STATE OF TENNESSEE
OFFICE OF THE ATTORNEY GENERAL

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Opinion No. 17-51

Constitutionality of Legislation Allowing Local Governments to Deposit Funds in State-Chartered Credit Unions

Question

If the Tennessee Code were amended to allow a county, city, or town to deposit its funds in a state-chartered credit union, would the amendment violate that portion of article II, section 29 of the Tennessee Constitution that forbids a county, city, or town from becoming a "stockholder with others in any company, association or corporation"?

Opinion

Yes. Therefore, legislation allowing a county, city, or town to make such a deposit would not be constitutionally permissible unless the legislation provided for the requisite referendum under article II, section 29 of the Tennessee Constitution.

ANALYSIS

Credit unions are cooperative associations that offer low-interest loans and other consumer banking services to persons sharing a "common bond." See Black's Law Dictionary p. 426 (9th ed. 2009). Typically, the common bond links persons by occupation, organization, or geographic location. See id.; 12 C.J.S. Building & Loan Assoc. §§ 1, 5 (2017).

Credit unions are organized under special statutory provisions. They are not ordinary private corporations for profit. See 10 Am.Jur.2d Banks and Financial Institutions § 15 (2017). Rather, credit unions are organized as mutuals; that is, they are owned by their depositors. Stanley G. Eakins, Finance: Investment, Institutions, and Management p. 62 (1999). Account holders in a credit union are referred to as "members," and they receive "shares" when they make deposits. See National Credit Union Admin. Bd. v. Jurcevic, 867 F.3d 616, 620 (6th Cir. 2017). See generally LaManna v. Electrical Workers' Local Union No. 474, 518 S.W.2d 348, 351 (Tenn. 1974); Congressional Research Serv., A Reference Guide to Banking and Finance p. 14 (2d rev. ed. 1983). A member's shares evidence that member's ownership of the credit union, and any profit of the credit union inures to its members, generally in the form of dividends or lower interest rates. See Jurcevic, 867 F.3d at 620; Kelly Culp, Banks v. Credit Unions: The Turf Struggle for Consumers, 53 Bus. Law 193, 215 (1997). See generally LaManna, 518 S.W.2d at 351.

Credit unions are chartered by the states and the federal government. The first state-regulated credit union in the United States was established in Massachusetts in 1909. Barany v. Buller, 670 F.2d 726, 733 (7th Cir. 1982); J. Carroll Moody and Gilbert C. Fite, The Credit Union

Movement Origins and Development, 1850-1970 p. 353 (1971). Other states followed, including Tennessee, which enacted its first credit union laws in 1923. 1923 Tenn. Pub. Acts ch. 68. Federal credit unions were created by Congress in 1934. *See* Pub. L. No. 73-467, 48 Stat. 1216 (1934).

State-chartered Credit Unions in Tennessee

State-chartered credit unions in Tennessee are established in accordance with Chapter 4 of Title 45 of the Tennessee Code. Initially, incorporators come together for the purpose of forming a corporation to "carry[] on a credit union," *see* Tenn. Code Ann. § 45-4-101(a), and they submit an application for a charter of incorporation as a credit union to the Commissioner of Financial Institutions for approval. *See* Tenn. Code Ann. §§ 45-4-102, -103.

Assuming the Commissioner approves the application, the membership of the credit union consists of the "incorporators and persons, societies, associations, copartnerships and corporations that have been duly elected to membership" – all of whom must have a "common bond of occupation or association or to groups within a well-defined neighborhood, community, or rural district." Tenn. Code Ann. § 45-4-301(a). To be duly elected to membership, each member must "have subscribed to one (1) or more shares and have paid for the same in whole or in part,[1] with the entrance fee as required by the by-laws, and have complied with other requirements that the certificate of organization may contain." *Id*.

Once formed, the credit union receives the savings of its members "through the purchase of various classes of share accounts, including general or regular shares, share certificates, special accounts, share draft accounts or members' special accounts, savings accounts, certificates and notes." Tenn. Code Ann. § 45-4-501(1). The credit union must obtain and maintain "insurance of its share and deposit balances by membership in either the state credit union share insurance corporation[2] or the National Credit Union Association."[3] Tenn. Code Ann. § 45-4-505(a).

The capital of the credit union consists of the payments that have been made by its members on shares. Tenn. Code Ann. § 45-4-701. The credit union uses its capital primarily to make loans to its members. *See* Tenn. Code Ann. § 45-4-501(2). Capital, undivided profits, reserve funds, and other assets not required for loans to members may be invested. Tenn. Code Ann. § 45-4-501(3).

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[1] While Tennessee Code Annotated § 45-4-101(b) provides that the par value of shares of capital stock is five dollars ($5.00), the par value may be a different amount. Tennessee-chartered credit unions "may exercise any power or engage in any activity that it could exercise or engage in if it were a federally chartered credit union, subject to the regulation by the commissioner of financial institutions for the purpose of maintaining the credit union's safety and soundness." Tenn. Code Ann. § 45-4-501(9). Federal law allows for par value of any amount. *See* 12 U.S.C. §§ 1753(4), -1761b(11).

[2] *See* Tenn. Code Ann. §§ 45-4-1101 to -1114.

[3] The National Credit Union Association administers the National Credit Union Share Insurance Fund (NCUSIF). Like the FDIC's Deposit Insurance Fund, the NCUSIF is a federal insurance fund backed by the full faith and credit of the United States government. Deposits at all federal credit unions and a vast majority of state-chartered credit unions are covered by NCUSIF protection. Deposits are insured up to at least $250,000 per depositor. *See* https://www.mycreditunion.gov/protect/Pages/SI.aspx.

The credit union may also declare dividends for its members. Tenn. Code Ann. § 45-4-503. A member's number of shares can affect the amount of dividends that member receives. *See* Tenn. Code Ann. § 45-4-503(2) (higher dividend rates may be established for shares held in excess of specified minimum amounts).

A member's right to vote at meetings, however, is not affected by the number of shares held. Each member of the credit union has one vote. *See* Tenn. Code Ann. § 45-4-1003(c). At an annual meeting, the members of a credit union elect a board of directors. Tenn. Code Ann. § 45-4-201(a). All of the directors must be members of the credit union. *Id*. The board of directors has the "duty of general management of the affairs, funds and records of the corporation." Tenn. Code Ann. § 45-4-202.

In addition to voting rights, a member is authorized to transfer or withdraw shares under certain conditions. A member may transfer "fully paid-up shares" to any person upon election to membership in accordance with the terms that the by-laws may provide. Tenn. Code Ann. § 45-4-403. When a member withdraws or is expelled,[4] "[a]ll amounts paid in on shares of an expelled or withdrawing member with any dividends credited to the member's shares to the date of expulsion or withdrawal shall be paid to the member, but only after funds become available and after deducting any amounts due to the corporation by the member." Tenn. Code Ann. § 45-4-302(b).

Finally, in the event of liquidation or dissolution, the assets of the credit union must be used to pay expenses incidental to the liquidation, any liability due nonmembers, and redemption of shares, share accounts, and members' special accounts. Tenn. Code Ann. § 45-4-902(a). "Assets then remaining shall be distributed to the members proportionately to the purchase price of shares held by each member as of the date of dissolution was voted, or the date of order of liquidation or suspension by the commissioner." *Id*.

Article II, Section 29 of the Tennessee Constitution

Article II, section 29 of the Tennessee Constitution provides in pertinent part:

> The General Assembly shall have power to authorize the several counties and incorporated towns in this State, to impose taxes for County and Corporation purposes respectively, in such manner as shall be prescribed by law; and all property shall be taxed according to its value, upon the principles established in regard to State taxation. *But the credit of no County, City or Town shall be given or loaned to or in aid of any person, company, association or corporation, except upon an election to be first held by the qualified voters of such county, city or town, and the assent of three-fourths of the votes cast at said election. Nor shall any county, city or town become a stockholder with others in any company, association or corporation except upon a like election, and the assent of a like majority. . . .*

[4] A member may be expelled from a credit union by a two-thirds (2/3) vote of the members at a regularly called meeting. Tenn. Code Ann. § 45-4-302(a).

(Emphasis added).

The italicized language quoted above was adopted as part of the Constitution of 1870 at the end of the Reconstruction government in Tennessee. *Cleveland Surgery Ctr. v. Bradley Cnty. Mem'l Hosp.*, 30 S.W.3d 278, 283 (Tenn. 2000). As explained by the Tennessee Supreme Court, these provisions were aimed at ending the abuses that occurred during Reconstruction:

> During the early part of the nineteenth century, at the beginning of the industrial revolution and increased westward expansion, railroads and canals were viewed as critical modes of transportation. Because private industry was unable to raise the capital necessary to complete these projects, many states and cities borrowed heavily to finance these improvement and transportation projects and issued bonds to buy stock in private companies or guaranteed loans to private companies. Unfortunately, many of these public-private ventures failed causing the states and cities to lose tax money they had invested and leaving the states and cities with a burden of debt. As a result of these failed ventures, between the years 1840 and 1855, nineteen states enacted constitutional provisions which limited the ability of state and local governments to incur debt and extend credit to private businesses.
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> Adoption of constitutional provisions restricting the extension of public credit did not become prevalent in the South until after the Civil War. As a result of the Civil War, most infrastructure in the South had been destroyed including railroads, roadways, canals, and bridges. To rebuild the infrastructure, southern states borrowed money and authorized large bond issues. In addition, Reconstruction governments in the South were said to have incurred debt and authorized bond issues for personal gain. When the period of Reconstruction ended, many southern states adopted constitutional provisions limiting the extension of public credit. Tennessee is a clear example of this trend. . . .

Id. at 282-283 (internal citations omitted).

In short, article II, section 29 was amended in 1870 to shield local governments from the pecuniary expense or liability that could arise from participating in projects originated by private parties.[5] *Ransom v. Rutherford Cnty.*, 123 Tenn. 1, 32-36, 130 S.W. 1057, 1065 (1910).

> [T]he letter and spirit of this provision is that [a county, city or town] shall not be a stockholder or joint owner with any company, association, or corporation in any enterprise or improvement; that the mischief it seeks to prevent is a business

[5] Like constraints were also placed on the State by the contemporaneous adoption of article II, section 31 of the Tennessee Constitution, which provides: "The credit of this State shall not be hereafter loaned or given to or in aid of any person, association, company, corporation or municipality: nor shall the State become the owner in whole or in part of any bank or a stockholder with others in any association, company, corporation or municipality." While similar to article II, section 29, this provision has no application to counties, cities, or towns. *See Eye Clinic, P.C. v. Jackson-Madison Cnty. Gen. Hosp.*, 986 S.W.2d 565, 575-576 (Tenn. Ct. App. 1998) (reasoning that article II, section 29 would be unnecessary if article II, section 31 applied to counties, cities and towns).

> partnership between a municipality or subdivisions of the state and individuals or private corporations or associations; that it forbids the union of public and private capital in any enterprise whatever.

Heiskell v. Knox Cnty., 132 Tenn. 180, 190, 177 S.W. 483, 486 (1915) (citing *Ransom v. Rutherford Cnty.*, 123 Tenn. 1, 130 S.W. 1057 (1910)).

Recent cases repeat this admonishment. In construing particular phrases in article II, section 29, such as "county, city or town" and "company, association or corporation," the courts' respective conclusions contain a common thread in the analysis – the purpose of article II, section 29 is to place limitations on the power of local governments to extend credit or otherwise become financially involved in private enterprises. *See Cleveland Surgery Ctr.*, 30 S.W.3d at 284; *Eye Clinic*, 986 S.W.2d at 570; *Phillips v. County of Anderson*, E2000-01204-COA-R3-CV, 2001 WL 456065 *6 (Tenn. Ct. App. 2001).

Application of Article II, Section 29 to State-Chartered Credit Unions

The Tennessee Constitution derives its power and authority from the people. *The Judges' Cases*, 102 Tenn. 509, 520, 53 S.W. 134, 136 (1899); *Stratton Claimants v. Morris Claimants*, 89 Tenn. 497, 512-513, 15 S.W. 87, 90 (1891). Thus, constitutional provisions must be construed with respect to the intentions of the persons who adopted them. *Cleveland Surgery Ctr.*, 30 S.W.3d at 281-282. *See Hatcher v. Bell*, 521 S.W.2d 799, 803 (Tenn. 1974). These intentions are reflected in the words of the constitution itself. *Cleveland Surgery Ctr.*, 30 S.W.3d at 282. *See Prescott v. Duncan*, 126 Tenn. 106, 128, 148 S.W. 229, 234 (1912).

Accordingly, the text of a constitutional provision is the primary guide to the provision's purpose. *Estate of Bell v. Shelby Cnty. Health Care Corp.*, 318 S.W.3d 823, 835 (Tenn. 2010). Courts must interpret constitutional provisions in a principled way that attributes plain and ordinary meaning to their words, and that takes into account the history, structure, and underlying values of the entire document. *Id.* at 835. To accomplish this end, courts must construe the text in light of the practices and usages that were well-known when the provision was ratified. *Cleveland Surgery Ctr.*, 30 S.W.3d at 282; *Peay v. Nolan*, 157 Tenn. 222, 230, 7 S.W.2d 815, 817 (1928). And they must consider terms with reference to what the people who ratified the provision thought they meant. *State ex rel. Doyle v. Torrence*, 203 Tenn. 175, 182, 310 S.W.2d 425, 427-28 (1958).

Further, courts are to construe constitutional provisions as written without reading any ambiguities into them. *Hooker v. Haslam*, 437 S.W.3d 409, 426 (Tenn. 2014); *Chattanooga-Hamilton Cnty. Hosp. Auth. v. City of Chattanooga*, 580 S.W.2d 322, 327 (Tenn. 1979). When a provision clearly means one thing, courts should not give it another meaning. *Hooker*, 437 S.W.3d at 426. The intent of the people adopting the Constitution should be given effect as that meaning is found in the instrument itself, and courts must presume that the language in the Constitution has been used with sufficient precision to convey that intent. *Id.* (citing *State ex rel. Sonnenburg v. Gaia*, 717 S.W.2d 883, 885 (Tenn. 1986)). Unless examination demonstrates that the presumption does not hold, nothing remains except to enforce it. *Prescott*, 126 Tenn. at 128, 148 S.W. at 234.

Article II, section 29 of the Tennessee Constitution is unambiguous in its command: "Nor *shall* any county, city or town become a stockholder with others in any company, association or corporation" without an election. "[T]he use of the word 'shall' stamps a constitutional provision as mandatory." *Biggs v. Beeler*, 180 Tenn. 198, 217, 173 S.W.2d 946, 947 (1943). Thus, without the requisite election, a county, city or town *may not* become a "stockholder with others in any company, association or corporation."

The provisions in Chapter 4 of Title 45 clearly indicate state-chartered credit unions in Tennessee are corporate beings. *See, e.g.*, Tenn. Code Ann. § 45-4-102 (those organizing a credit union are referred to as "incorporators," and they must apply for a "charter of incorporation" and submit by-laws); Tenn. Code Ann. § 45-4-202 (the general management of the "corporation" is placed on the "board of directors"); Tenn. Code Ann. § 45-4-203 (addressing those authorized to make loans on behalf of the "corporation"); Tenn. Code Ann. § 45-4-503 (addressing the payment of dividends on shares held by members). Moreover, these corporations are organized, managed, and operated by private entities and individuals. *See* Tenn. Code Ann. § 45-4-301(a). Thus, a county, city or town cannot become a "stockholder" in this type of corporation. *See Heiskell*, 132 Tenn. at 190, 177 S.W. at 486; *Ransom*, 123 Tenn. at 34-36, 130 S.W. at 1065.

The final consideration, then, is whether a county, city or town would become a "stockholder" as that term is used in article II, section 29, if permitted to deposit funds in a state-chartered credit union.

A member of a Tennessee-chartered credit union has some characteristics of a stockholder in an ordinary for-profit corporation, but not all. Like a stockholder, a member has an ownership stake. A deposit into a credit union account equates to "shares" evidencing a member's ownership of the credit union. Upon making the initial deposit, the member is granted voting rights, along with surplus income that can be returned to the member in the form of dividends. A credit union member also has the right to share in the remaining assets of the credit union upon liquidation.

But there are some differences between a member of a credit union and a stockholder in an ordinary for-profit corporation. While a credit union member is granted the right to vote, the right is of less importance than that of a stockholder in an ordinary for-profit corporation because a credit union member has only one vote to cast regardless of the number of shares held. Additionally, a credit union member does not make a permanent contribution of capital as does a purchaser of stock upon formation of an ordinary for-profit corporation. A credit union member has the ability to withdraw his or her shares, subject to some restrictions; a shareholder of a for-profit corporation may own stock subject to a number of restrictions, and in any event must sell that stock to reclaim his or her investment. The sale may result in gain or loss depending on the market.

These differences, in large part, are the reason that state-chartered credit unions are generally exempt from federal taxation under 26 U.S.C. 501(c)(14)(A), which gives tax-exempt status to "[c]redit unions without capital stock organized and operated for mutual purposes and

without profit."[6] As one New Hampshire court explained, credit unions may avail themselves of this exemption because "[t]here is no 'capital stock.' The shares owned by the members cannot appreciate in value." Moreover, the credit union will buy back a member's share for the same price that the member paid for the share. Thus, there can be no gain or loss. *La Caisse Populaire Ste. Marie v. United States*, 425 F.Supp. 512, 522 (D. N.H. 1976). The court cites a United States Attorney General opinion that provides further reasoning for determining that credit unions are "without capital stock" for federal tax purposes:

> No certificate of stock is issued to the shareholder, and it seems clear that the term 'capital stock' as used in connection with credit unions is in no sense similar to the accepted business meaning of that term, which Congress doubtless had in mind when the words 'without capital stock' were inserted in the fourth paragraph of section 11 of the income-tax law.
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> While in a credit union dividends are paid on shares of stock, it is in reality the same as paying interest on deposits. At the annual meeting of the association each member (shareholder and depositor) has but one vote, and no member can vote by proxy. At this meeting the members may, upon recommendation of the board of directors, declare a dividend from income which has been actually collected during the fiscal year, after certain deductions have been made, but as a practical matter the dividend simply takes the place of interest. Thus, shareholding is only a means of saving and is one of the privileges of membership in the credit union.

31 U.S. Op. Atty. Gen. 176, 179 (1917).

The term "stockholder" in article II, section 29 of Tennessee's Constitution, however, is used in a broader sense and a different context than "stock" in the federal statute that provides tax-exempt status to "credit unions without capital stock . . . ." The prohibition of private investments in article II, section 29 is not limited to corporations. Article II, section 29 also prohibits a county, city or town from becoming a stockholder with others in companies and associations. Often, companies and associations do not issue certificates of stock.

To construe article II, section 29 as applying only to companies and associations that issue certificates of stock would impermissibly limit the prohibition's force. Article II, section 29 prohibits counties, cities or towns from becoming stockholders with "*any* company, association or corporation." Accordingly, the term "stockholder" cannot be confined to one holding a certificate of stock. *See Estate of Bell*, 318 S.W.3d at 835 (each provision of the Tennessee Constitution must be construed "in a way that gives the *fullest* possible effect to the intent of the Tennesseans that adopted it").

The Tennessee Supreme Court in 1915 equated the term "stockholder" to a "joint owner" when it stated that "the letter and spirit of this provision is that [a county, city or town] shall not be a stockholder *or joint owner* with any company, association, or corporation . . . ." *Heiskell,* 132

[6] Federal credit unions are specifically exempt from taxation under § 23 of the Federal Credit Union Act of 1934, 12 U.S.C. § 1768. Since federal credit unions are elsewhere exempt, § 501(c)(14)(A) applies to state-chartered credit unions. *La Caisse Populaire Ste. Marie v. U.S.*, 563 F.2d 505, 509 (1st Cir. 1977).

Tenn. at 190, 177 S.W. at 486 (emphasis added). The Court stated that the purpose of the prohibition was to prevent a business partnership – and the union of public and private capital – between local government entities and private individuals or entities. *Id*.

Accordingly, we conclude that a county, city or town that deposits funds in a Tennessee-chartered credit union would become a "stockholder" as that term is used in article II, section 29 of the Tennessee Constitution because one cannot deposit funds in a Tennessee-chartered credit union without becoming a member and purchasing at least one share.[7] *See* Tenn. Code Ann. § 45-4-301(a). In short, the county, city or town would impermissibly join public funds with the funds of others in the ownership of a private enterprise.

Moreover, those public funds would receive less protection in a state-chartered credit union than a state-chartered bank. The relationship between a bank and a general depositor is that of debtor and creditor – the debt being due on demand. *American Nat'l Bank v. Miles*, 18 Tenn. App. 440, 446, 79 S.W.2d 47, 51 (1934). *See Dickson v. Simpson*, 172 Tenn. 680, 687-688, 113 S.W.2d 1190, 1192-93 (1938). A depositor's right to withdraw his or her deposit is absolute. *American Nat'l Bank*, 18 Tenn. at 447, 79 S.W. at 51. While a member of a credit union has the right to withdraw his or her shares, a member's shares will be paid "only after funds become available and after deducting any amounts due to the corporation by the member." *See* Tenn. Code Ann. § 45-4-302(b). Moreover, in the case of a state-chartered bank's dissolution, all claims of creditors are paid *before* those of the bank's investors. *See* Tenn. Code Ann. §§ 45-2-1504(h), (i). A county, city or town that deposits its funds in a state-chartered bank would have a claim, as a creditor, superior to that of the bank's investors. That would not be the case in the dissolution of a credit union. The payment of creditors' claims would dissipate the funds available for the redemption of the shares held by a city, county, or town. *See* Tenn. Code Ann. § 45-4-902(a) (discussed earlier).

A county, city or town that deposits funds in a Tennessee-chartered credit union would become a "stockholder" as that term is used in article II, section 29 of the Tennessee Constitution. And under article II, section 29, a county, city, or town may not become a stockholder "except upon a like election, and the assent of a like majority." "Like election" and "like majority" refer to the immediately preceding sentence in article II, section 29, which prohibits the lending of the credit of any county, city, or town "to or in aid of any person, company, association or corporation, except upon an election to be first held by the qualified voters of such a county, city or town, and the assent of three-fourths of the votes cast at said election."

[7] We are aware that federal law allows federal credit unions to accept "nonmember" deposits from certain local governments and subdivisions of States under specified conditions. *See* 12 U.S.C. § 1757(6). Tennessee-chartered credit unions "may exercise any power or engage in any activity that it could exercise or engage in if it were a federally chartered credit union, subject to the regulation by the commissioner of financial institutions for the purpose of maintaining the credit union's safety and soundness." Tenn. Code Ann. § 45-4-501(9). But for purposes of this opinion, we have assumed that the contemplated state-law amendment would amend provisions in Title 9 of the Tennessee Code that address public deposits. Accordingly, we have further assumed that the contemplated deposits would be made pursuant to Tennessee's state-chartered credit union statutory scheme. Thus, the provision of Tennessee Code Annotated § 45-4-301(a) that requires membership and the purchase of at least one share would apply.

Consequently, legislation that permits a county, city or town to deposit funds in a state-chartered credit union would have to provide for the election required by article II, section 29 because "an election cannot be held unless its holding be directed by law." *Berry v. Shelby Cnty*., 139 Tenn. 532, 545, 201 S.W. 748, 751 (1918). In *Berry*, the Court found a statute authorizing the lending of the county's credit to be fatally incomplete and void because it did not also provide for the election required by the provision of article II, section 29. Accordingly, in the absence of the requisite referendum provision set forth in article II, section 29, legislation authorizing a county, city or town to deposit funds in a state-chartered credit union would be "fatally incomplete and void." *See id*. at 545, 201 S.W. at 751.

In sum, legislation that allows a county, city, or town to deposit its funds in a state-chartered credit union, would violate that portion of article II, section 29 of the Tennessee Constitution that forbids a county, city, or town from becoming a "stockholder with others in any company, association or corporation." Therefore, legislation allowing a county, city, or town to make such a deposit would not be constitutionally permissible unless the legislation provided for the requisite referendum under article II, section 29 of the Tennessee Constitution.

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