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MEMORANDUM

TO: Kevin Hyde

FROM: Gardner Davis
Richard Guyer

DATE: October 21, 2019

RE: Sale of JEA – Pillsbury's question regarding ability to establish wholly-owned subsidiary of JEA to own utility and structure transaction as a merger

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Pillsbury Winthrop Shaw Pittman ("Pillsbury") has asked whether JEA may establish a new, wholly-owned subsidiary of JEA to own the utility and structure the sale of the utility as a subsidiary merger transaction. We have not located a Florida case directly addressing this specific issue and therefore we are reluctant to provide an unqualified answer. However, we believe that if the issue was properly presented to a Florida court, the court more likely than not would rule the proposed structure is permitted by JEA's Charter and applicable Florida law.

This memorandum addresses the legality of the proposed subsidiary merger structure for the sale of JEA (the "Sale") under Florida law. We conclude that the Sale as proposed is more likely than not allowed under Florida law, provided that (1) the necessary approvals by the JEA Board, the Jacksonville City Council and Jacksonville voters in a referendum are achieved and (2) the Sale does not result in JEA assuming any obligations of the potential acquiring entity (the "Buyer").

1. The Proposed Transaction

On July 23, 2019, the JEA Board (the "Board") approved resolutions authorizing the utility to explore, among other strategic alternatives, the privatization and sale of JEA. Pillsbury has asked whether JEA has the flexibility to structure the Sale in three steps: first, JEA will form a wholly-owned subsidiary entity (the "JEA Sub"); second, JEA will transfer the business and assets being sold to the Buyer to the JEA Sub; and third, either (A) the Buyer will purchase all of the equity of the JEA Sub or (B) a wholly-owned subsidiary of Buyer will merge with and into the JEA Sub, with the JEA Sub surviving, each case resulting in the selected business and target assets of JEA being owned by a subsidiary of the Buyer.

Pillsbury believes that merger transactions, and to a lesser degree securities sales transactions, are more commonly used as the structure of acquisitions where the seller does not retain any indemnification obligation to the buyer and the seller's representations and warranties in the transaction documents do not survive the closing.

2. The Sale is Authorized Under the Charter

As a statutorily created entity, JEA may only exercise such powers expressly granted by statue or necessarily exercised in order to carry out an express power. Therefore, a review of each stage of the proposed transaction under the Charter is required. Although any reasonable doubt as to the lawful existence of a particular power sought to be exercised must be resolved against the exercise thereof, it is clear here that the Charter authorizes JEA to consummate the Sale.

Article 21 of the City of Jacksonville Charter (the "Charter") provides plenary power to JEA to "manage, operate and promote the utilities system."[1] Among this, JEA may "enter into contracts with any person or entity, public or private, deemed necessary or desirable by JEA in connection with carrying out its powers and duties."[2] JEA may also "do all acts and deeds necessary, convenient or desirable, incidental to the exercise and performance of the powers and duties grated to JEA in this article."[3]

Article 21.04(d) authorizes JEA "to sell, lease or otherwise transfer, with or without consideration, any such property when in JEA's discretion it is no longer needed or useful, or such sale, lease or transfer otherwise is in the best interest of JEA, all upon such terms as JEA shall by resolution fix and determine."[4] The construction of this sentence indicates that JEA is granted the right to determine what is in its best interest, as the sentence should be read "to sell, lease or otherwise transfer...when in JEA's discretion...such sale, lease or transfer otherwise is in the best interest of JEA." Since "the governing body of JEA" is the Board, the Board possesses the discretion to determine whether a sale of JEA's property is in its best interest.[5] Therefore, JEA is authorized to consummate the Sale, provided the Board determines the Sale is in the best interest of JEA, subject to the additional conditions set forth below.

In addition to approval by the JEA Board, the Charter requires that the Sale be approved by the Jacksonville City Council and the voters in a referendum:

> Nothing in this article shall authorize or be construed to authorize JEA to transfer any function or operation which comprises more than ten percent of the total of the utilities

[1] Charter at s. 21.04(a).
[2] Charter at s. 21.04(e).
[3] Charter at s. 21.04(t).
[4] Charter at s. 21.04(d).
[5] Charter at s. 21.03(a).

system[6] by sale, lease or otherwise to any other utility, public or private without approval of the council; provided, however, that no approval by the council shall become effective without subsequent referendum approval of the terms and conditions of the sale.[7]

The voter referendum requirement was added to the Charter via Ordinance 2018-141-E in November 2018.

3. Ownership of a Subsidiary Company is Authorized Under the Charter

Because JEA proposes to consummate the Sale through the transfer of its assets to Buyer via a merger or stock sale of the JEA Sub, JEA must be authorized by its Charter to own equity in a subsidiary company. The Charter authorizes JEA "to have ownership and membership in separate organization entities, including but not limited to corporations, to conduct utility related activities and functions."[8] The below section analyzes whether the ownership of a subsidiary company by JEA in order to consummate the Sale is authorized by the Charter.

There is no explanation in the Charter or in the case law regarding what "utility related activities and functions" encompass. However, the Charter intends that "[t]he powers of JEA shall be construed liberally in favor of JEA" and that "JEA should have all implied powers necessary or incidental to carrying out the expressed powers and the expressed purposes for which JEA is created."[9] Additionally, the sale of the "utilities system" fits clearly within the very broad description of "utility related activities and functions." Because JEA is a utility and the sale of the utilities system is expressly authorized by the Charter, the Sale should be deemed a utility related activity and function.

Accordingly, the Charter authorizes JEA to form and own a subsidiary company in order to consummate the Sale.

4. The Sale Does Not Violate the Florida Constitution

Although authorized by the JEA Charter, the Sale must also not violate any of the laws of the State of Florida. Therefore, this section analyzes the Sale under the Florida Constitution,

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[6] "Utilities system means the electric utility system and the water and sewer utility system now operated by JEA which shall include, except where inconsistent with Chapter 80-513, Laws of Florida, as amended, or where the context otherwise requires, any "system" or "project" authorized pursuant to the provisions of Chapter 80-513, Laws of Florida, as amended and any natural gas utility system to be operated in the future by JEA together with any other additional utility systems as may be hereafter designated as a part of the utilities systems operated by JEA as provided in section 21.04(v) herein." Charter at s. 21.02(a).
[7] Charter at s. 21.04(p).
[8] Charter at s. 21.04(dd).
[9] Charter at s. 21.05.

specifically the prohibitions in Article VII, Section 10 against "pledging credit" to and becoming a stockholder of any private entity. We analyze each of those prohibitions in turn.

A. The Sale Does Not Constitute "Pledging Credit"

Article VII, Section 10 of the Florida Constitution prohibits JEA from becoming a "joint owner with, or stockholder of, or giv[ing], lend[ing] or us[ing] its taxing power or credit to aid any corporation, association, partnership or person."[10] The Florida Supreme Court in *Jackson-Shaw Co. v. Jacksonville Aviation Authority* traced the history and intent of this provision.[11] The Court noted that the predecessor to the current provision, Article IX, Section 10 of the 1885 Florida Constitution, was substantially similar to the current provision.[12] The Court further explained that, prior to the 1885 Florida Constitution, the Legislature was not prohibited "from authorizing local governments to provide public money to private business" and that, at the time, it was common to have a local government loan or invest funds in private companies.[13] For instance, local governments would often purchase stock in railroad companies, thus causing the local government (and ultimately the taxpayers) to be responsible when they were poorly managed.[14]

The intent of Article VII, Section 10 is to "protect public funds and resources from being exploited in assisting or promoting private ventures when the public would be most only incidentally benefitted."[15] Put another way, the provision was enacted to "keep the State out of private business; to insulate State funds against loans to individual corporations or associations and to withhold the State's credit from entanglement in private enterprise."[16]

With that background, the Florida Supreme Court has described the pledging of credit as follows:

> As used in Article VII, section 10, "credit" means "the imposition of some new financial liability upon the State or a political subdivision which in effect results in the creation of a State or political subdivision for the benefits of private enterprises. This Court has explained that the lending of public credit means:
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> [T]he assumption by the public body of some degree of direct or indirect obligation to pay a debt of the third party. Where there is no direct or indirect undertaking by the public body to pay the obligation from public funds, and no public property is placed in jeopardy by a default of the third party, there is no lending of public credit.

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[10] Art. VII, § 10, Fla. Const. (1968).
[11] 8 So.3d 1076 (Fla. 2008).
[12] *Id.* at 1085.
[13] *Id.* (internal citations omitted).
[14] *Id.* (internal citations omitted).
[15] *Id.* (internal citations omitted).
[16] *Id.* (internal citations omitted)

> Under this definition, we conclude that the COP's in this case do not contemplate a pledge of the District's credit, and that only a public purpose, and not a paramount public purpose, need be shown.[17]

Here, JEA is not assuming any direct or indirect obligation to pay a debt of the Buyer or any other third party by virtue of the Sale. No public property is placed in jeopardy by default of the third party. It simply is a transfer of assets from a public entity to a private for consideration.

Given that no credit is being pledged, Article VII, Section 10 requires only that a public purpose be met. Reasons cited, among others, for pursuing the Sale are increased efficiency, lowered customer rates and the use of the proceeds to substantially reduce the City of Jacksonville's debt.

B. The Sale Does Not Involve JEA Becoming a Stockholder of a Private Entity

Article VII, Section 10 also prohibits JEA from becoming "a joint owner with, or stockholder of... corporation, association, partnership or person."[18] The relevant portion of the Sale at issue here is the formation and ownership by JEA of the JEA Sub and whether that ownership violates the constitutional prohibition against JEA becoming a stockholder of a private entity. Although JEA is authorized by the Charter to own a subsidiary company, it may only do so "to the extent permitted by the laws of the State of Florida."[19] Therefore, authorization under the Charter alone is not sufficient to authorize JEA to form and own the JEA Sub to consummate the Sale.

As the Florida Supreme Court explained in *Jackson-Shaw Co.*, "in those cases in which we have directly addressed the prohibition against a public entity becoming a joint owner with, or stockholder of, a private entity we have been concerned with the nature of the relationship that would arise through a proposed arrangement."[20] In that case, the Court analyzed whether a lease of facilities by the Jacksonville Aviation Authority, a body politic and corporate like JEA, to a private company resulted in a violation of the constitutional prohibition against joint ownership. JEA is not at risk of becoming a joint owner with a private entity, since it will not share ownership of the JEA Sub with the Buyer at any point in the Sale or after. However, the emphasis on the nature of the relationship is still directly applicable to determining whether JEA would violate the prohibition on owning stock.

Although there is no case directly on point, the case law is instructive. In *State v. Dade County,* the Florida Supreme Court considered the appropriateness of a transaction in which Dade

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[17] *Miccouskee Tribe v. South Florida Water Management District,* 48 So.3d 811, 823 (Fla. 2010) (internal citations omitted).
[18] Art. VII, § 10, Fla. Const. (1968).
[19] Charter at s. 21.04(dd).
[20] *Jackson-Shaw Co. v. Jacksonville Aviation Authority*, 8 So.3d 1076, 1091 (Fla. 2008).

County proposed to acquire all of the stock of private corporations owning transit companies operating in the county.[21] Under the agreement at issue, the county would purchase all of the common stock of the transportation companies free and clear of all encumbrances and then promptly dissolve the corporations, resulting in the county becoming the owner of the transportation systems.[22]

The Court focused on the provisions of the agreement that the purchase of all of the stock of the companies was for the purpose of acquiring the companies in their entireties including all of their assets.[23] Noting that Article VII, section 10 of the Florida Constitution prohibits subdivisions of the state from becoming stockholders with others in any corporation, company or association, the Court concluded that the manner used by the county to acquire the companies was not prohibited by the spirit or letter of the Constitution.[24]

Similarly, the Attorney General advised the St. Johns Water Management District that it may purchase real property by buying a private, for-profit corporation and immediately dissolving the corporation in order to transfer fee title to the property to the district without violating Article VII, section 10 of the Florida Constitution.[25] The Attorney General specified that, to avoid the constitutional prohibition, the transaction should be "structured such that the district assumes no liabilities of the corporation."[26]

The Sale as contemplated is the inverse of *Dade County* and the St. Johns Water Management District. Instead of acquiring property by purchasing all of the equity of a private company and immediately dissolving such company, JEA will form and then immediately sell the equity, or cause a merger, of the JEA Sub to the Buyer. JEA will own the JEA Sub only for an instant as in order to transfer the assets to be acquired to the JEA Sub, then immediately after it will be sold to, or merged with, the Buyer.

Jackson-Shaw Co., *Dade County* and the St. Johns Water Management District Attorney General opinion provide support for our conclusion that it is more likely than not that a Florida court would hold that mere ownership of stock by a governmental entity does not violate the Constitution. Here, the ownership by JEA of the equity of the JEA Sub is an incidental step in accomplishing a greater purpose; ownership is not the purpose.

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[21] 142 So.2d 79 (Fla. 1962).
[22] *Id.*
[23] *Id.* at 88.

[24] *Id.*; *see Brautigam v. White*, 64 So.2d 781, 782–84 (Fla. 1953) (finding that a transaction by which a county would acquire title to lands owned by a private club by entering into a purchase agreement with the club's holders of "participating ownership certificates," acquiring the property, dissolving the club, and vesting title to the lands in the county did not violate the constitutional prohibition).
[25] Fla. AGO 98-20 (Fla. A.G.), 1998 WL 136171.
[26] *Id.*

Further, the split-second ownership by JEA does not fall within the scope of governmental financing of private enterprise that Article VII, section 10 seeks to prevent. While under the umbrella of JEA ownership, the JEA Sub is not a private entity. There is no concern that public funds will be at risk in order to assist private entities, and therefore no risk of any private debt being assumed by the taxpayer.

We note for Pillsbury's consideration that the constitutional prohibition against "pledging credit" may require special attention in connection with the transfer and assignment of executory contracts by JEA to the Buyer, regardless of whether the transaction is structured as a direct sale of assets or through the creation of JEA Sub followed by a merger or sale of securities.

If JEA is party to so-called "executory contracts" where both parties have continuing performance obligations that will survive the Sale, the assignment by JEA of the executory contract to the Buyer (or to the JEA Sub) generally will not relieve JEA of continuing contractual liability to the counterparty absent either special language in the contract providing for a release of JEA upon assignment or a release from the counterparty in connection with the sale.

We do not know whether JEA is subject to any such executory contracts. However, we believe Pillsbury should consider the issue as part of its examination of potential structures.