the Origins of the Public Authority*, 21 AM. J. LEGAL HIST. 15 (1977); Quirk & Wein, *A Short Constitutional History of Entities Commonly Known as Authorities*, 56 CORNELL L. REV. 521 (1971).

loan of credit is implicated.<sup>136</sup> Instead, in these situations, the industrial developer and the agency providing the assistance create a binding contract, with mutual covenants consented to by each party. When a genuine exchange of concrete, specific, measurable consideration has occurred, there is no lending of money or credit.<sup>137</sup>

State constitutional provisions prohibit, under any circumstances, lending the credit of the state to private entities. Unlike the expenditure of public funds, whether or not the loan serves a "public purpose" is neither a relevant nor a determinative consideration in ascertaining the constitutional validity of the grant of state credit. This state constitutional restriction has lost most of its efficacy in recent years. New legal inventions allow for the commitment of public credit without this credit being classified as that "of the state." The rise of the public authority, the utilization of revenue bonds, and the making of bilateral contracts all permit private developers to take advantage of credit obtained through the public sector.

The constitutional restrictions on the extension of public credit, therefore, do not pose serious obstacles to state venture capital funds. These funds typically provide equity capital and therefore do not implicate state debt restrictions. Notably, all but three states have created separate public corporation or authorities to administer the distribution of state-provided venture capital. As a result, venture capital funds will not likely run afoul of prohibitions on lending the state's credit.

### III. LOCAL IMMUNITY FROM FEDERAL ANTITRUST LIMITATIONS

Local governments that provide financial assistance to select industries must also recognize the potential federal antitrust implications of their actions. In 1978 the United States Supreme Court eliminated local governmental immunity from federal antitrust limitations. In the seminal case *City of Lafayette v. Louisiana Power & Light Company*,<sup>138</sup> the Court held that the immunity that vests in state government actions does not extend to local governments unless such governments act pursuant to a "clearly articulated and affirmatively expressed" state

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136. *Cremer v. Peoria Hous. Auth.*, 399 Ill. 579, 593-94, 78 N.E.2d 276, 284 (1948); *Frank v. City of Cody*, 572 P.2d 1106 (Wyo. 1977).

137. *Washington Natural Gas v. Public Util. Dist. No. 1*, 77 Wash. 2d 94, 103-04, 459 P.2d 633, 639 (1969).

138. 435 U.S. 389 (1978).

policy.<sup>139</sup> In 1982 the Supreme Court, in *Community Communications Co. v. City of Boulder*,<sup>140</sup> expanded the potential for local liability when it held that immunity does not extend to cities operating under home rule powers.<sup>141</sup>

Congress recently eliminated most of the financial consequences that *Lafayette, Boulder*, and their progeny created for local governments.<sup>142</sup> In enacting the Federal Local Government Antitrust Act of 1984,<sup>143</sup> Congress exempted local governments from the imposition of monetary damage (treble or otherwise) and from the payment of litigation costs of successful antitrust claimants.<sup>144</sup> The federal legislation does, however, still allow for the grant of injunctive relief.<sup>145</sup> Congress noted that there is a need to subject local governments to some antitrust restrictions: "If Congress were confident that the actions of local governments and their officials were always in the public interest or would never work unnecessary anticompetitive injury, it could simply exclude them from the application of the antitrust laws entirely. The record does not support such action at this time."<sup>146</sup>

As under prior legislation, private challenges to a local government's actions must, even without local immunity, allege and prove the anticompetitive impacts of an industrial assistance program.<sup>147</sup> These activities are most likely to conflict with federal antitrust policy codified in the Clayton Act<sup>148</sup> and the Sherman Act.<sup>149</sup> The Clayton Act governs the actions of persons engaged in interstate commerce. Under the

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139. This test originated in the Supreme Court's decision in *Bates v. State Bar*, 433 U.S. 350, 362 (1977).

140. 455 U.S. 40 (1982).

141. *Id.* at 52.

142. See generally Henrick, *The Federal Local Government Antitrust Act of 1984 and the 1985 Amendments to the Florida Antitrust Act: A Survey and Analysis of Florida Local Government Antitrust Vulnerability*, 13 FLA. ST. U.L. REV. 77 (1985).

143. 15 U.S.C. §§ 34-36 (Supp. III 1985).

144. *Id.* § 36.

145. 15 U.S.C. § 26 (1982).

146. H.R. REP. NO. 965, 98th Cong., 2d Sess. 18, reprinted in 1984 U.S. CODE CONG. & ADMIN. NEWS 4619.

147. See generally Sharpe, *Unfair Competition by Public Support of Private Enterprises*, 95 L.Q. REV. 205 (1979). The "public purpose" doctrine was created largely to protect private enterprise from unfair competition by state-supported commercial endeavors. See, e.g., *Almond v. Day*, 199 Va. 1, 97 S.E.2d 824 (1957).

148. 15 U.S.C. §§ 12-27 (1982 & Supp. III 1985).

149. 15 U.S.C. §§ 1-7 (1982 & Supp. III 1985).

terms of the statute, specific acts are deemed anticompetitive and are prohibited. Among the proscribed activities are tying arrangements,<sup>150</sup> exclusive dealing arrangements,<sup>151</sup> and requirements contracts.<sup>152</sup> The Sherman Act is divided into two important proscriptions. Section 1 bans every unreasonable "contract, combination or conspiracy in restraint of trade."<sup>153</sup> Section 2 prohibits the acts of monopolization or attempted monopolization.<sup>154</sup>

### A. *The Recent Judicial Trend*

Local government immunity from antitrust liability initially flowed from creation of a state action exemption in the 1942 United States Supreme Court decision *Parker v. Brown*.<sup>155</sup> In *Parker* the Court observed that the Sherman Antitrust Act makes no mention of states, as such. Throughout the evolution of antitrust legislation, the Court said that it presumed that congressional intent was to regulate only the conduct of private parties.<sup>156</sup>

Local government antitrust liability first appeared possible with the Supreme Court's *Lafayette* decision.<sup>157</sup> In *Lafayette* the Supreme Court reviewed the actions of municipally-owned public utility companies. These utilities had refused to make electricity available outside their city limits to customers who did not also buy gas and water service. Louisiana Power & Light claimed the Clayton Act prohibited this practice as a "tying arrangement."<sup>158</sup> The municipal utilities claimed state action immunity, but the Supreme Court rejected that argument. The Court held that for immunity to attach to local activities, the actions must "reflect," "implement," or be done "pursuant to" a "clearly articulated and affirmatively expressed" state policy.<sup>159</sup>

Not surprisingly, substantial conflict developed over precisely what direction a local government must receive from the state in order to

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150. 54 AM. JUR. 2D *Monopolies* § 112 (1971 & Supp. 1986).

151. *Id.* § 118.

152. *Id.* § 115.

153. 15 U.S.C. § 1.

154. *Id.* § 2.

155. 317 U.S. 341 (1942).

156. *Id.* at 350-52.

157. 435 U.S. 389 (1978). See *supra* notes 138-39 and accompanying text for discussion of this case.

158. 435 U.S. at 408.

159. *Id.* at 410.



meet this *Lafayette* requirement. Some courts held, for example, that state legislation must set out the exact actions of the city being challenged,<sup>160</sup> while others held that only the policy and not the means must be identified.<sup>161</sup> Some courts held that local government actions must be mandated by the state,<sup>162</sup> while others held that immunity arose if the local action was a foreseeable consequence of the state's policy.<sup>163</sup> Finally, some courts held that the state must actively supervise any anticompetitive actions of a local government,<sup>164</sup> while others found no such supervision necessary.<sup>165</sup> Substantial litigation, therefore, has been devoted to further refinement of the requirements set forth in *Lafayette*.

The most recent Supreme Court pronouncement on the subject came in the 1985 decision *Town of Hallie v. City of Eau Claire*.<sup>166</sup> In *Town of Hallie* the Court considered a challenge to the city's refusal to provide sewage treatment services to adjacent unincorporated townships unless those townships agreed to be annexed by the community and to use the city's sewage collection and transportation services. The townships argued that the city's requirements were an attempt to gain a monopoly prohibited by section 1 of the Sherman Act.<sup>167</sup> The city claimed state action immunity under the *Parker* doctrine. The Court held that municipal action obtained immunity under the *Parker* doc-

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160. *Brontel Ltd. v. City of New York*, 571 F. Supp. 1065 (S.D.N.Y. 1983), *aff'd sub nom. Rent Control Memorial Corp. v. City of New York*, 742 F.2d 1439 (2d Cir.), *cert. denied*, 105 S. Ct. 248 (1984); *Parks v. Watson*, 716 F.2d 646 (9th Cir. 1983); *City of North Olmstead v. Greater Cleveland Regional Transit Auth.*, 722 F.2d 1284 (6th Cir. 1983), *cert. denied*, 467 U.S. 1205 (1984); *Corey v. Look*, 641 F.2d 32 (1st Cir. 1981).

161. *Scott v. City of Sioux City*, 736 F.2d 1207 (8th Cir. 1984); *Serlin Wine & Spirit Merchants, Inc. v. Healy*, 512 F. Supp. 936 (D. Conn.), *aff'd sub nom. Morgan v. Division of Liquor Control*, 664 F.2d 353 (2d Cir. 1981).

162. *Schiessle v. Stephens*, 525 F. Supp. 763 (N.D. Ill. 1981); *United States v. Southern Motor Carriers*, 672 F.2d 469 (5th Cir. 1982), *rev'd*, 105 S. Ct. 1721 (1985).

163. *Highfield Water Co. v. Public Serv. Comm'n*, 488 F. Supp. 1176 (D. Md. 1980); *Town of Hallie v. City of Eau Claire*, 700 F.2d 376 (7th Cir. 1983), *aff'd*, 105 S. Ct. 1713 (1985).

164. *Charley's Taxi Radio Dispatch v. SIDA of Hawaii*, 562 F. Supp. 712 (D. Haw. 1983); *Ronwin v. State Bar*, 686 F.2d 692 (9th Cir. 1981), *rev'd sub nom. Hoover v. Ronwin*, 466 U.S. 358 (1984).

165. *Ajax Aluminum v. Goodwill Industries*, 564 F. Supp. 628 (W.D. Mich. 1983); *Gold Cross Ambulance & Transfer v. City of Kansas City*, 705 F.2d 1005 (8th Cir. 1983), *cert. denied*, 105 S. Ct. 1864 (1985).

166. 105 S. Ct. 1713 (1985).

167. *Id.* at 1716.

trine if it was a foreseeable result of state legislation.<sup>168</sup> The Court said that the legislature need not specifically provide for the challenged municipal acts, as long as the local government actions were among the kind of action contemplated. Finally, the Court held that municipal actions need not be under the state's direct supervision because they are constrained by the "clearly articulated state policy" first discussed in *Lafayette*.<sup>169</sup>

In spite of *Town of Hallie*, it is clear that state legislatures cannot simply exempt local governments from the requirements and regulations of federal antitrust statutes. Instead, federal courts rule that when the state sovereign, operating through a municipal government in appropriately confined instances, determines that it is in the interest of the state to displace competition, the federal antitrust laws do not serve to prohibit such displacement. This limitation on state action immunity inhered in the *Parker* exemption from its inception.<sup>170</sup> The state, the Court said in *Town of Hallie*, "may not validate a municipality's anticompetitive conduct simply by declaring it to be lawful."<sup>171</sup> The Court favorably noted *Lafayette's* assertion that municipal governments would not be permitted to use "purely parochial interests to disrupt the Nation's free market goals."<sup>172</sup>

These cases underscore the need for local governments, facing challenges to public sector assistance for private sector developers, to be careful of the public policy upon which they rely as a justification for their actions. The *Parker* state action treatment creates two threshold requirements for local governments. First, the public policy must involve a decision to displace competition with some sort of alternative state scheme.<sup>173</sup> This displacement of competition may take many forms. Regulation, for example, may be substituted for competitive forces when a local government places conditions on the extension of utility services. Government price-fixing may take precedent over what would otherwise be market-determined rates. Publicly provided

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168. *Id.* at 1718.

169. *Id.* at 1721.

170. *Parker* held that immunity applied only to "conduct engaged in as an act of government by the State as sovereign, or, by its subdivisions, pursuant to state policy to displace competition with regulation or monopoly public service." *Lafayette*, 435 U.S. at 413.

171. 105 S. Ct. at 1716.

172. *Id.* at 1717.

173. 435 U.S. at 413.

monopoly service, such as ambulance service, may be substituted for competing private sector alternatives. Legitimate questions may be raised as to whether programs of providing public assistance for private industries fall within this state determination of a need to displace competition with regulation or monopoly service.

Second, the displacement of competition by local public sector alternatives must result in the promotion of a statewide public policy.<sup>174</sup> Local economic development, in other words, that is not part and parcel of a statewide scheme will not pull otherwise anticompetitive activities within the state action antitrust exemption. Supportive of this view, the *Lafayette* Court expressed hostility towards the promotion of merely local policies, referring to them on more than one occasion as "parochial interests."<sup>175</sup> The Court expressed this concern again in *Town of Hallie*, stating that there is a "real danger" that a municipality "will seek to further purely parochial public interests at the expense of more overriding state goals."<sup>176</sup> This danger will be minimized only by requiring municipalities to adhere to statewide public policies, the Court noted. This judicial tendency to eschew reliance on local policies as a justification for exemption from federal antitrust regulation has been reflected in lower court decisions as well.<sup>177</sup>

### B. *The Immunity of a Public Authority*

In addition to the above public policy factors, local governments must carefully consider the form of entity through which public involvement in private enterprise is undertaken in order to avoid potential antitrust conflicts. The potential for misstep seems greatest in the area of creating quasi-public corporations.<sup>178</sup> By using public authorities to address state constitutional problems with industrial financing programs,<sup>179</sup> a local government may well open itself up to antitrust

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174. 105 S. Ct. at 1721.

175. 435 U.S. at 408, 412-13, 415-16; see also *Community Communications Co. v. City of Boulder*, 455 U.S. 40, 70-71 (1982).

176. 105 S. Ct. at 1721.

177. "[M]unicipalities might make shortsighted economic decisions that could benefit their constituents but disserve others, and might cause severe economic hardship outside of the local government boundaries." *Woolen v. Surtran Taxicabs, Inc.*, 461 F. Supp. 1025, 1028 (N.D. Tx. 1978); see also *In re Airport Car Rental Antitrust Litigation*, 474 F. Supp. 1072, 1095-96 (N.D. Cal. 1979), *aff'd*, 693 P.2d 84 (9th Cir. 1982), *cert. denied*, 462 U.S. 1133 (1983).

178. See *supra* notes 132-35 and accompanying text.

179. See *supra* notes 64-71 and accompanying text.

problems.

State constitutional provisions prohibit lending the credit of the state to private entities for any purpose. Courts have held that for the credit of the state to have been loaned, the general taxing power of the sovereign must be pledged as security. Among the mechanisms invented to avoid this constitutional limitation is the public authority. The authority is a quasi-public corporation, apart from the state, that derives its investment funds from sources other than the general taxing power. In addition, the primary legal prerequisite for the formation of a public authority is that it be a separate entity and not a mere appendage of its creating government. As a result, to the extent that any credit is loaned to private developers through a public authority, it is not the credit of the state.

Reliance on the public authority organization, however, results in exposure to antitrust liability that might not otherwise exist. The 1984 federal legislation,<sup>180</sup> for example, does not exempt the actions of public authorities as actions of a local government. Under section 2 of that statute, "local government" includes both general and special purpose political subdivisions of the state.<sup>181</sup> Courts generally hold, however, that public authorities are quasi-public corporations and do not constitute political subdivisions.<sup>182</sup> Moreover, the federal statutory scheme expressly contemplates that exempted local governments have a geographic element to their make-up,<sup>183</sup> an element that can not be attributed to most public corporations. Section 3 creates immunity for official conduct of the local government.<sup>184</sup> This exemption extends to local departments, employees, and agents. The committee report accompanying the legislation, however, makes clear that this exemption applies only if the local government either has control over the challenged actions, or has expressly mandated the actions on the part of a

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180. See *supra* notes 142-46 and accompanying text.

181. 15 U.S.C. § 34(1).

182. See *supra* note 132 and accompanying text.

183. See, for example, the statutory definition of special purpose political subdivisions. The committee report states: "included within the definition are planning *districts*, water *districts*, sewer *districts*, irrigation *districts*, drainage *districts*, road *districts*, and mosquito control *districts*." (emphasis added). It goes on to state more explicitly: "Such a subdivision would have a geographic jurisdiction that is not contiguous with, and is generally substantially smaller than, that of the State that established it." H.R. REP. NO. 965, 98th Cong., 2d Sess. 19-20, reprinted in 1984 U.S. CODE CONG. & ADMIN. NEWS 4620-21.

184. 15 U.S.C. § 35(a).

private entity.<sup>185</sup> Both of these factors are contrary to the legal prerequisites of a public authority's existence.<sup>186</sup>

Additional concern stems from the potential antitrust liability of public authorities that act in a proprietary as opposed to a governmental capacity. Federal court decisions finding local antitrust immunity often turn on how closely the local action resembles the activity of a private sector player.<sup>187</sup> In a variety of circumstances, the stringency of the Supreme Court requirements placed on entities seeking *Parker* state action immunity varies in direct proportion to how closely the challenged action resembles private sector actions. In *California Retail Liquor Dealers v. Mid-Cal Aluminum*<sup>188</sup> the Supreme Court held that a state-sanctioned private price-fixing scheme needed active state supervision to be exempt from federal price-fixing proscriptions.<sup>189</sup> Similarly, in *Goldfarb v. Virginia State Bar*<sup>190</sup> the Supreme Court denied state action immunity to a private price-fixing scheme because although the state sanctioned the process, state policy did not mandate it.<sup>191</sup>

Even though an activity may clearly be that of a local government, if it is in the nature of private action a court will apply a more stringent antitrust standard. Chief Justice Burger provided the key vote in *Lafayette* when he drew this distinction between local activities that are

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185. H.R. REP. NO. 965, 98th Cong., 2d Sess. 20, reprinted in 1984 U.S. CODE CONG. & ADMIN. NEWS 4621.

186. See *supra* notes 133-35 and accompanying text.

187. Lower courts usually depend upon a determination of whether the local government was undertaking a "traditional governmental function." *Town of Hallie v. City of Eau Claire*, 700 F.2d 367 (7th Cir. 1983); *Hybud Equip. Corp. v. City of Akron*, 654 F.2d 1187 (6th Cir. 1981), vacated, 455 U.S. 931 (1982); *Pueblo Aircraft Serv. v. City of Pueblo*, 679 F.2d 805 (10th Cir. 1982), cert. denied, 459 U.S. 1126 (1983); *All American Cab Co. v. Metropolitan Knoxville Airport Auth.*, 547 F. Supp. 509, 511 (E.D. Tenn. 1982), aff'd, 723 F.2d 908 (6th Cir. 1983). Two district courts based their decisions on the fact that there was no profit-making activity involved, as in *Lafayette*. *Cedar-Riverside Assocs. v. United States*, 459 F. Supp. 1290, 1299 (D. Minn. 1978), aff'd on other grounds, 606 F.2d 254 (8th Cir. 1979); *Shrader v. Horton*, 471 F. Supp. 1236, 1242 (W.D. Va. 1979), aff'd, 626 F.2d 1163 (4th Cir. 1980). One commentator suggests that the issue of municipal antitrust immunity "may require a resuscitation of Justice Burger's proprietary-nonproprietary distinction from *City of Lafayette*." Spiegel, *Local Governments and the Terror of Antitrust*, 69 A.B.A. J. 163, 165 (1983).

188. 445 U.S. 97 (1980).

189. *Id.* at 105-06.

190. 421 U.S. 773 (1975).

191. *Id.* at 789-91.

proprietary and those that are traditionally governmental.<sup>192</sup> The Seventh Circuit also relied upon this distinction in *Town of Hallie*.<sup>193</sup> In that decision, the court held that active state supervision of municipal activities was unnecessary when "a local government perform[s] a traditional municipal function."<sup>194</sup> The Supreme Court, in affirming the Seventh Circuit decision, relied heavily on the difference between the actions of a private and public entity.<sup>195</sup> The presumption, the Court said, is that while a private party acts "primarily on his or on its own behalf," a municipality "acts in the public interest."<sup>196</sup> The rule that distinguishes between the governmental and proprietary functions of local governments can be considered universal.<sup>197</sup>

### CONCLUSION

A recent development in government efforts to promote economic development in response to a variety of social ills is the public provision of equity funding for private corporations. This type of industrial assistance is generally funneled through a public or quasi-public corporation or authority. Equity funding endeavors, particularly those of local governments, raise a number of legal issues. State constitutional provisions place restrictions on the grant of public funds for anything but a public purpose, while banning the loan of public credit in all circumstances. Moreover, recent Supreme Court decisions raise the spectre of possible federal antitrust liability for local governments.

Constitutional restrictions on the use of public monies do not pose serious obstacles to local venture capital programs. Well-reasoned court decisions have closely examined claims that a public purpose is served by economic development arising from industrial inducement programs similar to venture capital funds. These decisions concentrate on whether there is a demonstrated need for additional development

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192. *Lafayette*, 435 U.S. at 424 (Burger, C.J., concurring in part, concurring in judgment).

193. 700 F.2d 376 (7th Cir. 1983). See *supra* notes 166-69 and accompanying text.

194. *Id.* at 384.

195. 105 S. Ct. 1713, 1720-21 (1985).

196. *Id.* at 1720; see also *State ex rel. Ohio County Comm'n v. Samol*, 165 W. Va. 714, 720-29, 275 S.E.2d 2, 5-10 (1980) (Neely, J., concurring).

197. See *Department of Treasury v. City of Evansville*, 223 Ind. 435, 440-42, 60 N.E.2d 952, 954-55 (1945). The rule applies in a variety of circumstances. For example, whether a local government is immune from tort liability on a sovereign immunity basis may turn on the distinction. Similarly, whether particular property is exempt from property taxation as governmental often turns on this determination.

and whether specific economic benefits will arise from the program. As a general rule, broadly stated economic benefits will not suffice to prove a public purpose. Any new manufacturing plant, commercial complex, or retail establishment will result in some benefit. The statement of benefit by proponents of a particular program must, therefore, be specific. In addition, new legal inventions which have been incorporated into venture capital endeavors have eliminated most of the efficacy of restrictions on lending the credit of the state.

Federal antitrust restrictions pose more significant questions for local venture capital funds. Historical limits on public participation in private enterprise were, in part, based on the anticompetitive impacts of such participation. The Supreme Court has, in recent years, expanded the potential for local government antitrust liability. In light of the local as opposed to statewide policies promoted by venture capital programs, and due to the proprietary nature of these funds, local policymakers must be extremely cognizant of the anticompetitive impacts of their decisions. Though venture capital funds do not appear to be *per se* in violation of federal antitrust statutes, they will not be protected by recent judicial and legislative protections developed for local governments.

