

SPRBs FOR PRIVATE SCHOOLS: PRACTICAL AND CONSTITUTIONAL CONSIDERATIONS

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Report No. 2, 2001

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State Capitol
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Internet: www.state.hi.us/lrb/

This report has been cataloged as follows:

Carter-Yamauchi, Charlotte A. and Fukumoto, Keith.

SPRBs for private schools: practical and constitutional considerations. Honolulu, HI:
Legislative Reference Bureau, January 2001.

1. Private schools - Finance - Law and legislation - Hawaii. 2. State bonds - Law and
legislation - Hawaii.

KFH421.5.L35 A25 01-2

FOREWORD

This report has been prepared in response to Act 259, Session Laws of Hawaii 2000, which requests the Legislative Reference Bureau to conduct a study on how independent schools can work together to create a consortium to finance the construction and renovation of educational facilities at independent not-for-profit elementary schools, secondary schools, universities, and colleges. The Bureau's study is to include the following:

- (1) Conducting a survey of how other states finance the construction and renovation for both private sectarian and private non-sectarian elementary, secondary, and post-secondary schools;
- (2) Researching and determining applicable federal and state case law on this issue; and
- (3) Working with the Hawaii Association of Independent Schools and other stakeholders (*e.g.*, the Hawaii Catholic Schools Department) to determine their interests in using special purpose revenue bonds (SPRBs) to finance construction and renovation of their facilities.

The Bureau would like to thank the Department of the Attorney General, the Department of Budget and Finance, the Hawaii Association of Independent Schools, the Hawaii Catholic Schools Department, Standard and Poor's, Moody's Investors Service, and Fitch, Incorporated for giving its researchers access to their staff and resources. In addition, the Bureau would like to express its appreciation to the many individuals who participated in the Bureau's telephone survey and patiently attempted to explain the principles, complexities, and subtleties of municipal securities.

Wendell K. Kimura
Acting Director

January 2001

Fact Sheet

SPRBs FOR PRIVATE SCHOOLS: PRACTICAL AND CONSTITUTIONAL CONSIDERATIONS

I. Highlights

Feasibility of special purpose revenue bonds (SPRBs).

Authorizing the issuance of SPRBs to assist private nonprofit grade schools, and universities and colleges with their capital improvement projects may not provide the desired assistance to all the institutions that need or want it. Some schools will benefit from the issuance of SPRBs, others will not. Special purpose revenue bonds are loans that must be repaid promptly and with interest; and not all loan applicants may be considered adequately creditworthy. Despite these limitations, private nonprofit grade schools, and universities and colleges could benefit from the authorization of joint issuance techniques such as composite issues and bond pools, in addition to stand alone techniques.

II. Frequently Asked Questions

A. Would private school SPRBs take money directly away from public schools?

No. Because investors provide the money that is actually loaned to a private business for a capital improvement project, and because the principal of and interest on the loan (*i.e.*, the SPRBs) are paid by the private business, it is inaccurate to imply that private school SPRBs would take money directly away from public schools. Selling SPRBs is a way for the State to loan funds (for private business projects that are found to be in the public interest by the Legislature) without actually having to spend taxpayers' money. It should be noted, however, that the tax exempt status of SPRBs means that less income taxes would be collected by the State from Hawaii taxpayers (as compared to the issuance of taxable bonds). While the loss of state income tax revenues would not take money directly away from public schools, it would result in the loss of revenues for all state programs, including public schools, whenever private school SPRBs are purchased by Hawaii taxpayers. The loss of state income tax revenues would be less than—not equal to—the amount of SPRBs sold by the State.

It is important to stress that the purchase of private school SPRBs would result in a loss of state income tax revenues only when these bonds are purchased by Hawaii taxpayers. The purchase of private school SPRBs by out-of-state investors would not result in the loss of state income tax revenues (for Hawaii) unless these out-of-state investors also paid Hawaii state income taxes.

B. Would special purpose revenue bond financing for private schools, including sectarian schools, violate the First Amendment’s Establishment Clause?

Establishment Clause challenges have been determined on a fact specific basis. The rationale of *Hunt, Johnson, and Virginia College Building Authority* seem persuasive that tax-exempt revenue bond financing is a “special type of aid” that defies simple categorization as either direct or indirect government aid. Regardless of how it ultimately may be categorized, however, it would appear that a carefully crafted tax-exempt bond financing program to assist religious schools could withstand an Establishment Clause challenge. Moreover, given the United States Supreme Court’s recent rulings, there are a number of factors, while not exhaustive, that would appear to be significant in analyzing any future Establishment Clause challenge to government school aid programs generally. Thus, for example, a tax-exempt bond financing program could be devised with the following characteristics: has a clear secular purpose; determines aid eligibility in a nondiscriminatory manner on the basis of neutral secular criteria; makes aid available to religious and nonreligious schools alike on the basis of neutral secular criteria; imposes sufficient use restrictions and other safeguards to ensure that neither the funds nor the facilities constructed or improved with the funds will be used only for sectarian purposes and yet avoids excessive entanglement; requires that aid be supplemental to funds otherwise available to the religious school; and contains sufficient disclaimers of any endorsement of the religious practices or beliefs of the school.

C. Would special purpose revenue bond financing for private schools, including sectarian schools, violate Article X, section 1, of the Hawaii Constitution prohibiting the appropriation of public funds for the support or benefit of any sectarian or private educational institution?

Hawaii case law provides little guidance as to what constitutes “public funds” generally. In *Hunt v. McNair* (upholding tax-exempt revenue bond financing for the benefit of religiously affiliated educational institutions), the United States Supreme Court recognized (in dictum) that this type of “state aid” is of a “very special sort” Although notable exceptions, the prevailing view of authority in other jurisdictions appears to be that the issuance of special purpose revenue bonds does not involve the use of public funds. Furthermore, nearly half of the states permit the use of special purpose revenue bonds or some type of conduit bond to assist private educational facilities.

However, in *Spears v. Honda*, the Hawaii Supreme Court found an “unequivocal” constitutional prohibition on public aid, based upon the framers’ “clear cut” intent to ensure support of the public schools and protection from any public assistance that would “build up, strengthen and make successful the private schools” at the expense of public schools. Moreover, the court in *Spears* concluded that “the

State has totally denied itself the power to make appropriations aiding private and sectarian schools under Article IX, Section I.” Despite the persuasive view of other jurisdictions, the present day court, if faced with the issue, may be compelled to decide the issue consistent with Spear’s finding of the “clear” intent underlying Article X, section 1. Finally, prior legislative action in seeking a constitutional amendment to Article X, section 1, to permit the issuance of special purpose revenue bonds to be used to finance or assist early childhood education care and facilities provided to the general public by not-for-profit corporations will be viewed in all likelihood as persuasive evidence of legislative recognition that “special purpose revenue bonds are considered public funds.”

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Chapter 1

Introduction

Act 259, Session Laws of Hawaii 2000, requests the Legislative Reference Bureau to conduct a study on how independent schools can work together to create a consortium to finance the construction and renovation of educational facilities at independent not-for-profit elementary schools, secondary schools, universities, and colleges. (See Appendix A) The Bureau's study is to include the following:

- (1) Conducting a survey of how other states finance the construction and renovation for both private sectarian and private non-sectarian elementary, secondary, and post-secondary schools;
- (2) Researching and determining applicable federal and state case law on this issue; and
- (3) Working with the Hawaii Association of Independent Schools and other stakeholders (*e.g.*, the Hawaii Catholic Schools Department) to determine their interests in using special purpose revenue bonds (SPRBs) to finance construction and renovation of their facilities.

This report is divided into two parts. Part I, which consists of chapters 2 to 5, deals with methods for financing the construction and renovation for private sectarian and private non-sectarian elementary, secondary, and post-secondary schools. Part II, which consists of chapters 6, 7, and 8, deals with the applicable federal and state case law on this issue, and summary and conclusions.

Chapter 2 familiarizes the reader, at a very general level, with terms that are used in the municipal bond market. This chapter explains what happens after the Legislature authorizes the issuance of municipal bonds (*i.e.*, SPRBs).

Chapter 3 discusses other funding mechanisms that could be used to assist private nonprofit schools that cannot qualify for SPRBs or that are unwilling to make a binding, long-term commitment to repay the principal of and interest on a loan, to finance capital improvement projects.

Chapter 4 familiarizes the reader, at a very general level, with some financing techniques that can be used by the State to reduce the costs of issuing SPRBs on behalf of 501(c)(3) organizations. This chapter explains some of the distinguishing features, as well as the relative advantages and disadvantages, of these financing techniques.

Chapter 5 informs the reader, in very general terms, about the extent to which tax-exempt municipal bonds have been issued on behalf of private nonprofit grade (*i.e.*, elementary and secondary) schools in other states, the ratings that were assigned to these bonds and the criteria

that were used to determine these ratings, and the outlook for issuing additional tax-exempt bonds in the foreseeable future.

Chapter 6 examines applicable case law relating to First Amendment Establishment Clause issues under the United States Constitution as they pertain to government school aid programs.

Chapter 7 reviews relevant Hawaii constitutional and statutory provisions, as well as applicable Hawaii case law, pertaining to state assistance to private sectarian and nonsectarian schools, primarily through the use of special purpose revenue bonds to finance construction and renovation of educational facilities.

Chapter 8 provides a summary and our conclusions.

Chapter 2

BONDS, MUNICIPAL BONDS, AND SPECIAL PURPOSE REVENUE BONDS

Introduction

The purpose of this chapter is to familiarize the reader, at a very general level, with terms that are used in the municipal bond market. This chapter attempts to explain what happens after the Legislature authorizes the issuance of municipal bonds. It does not discuss the mechanics of selling these bonds, which is an operation performed by qualified professionals within State and county government and within the municipal bond industry. A more detailed explanation of the municipal bond market is contained in publications such as *Fundamentals of Municipal Bonds (4th edition)*, by the Public Securities Association (which is now known as the Bond Market Association).

What Is A Municipal Bond?

A “bond” is a written promise to pay a specified sum of money (*i.e.*, the principal amount) at a specified time in the future (*i.e.*, the maturity date) and to periodically pay interest at a specified rate (*i.e.*, the coupon rate), in return for a loan. A “municipal bond” is a bond that is issued by the State or a county, or by an authority or agency of the same.

What Are Municipal Bonds Used For?

Municipal bonds are usually issued (*i.e.*, sold) to pay for capital improvement projects such as highways, schools, and housing. Capital improvement costs include plans, land acquisition, design, and construction, as well as the cost of initial, built-in equipment (*e.g.*, walk-in refrigerators) and necessary, common use furnishings (*e.g.*, student desks). Capital improvement projects are generally intended for long-term use or ownership (*e.g.*, twenty-five years) and are relatively permanent in nature. Capital improvement costs do not include operating, repair, or maintenance costs, nor do they include the cost of new or replacement equipment and furnishings for existing facilities.

Major renovations, including additions or improvements to, or the conversion of, existing facilities, qualify as capital improvement projects. Repair and maintenance work that does not involve the conversion of a facility from one type of use to another does not qualify as a capital improvement project.

Why Are Municipal Bonds Used?

The financing of capital improvement projects with borrowed moneys—a method labeled “pay-as-you-use”—allows present and future generations of facility users to share in the cost of building a facility (e.g., a prison or swimming pool) that is used over a long period of time. On the other hand, the financing of these projects with current revenues (i.e., “cash-on-hand”)—a method labeled “pay-as-you-go”—prevents future generations of facility users from being burdened with a previous generation’s binding commitment to repay the principal of and interest on a loan.

What Types Of Municipal Bonds Are There?

In Hawaii, there are two broad classes of municipal bonds based on the level of security that is pledged to support them: general obligation bonds and revenue bonds. A general obligation (GO) bond is backed by the “full faith and credit” of the State or a county. In other words, the State or a county is pledging its full taxing powers to guarantee the prompt payment of the principal of and interest on the GO bonds, as they become due. On the other hand, a revenue bond is backed solely by the income of a revenue-producing enterprise (e.g., the airports system). Unlike GO bonds, revenue bonds are not backed by the full faith and credit of the State or a county. All other things being equal, GO bonds are more secure (i.e., safer) investments than revenue bonds. Since interest rates increase as the risk of nonpayment increases, GO bonds command lower interest rates than revenue bonds.

What Are Special Purpose Revenue Bonds?

Article VII, section 12 of the state constitution allows the Legislature to authorize the issuance of four types of bonds: general obligation bonds, revenue bonds, bonds issued under special improvement statutes (e.g., special assessment bonds issued under chapter 47C, *Hawaii Revised Statutes*, and improvement district bonds issued under section 206E-6, *Hawaii Revised Statutes*), and special purpose revenue bonds. Special purpose revenue bonds (SPRBs) are a type of revenue bond that can be issued by the State to assist:

- (1) Manufacturing, processing, or industrial enterprises;
- (2) Utilities serving the general public;
- (3) Health care facilities provided to the general public by nonprofit corporations;
- (4) Early childhood education and care facilities provided to the general public by nonprofit corporations; and
- (5) Low and moderate income government housing programs.

Special purpose revenue bonds are issued by the State in order to make capital improvement loans available to private businesses, at interest rates that are lower than the rates offered by commercial lenders. The State makes a capital improvement loan by selling SPRBs to private investors, who actually provide the money for a capital improvement project and bear the risk of nonpayment in return for interest payments that are exempt from both federal and state income taxation. For the State, selling SPRBs is a way to loan public funds (for certain categories of private business projects that are found to be in the public interest by the Legislature) without actually having to spend taxpayers' money. In return for a loan, a private business must either pledge to repay the loan, or provide a guaranty concerning the prompt payment of the principal of and interest on the SPRBs.

In other states, SPRBs are sometimes referred to as “industrial development bonds” or “IDBs”.

What Are Some Of The Advantages And Disadvantages Of SPRBs?

Because the interest on SPRBs is exempt under applicable federal and state income tax laws, investors are willing to loan money at lower than usual interest rates. Issuers can obtain loans that are up to two percentage points—or twenty-five percent—below commercial (interest) rates because of these income tax exemptions. A lower interest rate results in lower costs to the private business on whose behalf SPRBs have been issued.

Although the State can sell SPRBs, there is no guarantee that investors will buy them. The creditworthiness of a private business is probably the single largest obstacle to the sale of SPRBs. In the world of finance, applying for a loan is not the same as qualifying for a loan.

By the same token, some private businesses may avoid having the Department of Budget and Finance issue SPRBs on their behalf because they create a binding, long-term commitment to repay the principal of and interest on a loan. Financing capital improvement projects with current revenues or through continuous fundraising is still practiced by many businesses because it provides them with a great deal of financial flexibility during hard economic times. Employee costs are flexible, a businesses' commitment to promptly repay the principal of and interest on SPRBs is not.

How Are SPRBs Issued?

Figure 1 illustrates the process of issuing SPRBs in Hawaii. The main players in this process are the project party (*e.g.*, a private hospital), the Legislature, the Department of Budget and Finance (*i.e.*, the issuer), the underwriter, the underwriter's counsel, the investors, and the trustee. Other key players include a bond counsel (*i.e.*, lawyer) and—on a case-by-case basis—a bond insurance company or letter of credit bank. The following paragraphs describe the role of each player in the process.

Bond counsel. A lawyer, with expertise in bond law, who writes a legal opinion addressing two principal areas of concern to investors and the underwriter: first, that the bonds are legal, valid, and binding obligations of the issuer under applicable state laws and, second, that the interest on the bonds is exempt under applicable federal and state income tax laws.

Bond insurance. An insurance policy guaranteeing the prompt payment of principal of and interest on a bond issue. The cost of bond insurance is usually paid by the party responsible for the prompt payment of the principal of and interest on the bonds. Bond insurance is not purchased unless its cost will be more than offset by the lower interest rate that will result from the use of the insurance, or unless the creditworthiness of the party responsible for the prompt payment of the principal of and interest on the bonds is considered a cause for concern. All other things being equal, insured bonds command higher ratings and lower interest rates than uninsured bonds. A letter of credit from a bank or other lending institution serves the same purpose as bond insurance.

Unlike bond insurance policies, which are usually issued for twenty to thirty years (or until all the bonds have matured), letters of credit are usually issued for only three to seven years. If a letter of credit is not renewed and if a satisfactory substitute (*e.g.*, another letter of credit or a bond insurance policy) cannot be found before the existing letter of credit expires, the bonds may have to be redeemed if the bond documents require the trustee to take this action.

The rating of bonds that are backed by bond insurance policies or letters of credit reflect the creditworthiness of the insurer (*e.g.*, AMBAC Indemnity Corporation), not the creditworthiness of the issuer (*e.g.*, in the Hawaii state government, the Department of Budget and Finance).

Investor. A person who buys a bond issue in return for periodic payments of principal and (tax exempt) interest. Investors provide the money that is actually loaned to a private business for a capital improvement project. The principal characteristic of all investors is that they are in a sufficiently high tax bracket that they can benefit from federal and state income tax exemptions. “Bondholders” are “investors”, and vice-versa.

Issuer. The public entity that is named as the issuer of a bond (*i.e.*, in the Hawaii state government, the Department of Budget and Finance). The public entity is the “issuer” even in those cases where the actual source of the money to pay the principal of and interest on the bonds is to be an entity other than the issuer (*e.g.*, a private hospital). The issuer borrows money through the sale of bonds and loans it to a business.

Paying agent. A bank or government office that is designated by the issuer of a bond to receive payments of principal and interest from the project party, and to make payments of principal and interest to investors.

Rating agency. An agency that rates a bond issue according to what the agency believes is the bond’s relative creditworthiness. Three well known rating agencies in the municipal bond market are Moody’s Investors Service, Standard & Poor’s Corporation, and Fitch Incorporated. A bond’s rating (*i.e.*, creditworthiness) can be improved through the use of bond insurance or a

letter of credit, which in turn can result in lower risks for investors and lower interest rates for issuers.

Securities firm. A company that handles financial transactions which involve the trading of stocks, bonds, notes, mortgages, commodities, currency, warrants, debentures, and other documents representing debt or an interest in property.

Trustee. A bank or trust company designated by the issuer of a bond to act as the custodian of funds and the official representative of the bondholders (*i.e.*, investors). The trustee acts as the go-between for investors (*i.e.*, bondholders) and the business that makes payments of interest and principal on the loan. In the event the business is unable to promptly pay the principal of and interest on the bonds, the trustee has the power to declare a “default” and make the payment with moneys from a bond insurance policy or letter of credit, or take other actions authorized by the bond documents.

Underwriter. A securities firm that facilitates the sale of bonds that will be offered to the public by purchasing the bonds from the issuer and then reselling them to investors. By promising to purchase the bonds from the issuer at a set price, whether this price is determined through a competitive or negotiated sale, the underwriter guarantees the issuer a known amount of proceeds (*i.e.*, money) and a fixed borrowing cost (*i.e.*, interest rate).

Underwriter’s counsel. A lawyer who represents the underwriter, takes part in discussions concerning the bond documents, and prepares or reviews disclosure documents required by the antifraud provisions of the federal securities laws.

The main difference between the issuance of SPRBs and the issuance of GO bonds in Hawaii is that the Department of Budget and Finance exercises its option to act as paying agent for the bondholders (*i.e.*, investors) when the Department issues GO bonds. Although the Department of Budget and Finance has the option to act as paying agent for the bondholders when the Department issues SPRBs, it does not exercise this option. For the purposes of discussion only, the duties of a “trustee” (with respect to the issuance of SPRBs) are considered to be the same as the duties of a “paying agent” (with respect to the issuance of GO bonds). The term “paying agent” is used in this paragraph, however, as it more accurately describes the duties of the Department of Budget and Finance when the Department issues GO bonds. In the case of SPRBs, either the trustee or the Department of Budget and Finance, or both, can declare a business to be in default on the bonds.

Is There A Limit On Issuing SPRBs?

Yes. In order for the interest on SPRBs to be exempt from federal and state income taxation, the SPRBs must qualify under the provisions of the Internal Revenue Code of 1986, as amended. The interest on SPRBs is exempt from federal and state income taxation if the SPRBs are considered qualified (private activity) bonds or, for the purposes of discussion only, qualified 501(c)(3) bonds. The interest on SPRBs is subject to federal and state income taxation if the SPRBs are not considered qualified bonds and if the sale of these SPRBs (*i.e.*, the one’s which

are not considered qualified bonds) will cause the State to exceed its private activity bond volume cap for the calendar year. For the purposes of discussion only, a private activity bond is a SPRB that is used for purposes or secured by property or payments unrelated to the trade or business of a 501(c)(3) (i.e., private nonprofit) organization or a government agency.

A SPRB is considered a qualified (private activity) bond or, for the purposes of discussion only, a qualified 501(c)(3) bond if all of the following conditions are met:

- (1) All of the property to be purchased with the net proceeds of the bond issue (i.e., gross proceeds minus allowable issuance expenses) will be owned by a 501(c)(3) organization or a government agency;
- (2) *Private business use test:* not more than five percent of the net proceeds of the bond issue will be used to purchase property for purposes that are unrelated to the trade or business of the 501(c)(3) organization or the government agency; and
- (3) *Private security or payment test:* not more than five percent of the net proceeds of the bond issue will be secured by property or payments that are unrelated to the trade or business of the 501(c)(3) organization or the government agency.

Proceeds used to pay issuance expenses may not exceed two percent of the face amount of a qualified 501(c)(3) bond issue. A trade or business that is unrelated to the trade or business of a 501(c)(3) organization or a government agency is considered a private business use. For example, a parking structure built for the employees of a 501(c)(3) organization may meet the private business use test if three of the four levels in the structure are rented to surrounding businesses. Similarly, the parking structure may meet the private security or payment test if seventy-five percent of the principal and interest payments for the bond issue will come from individuals who are not employed by the 501(c)(3) organization.

Federal law sets a “volume cap” (i.e., dollar limit) on the amount of (nonqualified) private activity bonds that can be issued by a state and its political subdivisions each calendar year. For the State of Hawaii as a whole, the cap is \$150,000,000: 50 percent of which (or \$75,000,000) is allocated to the State, 37.55 percent of which (or \$56,325,000) is allocated to the City and County of Honolulu, 5.03 percent of which (or \$7,545,000) is allocated to the County of Hawaii, 2.41 percent of which (or \$3,615,000) is allocated to the County of Kauai, and 5.01 percent of which (\$7,515,000) is allocated to the County of Maui. The volume cap applies to the sale of private activity bonds that are not considered qualified bonds. The volume cap does not apply to the sale of qualified 501(c)(3) bonds.

Would Private School SPRBs Take Money Directly Away From Public Schools?

No. Because investors provide the money that is actually loaned to a private business for a capital improvement project, and because the principal of and interest on the loan (i.e., the SPRBs) are paid by the private business, it is inaccurate to imply that private school SPRBs would take money directly away from public schools. As previously mentioned, selling SPRBs

is a way for the State to loan public funds (for private business projects that are found to be in the public interest by the Legislature) without actually having to spend taxpayers' money. It should be noted, however, that the tax exempt status of SPRBs means that less income taxes would be collected by the State from Hawaii taxpayers (as compared to the issuance of taxable bonds). While the loss of state income tax revenues would not take money directly away from public schools, it would result in the loss of revenues for all state programs, including public schools, whenever private school SPRBs are purchased by Hawaii taxpayers. The loss of state income tax revenues would be less than—not equal to—the amount of SPRBs sold by the State.

It is important to stress that the purchase of private school SPRBs would result in a loss of state income tax revenues only when these bonds are purchased by Hawaii taxpayers. The purchase of private school SPRBs by out-of-state investors would not result in the loss of state income tax revenues (for Hawaii) unless these out-of-state investors also paid Hawaii state income taxes.

Would Private School SPRBs Increase Competition For An Allocation Of The Volume Cap?

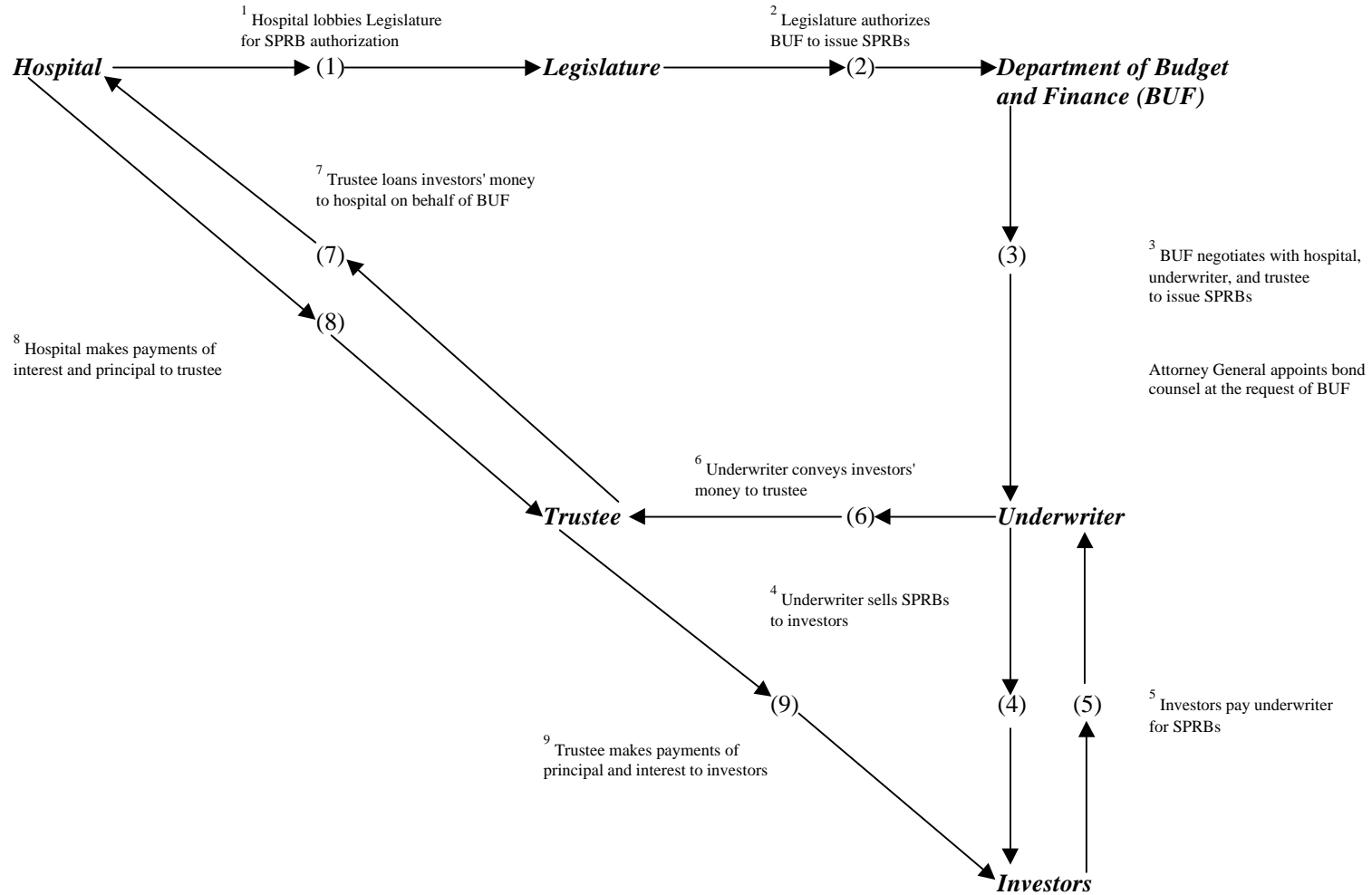
No, not if the private school SPRBs are structured properly to constitute qualified *501(c)(3)* bonds. As previously discussed, qualified *501(c)(3)* bonds do not require an allocation of the State's private activity bond volume cap in order for the interest on the qualified bonds to be considered exempt from federal and state income tax laws. Private school SPRBs would increase competition for an allocation of the volume cap only if the SPRBs are not considered qualified (private activity) bonds or qualified *501(c)(3)* bonds.

As of July 1, 1999, there are \$494,730,000, in authorized but unissued SPRBs that are subject to the private activity bond volume cap. Using the figure of \$75,000,000, per year as the State's portion of the private activity bond volume cap, it would appear that the Legislature has authorized more than six years worth of SPRBs that are subject to the volume cap. As a practical matter, the sale of SPRBs to benefit private nonprofit schools should be structured to avoid the need for an allocation of the State's limited volume cap and, consequently, unnecessary competition with utilities and industrial, manufacturing, and processing enterprises that require an allocation of the cap. This competition could delay the issuance of SPRBs, and thereby delay the construction of private school facilities, for up to six years.

Can A *501(c)(3)* Organization Issue Tax-Exempt Bonds?

No. A *501(c)(3)* organization is not a state entity or a political subdivision of a state and does not have any of the criteria that would allow it to issue tax-exempt bonds. These criteria are: police power, right of eminent domain (*i.e.*, the power to take private property for public use), and taxing power. A *501(c)(3)* organization would need a tax-exempt issuer or conduit—such as a city, a county, or a state entity—to issue tax-exempt bonds on behalf of the *501(c)(3)* organization.

Flowchart for Issuance of Special Purpose Revenue Bonds (SPRBs)



Chapter 3

OTHER FUNDING MECHANISMS

As previously mentioned in Chapter 2, financing capital improvement projects with current revenues or through continuous fundraising is still practiced by many private businesses because it provides them with a great deal of financial flexibility during hard economic times. Employee costs are flexible, a businesses' commitment to promptly repay the principal of and interest on special purpose revenue bonds (SPRBs) is not.

The purpose of this chapter is to discuss other funding mechanisms that could be used to assist private nonprofit schools that cannot qualify for SPRBs or that are unwilling to make a binding, long-term commitment to repay the principal of and interest on a loan, to finance capital improvement projects. This chapter is based on the assumption that the Legislature will address the following areas of concern:

- (1) Article VII, section 4 of the state constitution, which allows taxes to be levied, public money and property to be appropriated, and the public credit to be used, only for a "public purpose"; and
- (2) Article X, section 1 of the state constitution, which prohibits the appropriation of "public funds" for the support or benefit of sectarian or private educational institutions.

Grants

For the purposes of discussion only, a "grant" or "grant-in-aid" is money given by the Legislature to a private nonprofit organization (via a state agency such as the Department of Human Services) for a specific capital improvement project. Unlike SPRBs, which are loans and have to be repaid, grants are gifts and do not have to be repaid. There are, however, certain conditions placed on the use of facilities financed with state grant moneys. (A discussion of these conditions, which can include giving the State a security interest in the improvement, is beyond the scope of this study.) In the past, the Legislature has authorized the issuance of general obligation (GO) bonds to provide capital improvement grants to *501(c)(3)* organizations. For example:

- (1) Boys and Girls Club of Honolulu (Act 289, Session Laws of Hawaii 1993, item F-1), \$500,000;
- (2) Susannah Wesley Community Center (Act 252, Session Laws of Hawaii 1994, item F-1A), \$500,000;
- (3) Child and Family Service, Ewa Family Center (Act 252, Session Laws of Hawaii 1994, item F-4B), \$3,333,000; and

- (4) Maui Youth and Family Services, Campus Support Building (Act 116, Session Laws of Hawaii 1998, item F-2), \$2,000,000.

Because the State's ability to issue GO bonds is limited by Article VII, section 13 of the Hawaii constitution, grants of GO bond funds may compete with other public work projects (*e.g.*, public schools) for a portion of the State's debt limit. Similarly, because the principal of and interest on GO bonds is paid from current revenues, grants of GO bond funds may decrease the amount of moneys available for other government programs (*e.g.*, public education). On the other hand, grants of GO bond funds would make it possible for the Legislature to assist private nonprofit schools that cannot qualify for SPRBs or that are unwilling to make a binding, long-term commitment to repay the principal of and interest on a loan, to finance capital improvement projects.

The inability to qualify for SPRBs or the unwillingness to make a binding commitment to repay a loan, may have something to do with the fact that no SPRBs have been issued to assist nonprofit corporations that provide early childhood education and care facilities to the general public. The constitutional amendments making it possible to assist these nonprofit corporations were ratified, and the statutory provisions implementing the amendments became law, on November 8, 1994—more than six years ago. A funding mechanism based solely on SPRBs may not assist the most needy private nonprofit schools in the State.

Figure 2 illustrates the process of issuing GO bonds in Hawaii to make capital improvement grants. The main difference between the issuance of GO bonds and the issuance of SPRBs in Hawaii is that the Department of Budget and Finance exercises its option to act as paying agent for the bondholders (*i.e.*, investors) when the Department issues GO bonds. Although the Department of Budget and Finance has the option to act as paying agent for the bondholders when the Department issues SPRBs, it does not exercise this option. For the purposes of discussion only, the duties of a "paying agent" (with respect to the issuance of GO bonds) are considered to be the same as the duties of a "trustee" (with respect to the issuance of SPRBs). The term "paying agent" is used in this paragraph, however, as it more accurately describes the duties of the Department of Budget and Finance when the Department issues GO bonds.

As previously mentioned in Chapter 2, a trustee is a bank or trust company designated by the issuer of a bond to act as the custodian of funds and the official representative of the bondholders (*i.e.*, investors). The trustee acts as the go-between for investors (*i.e.*, bondholders) and the business that makes payments of interest and principal on the loan. In the event the business is unable to promptly pay the principal of and interest on the bonds, the trustee has the power to declare a "default" and make the payment with moneys from a bond insurance policy or letter of credit, or take other actions authorized by the bond documents.

Tax Exempt 501(c)(3) Lease-Purchase Agreements Securitized Through Certificates Of Participation

A securitized 501(c)(3) lease-purchase agreement is a form of financing in which rent payments, consisting of both principal and tax-exempt interest, are made by a 501(c)(3) organization to investors, based on each investor's share of the lease-purchase agreement, as determined by the investor's ownership of certificates of participation (COPs) in the agreement. The following paragraphs describe the concepts of "securitization" and "certificates of participation", and the role of the "vendor", as they relate to 501(c)(3) lease-purchase agreements.

Certificates of participation. A method for selling a tax-exempt lease-purchase agreement to individual investors by dividing the rental payments and the lease-purchase agreement into fractionalized interests or shares. Each share is represented by a formal certificate, much like a bond, and entitles an investor to periodic payments of principal and tax-exempt interest (*i.e.*, rent). For all intents and purposes, COPs function like municipal bonds.

Securitization. A way for vendors to manage the risks of loaning personal property or real estate to 501(c)(3) organizations. Selling a lease-purchase agreement to investors transfers the risk of nonpayment from the vendor to the investors. The vendor receives immediate payment for the personal property or real estate leased to the 501(c)(3) organization, and the investors receive periodic payments of principal and tax-exempt interest (*i.e.*, rent) from the 501(c)(3) organization for the use of the leased personal property or real estate.

Vendor. The seller or supplier of personal property (*e.g.*, equipment) or real estate (*e.g.*, land, buildings, and other improvements).

Although securitized 501(c)(3) lease-purchase agreements have many characteristics in common with SPRBs, lease-purchase agreements can be terminated. A lease-purchase agreement can be terminated by:

- (1) Failing to make the payments due under the agreement, a situation referred to as "default"; and
- (2) Paying the outstanding principal balance before it is due under the agreement, a situation referred to as "early payment".

If a lease-purchase agreement is terminated due to default, the leased property is repossessed and leased or sold to another person, and proceeds from the lease or sale of the repossessed property are paid to investors. When a lease-purchase agreement is terminated due to early payment, investors receive the balance of their outstanding principal but no interest.

Lease-purchase agreements may contain "non-substitution" (of assets) clauses that are intended to prohibit the replacement of leased property with any other assets for the same purpose, for a specified period of time. For example, a private nonprofit college enters into a seven-year lease-purchase agreement to acquire a bus to transport its athletes to and from

intercollegiate games. Two years into the college's lease-purchase agreement, a private nonprofit grade school with a practically identical bus declares bankruptcy and liquidates its assets for pennies-on-the-dollar. A non-substitution clause would prohibit the college from terminating its lease-purchase agreement and purchasing the bankrupt school's bus for a specified period of time (*e.g.*, two years), if the purchased bus would be used to transport the college's athletes to and from intercollegiate games.

Because lease-purchase agreements can be terminated due to default, investors may choose to limit their investments only to property that is deemed absolutely essential (*i.e.*, indispensable) to the daily operations of a private nonprofit grade school, or university or college. The non-essential nature of some property (*e.g.*, a bus to transport high school athletes to and from interscholastic games) may limit the use of securitized 501(c)(3) lease-purchase agreements with respect to those properties.

Figure 3 illustrates (in theory) the process of entering into a generic securitized 501(c)(3) lease-purchase agreement through certificates of participation. Although the State can enter into municipal lease-purchase agreements (*e.g.*, the Kakuhewea building in Kapolei, Oahu), it presently does not have the authority to enter into 501(c)(3) lease-purchase agreements (see chapter 37D, *Hawaii Revised Statutes*, relating to the management of financing agreements).

Credit Enhancement

As previously mentioned in Chapter 2, bond insurance is a policy that guarantees the prompt payment of principal of and interest on a bond issue. All other things being equal, insured bonds command higher ratings and lower interest rates than uninsured bonds. A letter of credit from a bank or other lending institution serves the same purpose as bond insurance. In addition to purchasing bond insurance for a municipal bond issue, the State has the power to guarantee the prompt payment of principal of and interest on a municipal bond issue. Alternatively, the State has the power to guarantee the reimbursement of any amounts expended by a bond insurance company to pay the principal of or interest on a municipal bond issue. For example, the State recently guaranteed \$47,500,000, in revenue bonds that may be issued by the Hawaii Health Systems Corporation (HHSC) (see Act 279, Session Laws of Hawaii 2000). Alternatively, the State guaranteed the reimbursement of any amounts that may be expended by a bond insurance company to pay the principal of or interest on the HHSC's revenue bond issue. The State's guaranty is considered a general obligation, and backed by its full faith and credit. The need for a guaranty from the State raises a very important point about bond insurance—not everyone is insurable, at reasonable rates.

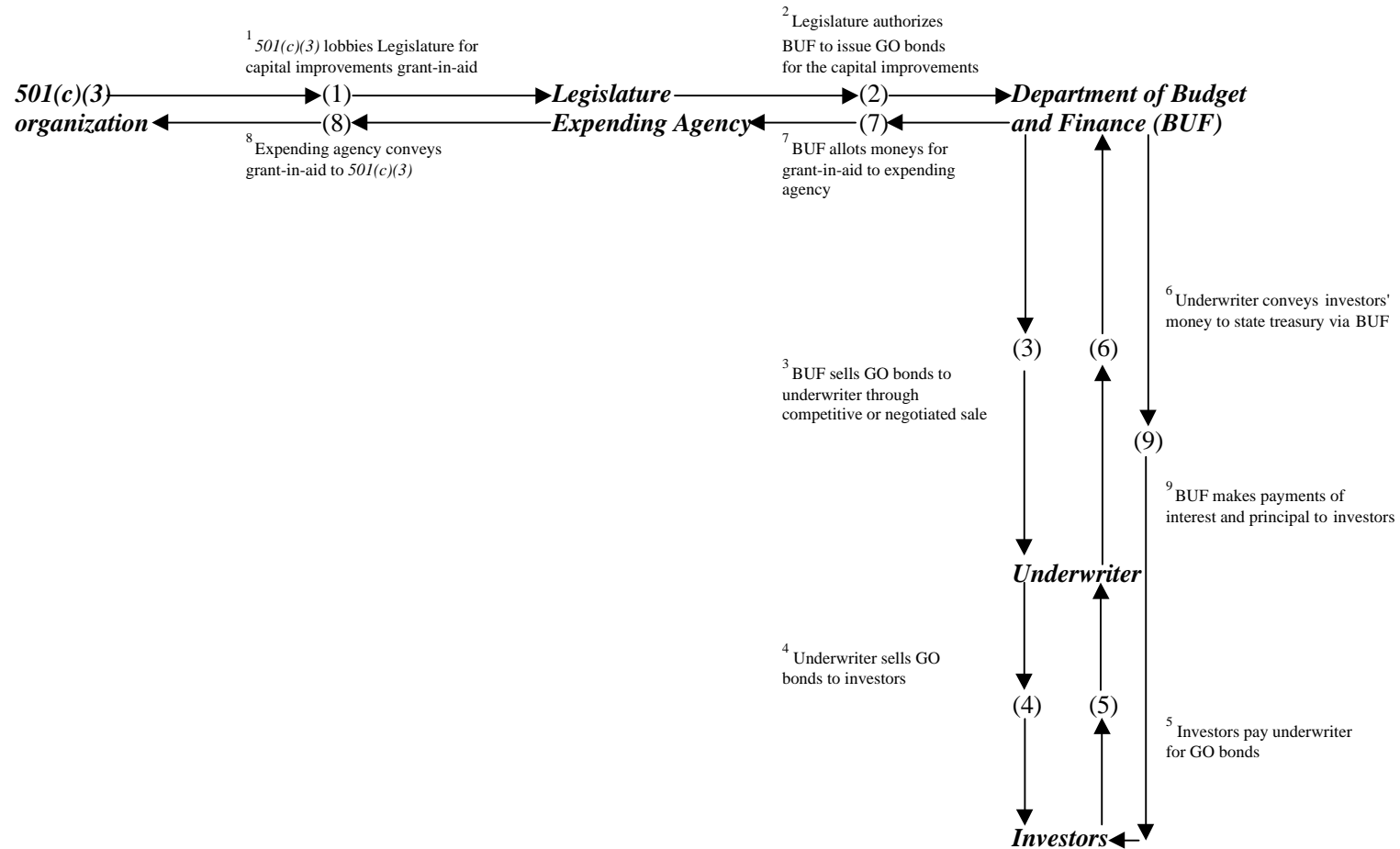
Article VII, section 12 of the state constitution, however, presently prohibits the State from guaranteeing a SPRB issue:

No special purpose revenue bonds shall be secured directly or indirectly by the general credit of the issuer or by any revenues or taxes of the issuer other than receipts derived from payments by a person under contract or from any security for such contract or special purpose revenue bonds and no moneys other than such receipts shall be applied to the payment thereof.

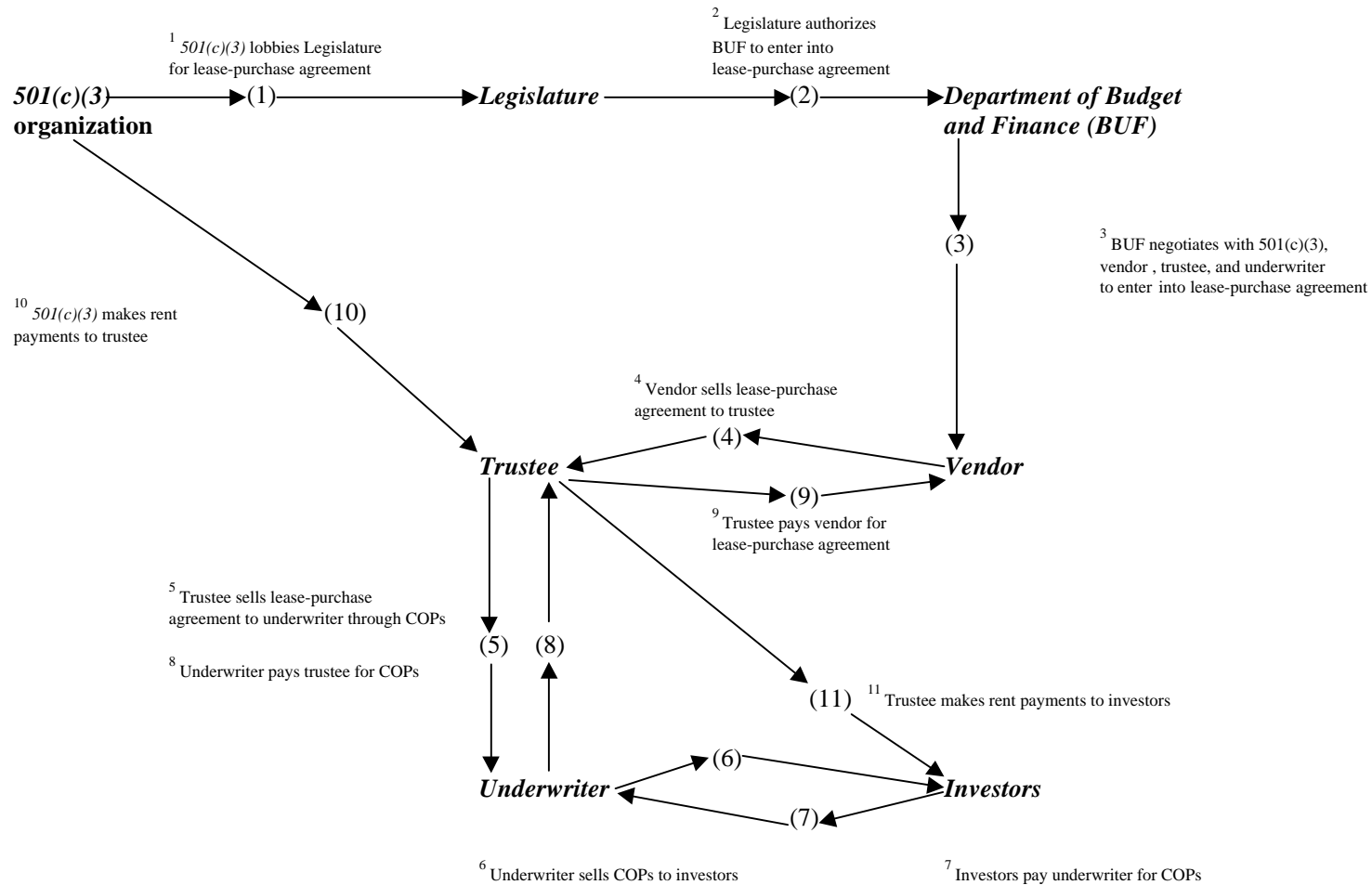
OTHER FUNDING MECHANISMS

In addition to prohibiting the State from guaranteeing a SPRB issue, Article VII, section 13 of the state constitution sets a limit on the amount of bonds that the State can guarantee. The constitutional cap creates competition for the State's bond guarantee, all but three percent of which (or \$6,360,348) has already been allocated for various housing projects and loan guarantee programs as of July 1, 1999. A loan guarantee program is a form of credit enhancement where the State is authorized to guarantee a portion of the principal balance of a loan made (for example) to a qualified small business concern by a private lender who is unable to otherwise lend the applicant sufficient funds at reasonable rates (see section 2 of Act 104, Session Laws of Hawaii 1998, relating to the Hawaii Capital Loan Program, which is codified as section 210-7.5, *Hawaii Revised Statutes*).

Flowchart for Awarding Grant-in-Aid to 501(c)(3) Organization Through Issuance of General Obligation (GO) Bonds



Flowchart for Entering into Securitized Lease-Purchase Agreements Through Certificates of Participation (COPs)



Chapter 4

BOND POOLS AND COMPOSITE ISSUES

Introduction

The purpose of this chapter is to familiarize the reader, at a very general level, with some financing techniques that can be used by the State to reduce the costs of issuing special purpose revenue bonds (SPRBs) on behalf of *501(c)(3)* organizations. Reducing the costs of issuing SPRBs may allow needy *501(c)(3)* organizations to access the public bond market instead of relying only on commercial loans and continual fundraising. This chapter attempts to explain some of the distinguishing features, as well as the relative advantages and disadvantages, of these financing techniques.

Bond Pools

What is a pool? For the purposes of this chapter, a “pool” or “pooled issue” is a single *501(c)(3)* bond issue that is intended to benefit more than one private nonprofit organization at a time. Just the opposite, a “stand-alone issue” is a single *501(c)(3)* bond issue that is intended to benefit only one private nonprofit organization at a time.

Differences between blind pools and dedicated pools. A bond pool can be either “dedicated” or “blind”. A dedicated pool is one where all of the participating private nonprofit organizations to be funded by a single *501(c)(3)* bond issue are known to investors before the sale of the bonds. Just the opposite, a blind pool is one where the participating private nonprofit organizations to be funded by a single *501(c)(3)* bond issue are not known to investors before the sale of the bonds. A partially blind pool is one where only some of the participating private nonprofit organizations to be funded by a single *501(c)(3)* bond issue are known to investors before the sale of the bonds.

Advantages And Disadvantages Of Pools

Dedicated pools. A dedicated pool allows a group of *501(c)(3)* organizations to share the costs of a bond issue (and thereby reduce their individual costs) by utilizing the same underwriter, trustee, bond counsel, *etc.* A dedicated pool can make it possible for *501(c)(3)* organizations with relatively small cash requirements (*i.e.*, less than \$1,000,000) to consider bonds as a financing option when it may not otherwise be possible due—among other things—to the costs of a bond issue.

Because the proceeds (*i.e.*, moneys) from a single *501(c)(3)* bond issue are loaned to the participants in a dedicated pool at the same time, all organizations participating in the pool need to have their projects in an equal state of readiness at the time the bonds are issued. Delaying a bond issue until all participants reach an equal state of readiness could increase project costs if

interest rates or construction costs, or both, are on the rise. Similarly, rushing a bond issue to market before all participants are ready to carry out their projects could result in expensive change orders and the need for additional bond issues.

Because all the bonds in a dedicated pool bear the same terms and conditions (*e.g.*, maturity date and coupon rate), a participating organization may not be able to tailor the terms of a bond issue to meet its specific (*e.g.*, cash flow) needs. In addition, the participating organization may not be able to change the terms of the bond issue (*e.g.*, to take advantage of lower interest rates) by paying the principal of and interest on the bonds before their stated maturity date.

In some states, dedicated pools are referred to as “designated pools” or “structured pools”.

Blind and partially blind pools. Once a blind pool has sold its bonds, the pool becomes a readily available source of funds to *501(c)(3)* organizations that qualify to use it. Like a dedicated pool, a blind pool allows a group of organizations to share the costs of a bond issue and can make it possible for organizations with relatively small cash requirements to consider bonds as a financing option when it may not otherwise be possible due to the costs of a bond issue.

With some blind pools, however, there may be a designated period of time (*i.e.*, a blackout period) after the bonds are sold when the proceeds are invested and not accessible to *501(c)(3)* organizations. In addition, there may be designated dates (*i.e.*, draw down periods) when eligible borrowers are permitted to access funds from the pool. Federal law also limits the period of time (*i.e.*, the origination period) during which loans can be funded from the proceeds of a blind pool. During the origination period, bond proceeds that have not been loaned to an organization can be invested with financial institutions to earn only enough interest to pay the interest on the bonds. At the end of the origination period, the unloaned proceeds must be used to retire (*i.e.*, pay off) the outstanding bonds. To the extent that they exist, blackout, origination, and draw down periods can create timing problems similar to those described for dedicated pools.

Because the *501(c)(3)* organizations to be funded by a blind pool are not known to investors when the bonds are sold, the issuer of the bonds—rather than the investor—must evaluate the creditworthiness of each potential pool participant. The creditworthiness and diligence of the issuer—rather than the blind pool—determines the bond’s rating and, consequently, its interest rate. (The rating given to bonds that are backed by a bond insurance policy or letter of credit reflects the creditworthiness and diligence of the insurer, not the issuer. Similarly, the premium that the issuer must pay for a bond insurance policy or letter of credit reflects the creditworthiness and diligence of the issuer, not the blind pool. While bond insurance policies and letters of credit are a source of added security for investors, issuers—rather than insurers—are the first source of money that investors will turn to for payment of principal and interest.)

Prior to the enactment of the Internal Revenue Code of 1986, blind pools were used by some issuing authorities to borrow money at tax-exempt (*i.e.*, lower) interest rates for the purpose of purchasing securities that paid interest at higher rates. Bonds would be sold, but the proceeds would not be loaned. Instead, the issuing authority would invest the proceeds and keep the money representing the difference between the interest rate on the securities it purchased and the interest rate on the bonds it sold. For example, if an issuing authority was paying 4.75 percent interest per year on a \$50,000,000, tax-exempt municipal bond, and if the authority had invested this \$50,000,000, in a security that was paying 6.50 percent interest per year, then the authority would make a profit of \$875,000 per year by not loaning the bond proceeds.

The more abusive forms of this practice, which is known in the municipal bond industry as “arbitrage”, were all but eliminated by the Internal Revenue Code of 1986. While blind pools and arbitrage still exist today, both are subject to substantial restrictions under the Internal Revenue Code of 1986, as amended.

There is no difference between a blind pool and a partially blind pool based on the ability of each pool to reliably identify its ratable participants.

Shared ratings and risks. An investor buys a specific portion of the bonds sold by a dedicated, blind, or partially blind pool but accepts the credit risk of all the 501(c)(3) organizations in the pool. Without bond insurance or a letter of credit, the credit rating of a bond pool is only as strong as the organization with the lowest credit rating. The cost of meeting the credit rating requirements of a bond pool (*e.g.*, purchasing bond insurance), however, may prevent the most needy organizations from taking part in the pool. Although an issuer of 501(c)(3) bonds can substitute its credit rating for the credit rating of a bond pool by guaranteeing the prompt payment of principal of and interest on the bonds, the issuer becomes legally—if not morally (at least in the case of moral obligation bonds)—responsible for the bonds.

For 501(c)(3) organizations in a bond pool, shared ratings and risks also mean assuming financial responsibility for the prompt payment of principal of and interest on the bonds if other organizations in the pool are unable to make their payments in a prompt manner. It also means that the tax-exempt status of the entire bond issue can be jeopardized by the careless acts of just one organization in the bond pool. To avoid jeopardizing an entire bond issue, the issuer could require each participating organization to purchase a “standby” letter of credit guaranteeing the prompt payment of principal of and interest on the bonds if the organization defaults on its payments.

Since the creditworthiness of standby letter of credit banks are not all the same (*i.e.*, some banks are more secure financially than others), it may be necessary for the participating organizations to purchase a “master” letter of credit in order to provide the entire bond issue with a uniform credit rating. (A uniform credit rating may make it easier to sell the bonds.) A master letter of credit bank guarantees the prompt payment of principal of and interest on the bonds if the standby letter of credit bank defaults on its payments. Unlike bank-issued letters of credit, bond insurance policies issued by the major municipal bond insurance companies (*e.g.*, MBIA Corporation, AMBAC, FGIC, Capital Guaranty Insurance Company, *etc.*) result in a Standard &

Poor’s bond rating of “AAA” (highest) or a Moody’s Investor Services bond rating of “Aaa” (highest).

Composite Issues

What is a composite issue? For the purposes of this chapter, a “composite issue” is two or more separate 501(c)(3) bond issues with similar terms and conditions that are packaged together and then sold at the same time. A single official statement (*i.e.*, document prepared by or for an issuer that gives detailed security and financial information about a bond issue) is used to sell the separate bond issues. An example of a composite issue would be two issuers who sell their separate, but comparable, bonds together and utilize the same bond counsel, underwriter, trustee, and official statement. The proceeds of the individual bond issues are separate, and each bond issue has a separate loan and a separate set of bond terms and conditions. Neither the proceeds of the individual bond issues nor the loans are pooled.

Differences between composite issues and dedicated pools. What are commonly called industrial development bond pools in some states are often composite issues. Confusion exists over the distinction between a dedicated pool and a composite issue because they have many similar characteristics. In fact, some government finance professionals believe that there is no difference between a dedicated pool and a composite issue. For the purposes of this study, the differences between a dedicated pool and a composite issue are shown in a table adapted from *The Use of Pool Financing Techniques in California: A Look at Joint Issuance Techniques By Public Agencies (1988)*, prepared by the California Debt Advisory Commission.

DIFFERENCES BETWEEN COMPOSITE ISSUES AND DEDICATED POOLS

Composite Issues	Dedicated Pools
Two or more bond issues are sold together on one official statement	One bond issue, one official statement
Two or more sets of bond terms	One set of bond terms
Separate proceeds for each bond issue and each participating organization	The proceeds from a single bond issue are loaned to the organizations in a pool
An investor purchases the bonds of a single organization and accepts the credit risk of only that organization	An investor purchases a percentage of a bond pool and accepts the credit risk of all the organizations in that pool

Advantages and disadvantages of composite issues. The potential advantages of composite issues are similar to the potential advantages of dedicated pools—cost sharing that can lead to cost savings. Similarly, the potential disadvantages of composite issues are similar to the potential disadvantages of dedicated pools—timing problems that can lead to project delays or hasty decisions, or both.

Private Placement With Accredited Investors And Qualified Institutional Buyers

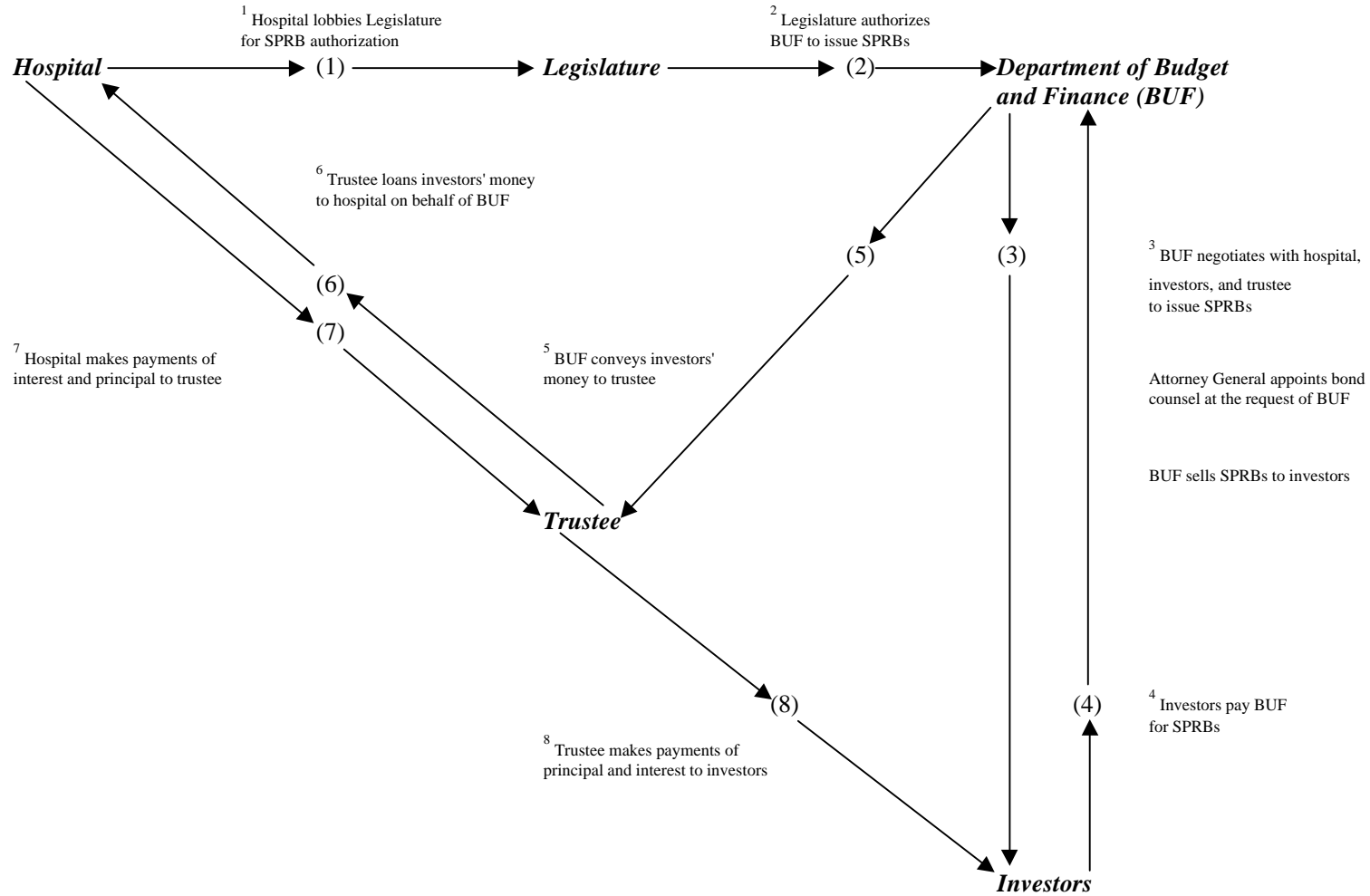
Figure 4 illustrates (in theory) the process of privately placing SPRBs with accredited investors and qualified institutional buyers. Although the Department of Budget and Finance brokered a private placement bond deal involving another government agency, the Department has not brokered such a deal involving a 501(c)(3) organization.

The private placement of bonds with an “accredited investor” or “qualified institutional buyer” is a deal directly negotiated between an issuer and an investor or institutional buyer (*e.g.*, a private lender or group of private lenders), and should not be confused with a negotiated sale to an underwriter. Federal regulations allow only accredited investors and qualified institutional buyers to buy and resell bonds through private placement deals, or securities transactions not involving public offerings (*i.e.*, sales to the general public). The reason for these restrictions is that private placement deals are not subject to the same antifraud disclosure requirements as public offerings. While the lack of full disclosure is not considered an indicator of a bond’s quality (*i.e.*, speculative grade versus investment grade), it is presumed that accredited investors and qualified institutional buyers are aware of the possible risks involved with these types of deals.

An “accredited investor” includes any individual (*i.e.*, natural person) who had an annual individual income in excess of \$200,000, in the past two years, or an annual joint income with that individual’s spouse in excess of \$300,000, in those years, and has a reasonable expectation of reaching the same income level in the current year (see 17 *CFR* 230.501 for a more complete listing). The term also includes any individual whose individual net worth, or joint net worth with that individual’s spouse, at the time of the individual’s purchase of the bonds, exceeds \$1,000,000.

A “qualified institutional buyer” is an institution, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least \$100,000,000, in securities of issuers that are not affiliated with the institution. These institutions include corporations, partnerships, business trusts, insurance companies, registered investment companies, business development companies, public employee benefit plans, ERISA (*i.e.*, the Employee Retirement Income Security Act of 1974) employee benefit plans, and 501(c)(3) organizations (see 17 *CFR* 230.144A for a more complete listing).

Flowchart for Private Placement of Special Purpose Revenue Bonds (SPRBs)



Chapter 5

ISSUERS, ISSUANCES, AND RATINGS

Introduction

The purpose of this chapter is to inform the reader, in very general terms, about the extent to which tax-exempt municipal bonds have been issued on behalf of private nonprofit grade (*i.e.*, elementary and secondary) schools in other states, the ratings that were assigned to these bonds and the criteria that were used to determine these ratings, and the outlook for issuing additional tax-exempt bonds in the foreseeable future. This chapter, including the materials on which it is based, should not be used by laypeople to rate private nonprofit grade schools in Hawaii.

Because the Bureau used a nonrandom (*i.e.*, selective) surveying technique to collect information on bond issuance techniques used to assist private nonprofit grade schools with construction projects (see Appendix B), the reader should not give too much weight to the apparent popularity of one bond issuance technique over another. The purpose of this survey was to give the Legislature a range of options for assisting private nonprofit grade schools, not the most popular option. These options are discussed in Chapter 3 and 4.

Issuers And Issuances

Toward the end of 1999, Standard & Poor's and Moody's Investors Service reported that thirty-six issuing authorities (*i.e.*, issuers), from twenty-one states, had issued rated tax-exempt municipal bonds on behalf of seventy-five private nonprofit grade schools (see table at end of chapter). By far, the most active of these issuing authorities were the Massachusetts Development Finance Agency (sixteen schools) and the Connecticut Health & Educational Facilities Authority (ten schools). At the time, most of the other issuing authorities had issued rated tax-exempt municipal bonds on behalf of only one private nonprofit grade school.

These figures most likely underestimated the extent to which tax-exempt municipal bonds had been issued on behalf of private nonprofit grade schools because they did not include the sale of unrated bonds. (Standard & Poor's, Moody's Investors Service, and Fitch Incorporated are "rating" agencies and would not be involved in the sale of "unrated" bonds.) Telephone interviews conducted with twenty-six of the issuing authorities identified by Standard & Poor's and Moody's Investors Service seemed to suggest that the public sale of unrated bonds, and the private placement of unrated bonds with accredited investors and qualified institutional buyers, represented a substantial amount of tax-exempt debt issued on behalf of these schools. These twenty-six issuing authorities, from nineteen states, had issued rated tax-exempt municipal bonds on behalf of sixty-six private nonprofit grade schools.

Ratings

The ratings given by Standard & Poor's to these tax-exempt municipal bond issues range from "AAA" to "BBB-" without credit enhancement (e.g., bond insurance or a letter of credit). A rating of AAA, with or without credit enhancement, is the highest rating given by Standard & Poor's. A rating of BBB- is the lowest rating given by Standard & Poor's to investment grade bonds. Anything lower than a rating of BBB- denotes noninvestment or speculative grade bonds. Similarly, the ratings given by Moody's Investors Service to these tax-exempt municipal bond issues range from "Aaa" to "Baa3". A rating of Aaa, with or without credit enhancement, is the highest rating given by Moody's Investors Service. A rating of Baa3 is the lowest rating given by Moody's Investors Service to investment grade bonds. Anything lower than a rating of Baa3 denotes noninvestment or speculative grade bonds.

For a 501(c)(3) organization evaluating potential financing strategies or entering the bond market for the first time, a Standard & Poor's Credit Assessment is a lower-cost alternative to a traditional credit rating. As its name indicates, a Credit Assessment is not a rating. Based upon a review of summary financial information, a Credit Assessment offers an idea of the general strengths and weaknesses of a proposed financing structure. By providing feedback on the credit aspects of a potential bond issue, a Credit Assessment allows an organization to evaluate a number of different financing strategies. Should an organization decide to obtain a traditional credit rating, the organization can apply the Credit Assessment fee toward the rating request. (Note: the writer's reference to Standard & Poor's Credit Assessments should not be construed as an endorsement of Standard & Poor's or its Credit Assessments.)

Student Demand

Student (or market) demand is one of many broad categories considered by Standard & Poor's, Moody's Investors Service, and Fitch Incorporated when they rate a private nonprofit grade school that wants to utilize tax-exempt municipal bonds to fund construction projects. Student demand affects a school's enrollment level, which in turn affects the amount of tuition-based money flowing into the school's treasury, which in turn affects the school's ability to repay the principal of and interest on a bond issue. Student demand is measured by looking at specific subcategories such as enrollment level, acceptance and matriculation rates, attrition or retention rate, student quality indicators, and academic reputation.

According to Fitch Incorporated's *Rating Guidelines for Private Colleges and Universities* (July 7, 1998, pp. 2-4), which are also used to rate private nonprofit grade schools, important student demand characteristics include positive or stable enrollment trends, low acceptance and high matriculation rates, low attrition or high retention rate, strong student quality indicators, and highly regarded academic reputation. These factors tend to indicate that a school will continue to have a steady flow of tuition payments over time.

Enrollment level. Enrollment level is considered a direct indicator of a school's ongoing efforts to maintain or increase student demand. Although a minimum student enrollment is not necessary to attain a certain rating level, schools with small enrollments may have to

demonstrate superior credit strength and flexibility in other areas (*e.g.*, personnel matters) to offset their potential exposure to enrollment shortfalls. For example, the loss of five students will have a greater financial impact on a school of 100 students than a school of 1,000 students.

Acceptance rate. Acceptance rate is defined as the number of students accepted into (as opposed to enrolled in) a school divided by the number of students submitting applications for entrance into the school. Acceptance rate is considered an indicator of a school's ability to control future enrollment. A high acceptance rate may limit a school's ability to maintain enrollment and student quality if there is a decline in applications since a large increase in acceptance rate usually results in a decrease in the quality of enrolled students.

Matriculation rate. Matriculation rate is defined as the number of students choosing to enroll in a school divided by the number of students accepted into the school. Matriculation rate is considered an indicator of a school's relative position among the pool of schools to which applicants apply as alternatives (*i.e.*, the school's competitors). A declining matriculation rate is viewed as a sign of weakening market position due to increased competition from other schools, declining performance, or changing demographics.

Attrition or retention rate. Attrition rate refers to the percentage of students, excluding graduates, who leave a school each year (*i.e.*, do not return). This characteristic is also expressed as retention rate, or the percentage of students, excluding graduates, who return to a school the following year. Attrition and retention rates are considered indicators of students' and parents' satisfaction with a school. These rates are used with information concerning the reasons why students chose not to return since some reasons are of greater concern to investors than others (*e.g.*, personal bankruptcy or financial difficulties versus run-down or out-of-date facilities).

Student quality. Schools with high student quality indicators (*e.g.*, standardized test scores) are better able to adjust their admission standards during periods of declining applications without substantially decreasing student quality. If a school's student quality indicators are better than the student quality indicators of its competitors, there is room for the school to relax its admission standards while maintaining comparably high student quality.

Academic reputation. Evaluating a school's academic reputation is critical when analyzing a bond issue because a solid academic reputation usually gives a school greater pricing flexibility when it is faced with financial difficulties.

Financial Strength And Flexibility

Financial strength and flexibility is another of many broad categories considered by Standard & Poor's, Moody's Investors Service, and Fitch Incorporated when they rate a private nonprofit grade school that wants to utilize tax-exempt municipal bonds to fund construction projects. Financial strength and flexibility, which the writer represents simply as the size of a school's endowment and the amount of unrestricted moneys available for the school's immediate use, can affect a school's ability to repay the principal of and interest on a bond issue during financially difficult times (*e.g.*, decreased enrollment due to increased competition). Financial

strength and flexibility is judged by Standard & Poor's, Moody's Investors Service, and Fitch Incorporated by looking at specific, quantifiable ratios and indicators, a discussion of which is beyond the abilities of the writer.

According to Fitch Incorporated's *Rating Guidelines for Private Colleges and Universities* (July 7, 1998, pp. 4-8), which are also used to rate private nonprofit grade schools, important financial strength and flexibility characteristics include consistent operating surpluses; manageable debt service burden (*i.e.*, payments of principal and interest); significant available funds relative to debt burden and operations; ongoing maintenance and capital improvements; growing endowment, with evidence of consistent earnings on invested moneys and strong alumni support; and diverse revenue sources (*e.g.*, earnings on invested moneys and alumni contributions).

Outlook

According to Standard & Poor's *ViewPoint on Independent Schools* (Winter 1999, p. 8), the number of private nonprofit grade schools entering the public bond market and seeking ratings is likely to increase. Among the reasons given by Standard & Poor's for the likely increase are:

- (1) Private nonprofit grade schools that successfully utilized tax-exempt municipal bonds to fund construction projects are introducing other schools to the idea of utilizing tax-exempt bonds; and
- (2) More states are either creating new issuing authorities to allow private nonprofit grade schools to utilize tax-exempt municipal bonds or broadening the powers of existing authorities to include private nonprofit grade schools.

According to the Moody's Investors Service *Special Comment* entitled, "Private Schools Have Stable To Positive Credit Outlook" (December 1999, p. 3), continued growth in the utilization of tax-exempt municipal bonds by private nonprofit grade schools is likely.

Issuance of Revenue Bonds in 1999 to Assist Private Nonprofit Elementary and Secondary Schools with Construction Projects (Rated Paper Only)

State	Issuing Authority	No. of Schools
California (2 schools)	City of Los Angeles	1
	California Statewide Communities Development Authority	1
Connecticut (11 schools)	Connecticut Health & Educational Facilities Authority	10
	City of Woodstock	1

SPRBs FOR PRIVATE SCHOOLS: PRACTICAL AND CONSTITUTIONAL CONSIDERATIONS

State	Issuing Authority	No. of Schools
District of Columbia (1 school)	District of Columbia	1
Illinois (1 school)	Illinois Development Finance Authority	1
Indiana (2 schools)	Indiana Development Finance Authority	1
	Indianapolis Economic Development Commission ¹	1
Kansas (1 school)	Kansas Development Finance Authority	1
Maine (2 schools)	Town of South Berwick	1
	Maine Finance Authority	1
Maryland (2 schools)	Maryland Health & Higher Educational Facilities Authority	1
	Montgomery County	1
Massachusetts (16 schools)	Massachusetts Development Finance Agency ²	16
Michigan (2 schools)	Oakland County Economic Development Corporation	2
Minnesota (4 schools)	City of Hopkins	1
	City of Golden Valley	1
	County of Stearns	1
	Saint Paul Housing & Redevelopment Authority	1
Missouri (2 schools)	Missouri Health & Educational Facilities Authority	2
New Hampshire (6 schools)	New Hampshire Health & Education Facilities Authority ³	4
	New Hampshire Business Finance Authority	1
	New Hampshire Municipal Bond Bank	1
New Jersey (5 schools)	New Jersey Economic Development Authority	5
New Mexico (1 school)	City of Albuquerque	1
New York (5 schools)	New York City Industrial Development Agency	5
Oklahoma (2 schools)	Oklahoma Development Finance Authority	1
	Tulsa County Industrial Authority	1
Pennsylvania (4 schools)	Montgomery County Industrial Development Authority	2
	Moon Township Industrial Development Authority	1
	Northeastern Pennsylvania Hospital & Education Authority	1
Texas (2 schools)	Houston Higher Education Finance Corporation ⁴	1
	Harlingen Higher Education Facilities Corporation	1

ISSUERS, ISSUANCES, AND RATINGS

State	Issuing Authority	No. of Schools
Vermont (2 schools)	Vermont Educational & Health Building Facilities Authority	2
Virginia (2 schools)	Madison County Industrial Development Authority	1
	Alexandria Industrial Development Authority	1
Total Number of Schools		75
Total Number of Issuing Authorities		36
Total Number of States		21

Notes:

Sources: (a) Moody's Investors Service, "Private Schools Have Stable To Positive Credit Outlook", December 1999, p. 8. (b) Standard & Poor's, "View Point on Independent Schools", Winter 1999, pp. 6-7. (c) Pamela Clayton, PClayton@fitchibca.com, "RE: Private Schools", Personal e-mail (June 15, 2000).

1. For purposes of enumeration only, the revenue bonds issued on behalf of the Archdiocese of Indianapolis were deemed to have been issued by the "Indianapolis" Economic Development Commission, not the "Indiana" Economic Development Commission. Source: Xander Mellish, "Liberty Bonds for Inner-City Schools", *The Wall Street Journal*, April 8, 1997, p. A-22.
2. The Massachusetts Government Land Bank and the Massachusetts Industrial Finance Agency were consolidated to form the Massachusetts Development Finance Agency. For purposes of enumeration only, the revenue bonds issued by the Government Land Bank and the Industrial Finance Agency were deemed to have been issued by the Development Finance Agency. Source: <http://www.magnet.state.ma.us/sec/cis/ciscig/A/A4A13.HTM>.
3. The New Hampshire Higher Educational & Health Facilities Authority was renamed the New Hampshire Health & Education Facilities Authority. Source: <http://webster.state.nh.us/genccourt/ols/rules/sourcehefa.html>.
4. For purposes of enumeration only, the revenue bonds issued on behalf of Saint John's School were deemed to have been issued by the Houston Higher Education "Finance" Corporation, not the Houston Higher Education "Facilities" Corporation.

Chapter 6

ESTABLISHMENT CLAUSE ISSUES

Early Establishment Clause Cases

The Establishment Clause of the First Amendment of the United States Constitution states that “Congress shall make no law respecting an establishment of religion.” In *Everson v. Bd. of Ed. of Ewing*,¹ the United States Supreme Court affirmed that the Establishment Clause applicable to the states through the Fourteenth Amendment. *Everson* appears to have been the first United States Supreme Court case to have directly considered the Establishment Clause in the context of government aid to religious schools. In this 1947 decision, the Court upheld a New Jersey law authorizing reimbursement to parents for fares paid for the transportation of children attending private not-for-profit schools, including sectarian schools.² In rejecting the Establishment Clause challenge, the Court declared that the First Amendment requires states to be “neutral in [their] relations with groups of religious believers and nonbelievers; it does not require the [states] to be their adversary. State power is no more to be used so as to handicap religions than it is to favor them.”³ The Court concluded that it was unable to rule that the First Amendment, measured by such standards, prohibits New Jersey from spending tax-raised funds to pay the bus fares of sectarian school students as a part of a general program under which it pays the fares of students attending public and private nonsectarian schools.⁴

In *Board of Education of Central School District No. 1 v. Allen*,⁵ the Court concluded New York’s statute requiring local public school authorities to lend textbooks free of charge to both public and private school students in grades seven through twelve. Noting that “the line between state neutrality to religion and state support of religion is not easy to locate,”⁶ the Court

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1. 330 U.S. 18 (1947).
 2. At issue was a township board of education resolution, authorizing the reimbursement of parents for fares paid for the transportation by public carrier of children attending public and Catholic schools. The resolution was adopted pursuant to a New Jersey statute authorizing district boards of education to make rules and contracts for the transportation of children to and from schools other than private schools operated for profit. *Id.* at 3.
 3. *Id.* at 18. The Court acknowledged the need to balance religious rights, stating that: “While we do not mean to intimate that a state could not provide transportation only to children attending public schools, we must be careful, in protecting the citizens of New Jersey against state-established churches, to be sure that we do not inadvertently prohibit New Jersey from extending its general state law benefits to all its citizens without regard to their religious belief.” *Id.* at 16.
 4. *Id.* at 18. The court concluded that, although the “First Amendment has erected a wall between church and state[,] ... New Jersey has not breached [the wall] here. ... Its legislation, as applied, does no more than provide a general program to help parents get their children, regardless of their religion, safely and expeditiously to and from accredited schools.” *Id.*
 5. 392 U.S. 236 (1968). The challenge was brought by a local school board, desiring to block the allocation of state funds for private sectarian schools.
 6. *Id.* at 242 (“The constitutional standard is the separation of Church and State. The problem, like many problems in constitutional law, is one of degree.” *Id.*)

turned to a test it had formulated in *Abington School District v. Schempp*,⁷ to assist in “distinguishing between forbidden involvements of the State with religion and those contacts which the Establishment Clause permits”⁸ The test, in essence, held that, to “withstand the strictures of the Establishment Clause,” a statutory enactment must have “a secular legislative purpose and a primary effect that neither advances nor inhibits religion.”⁹

The Court found that the New York law met this test:

The express purpose of [the statute] was stated by the New York Legislature to be furtherance of the educational opportunities available to the young. Appellants have shown us nothing about the necessary effects of the statute that is contrary to its stated purpose. The law merely makes available to all children the benefits of a general program to lend school books free of charge. Books are furnished at the request of the pupil and ownership remains, at least technically, in the State. Thus, no funds or books are furnished to parochial schools, and the financial benefit is to parents and children, not to schools.¹⁰

In addition, the Court apparently found it significant that only secular books were loaned to students.¹¹

In *Walz v. Tax Commission of the City of New York*,¹² the Court upheld the granting of a property tax exemption, by the New York Tax Commission, to religious organizations for properties used for religious worship. The Court rejected the argument that the exemption amounted to state support of religion, stating that:

[F]or the men who wrote the Religion Clauses of the First Amendment the “establishment” of a religion connoted sponsorship, financial support, and active involvement of the sovereign in religious activity....

[T]he basic purpose of these provisions ... is to insure that no religion be sponsored or favored, none commanded, and none inhibited.¹³

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7. 374 U.S. 203 (1963) (Establishment Clause challenge to mandatory daily bible readings over school intercom).
 8. 392 U.S. at 243. The Court noted that eight of the Justices in *Schempp* subscribed to the test.
 9. *Id.* at 243, citing *Schempp*, 374 U.S. at 222.
 10. 392 U.S. at 243-244 (footnote omitted).
 11. *See id.* at 244-245. The Court also rejected the argument that free textbooks should be distinguished from free bus fares because books (but not buses) are critical to the teaching process, which in sectarian schools is employed to teach religion. *Id.* at 245. The Court stated: “Against this background of judgment and experience, unchallenged in the meager record before us in this case, we cannot agree with appellants either that all teaching in a sectarian school is religious or that the processes of secular and religious training are so intertwined that secular textbooks furnished to students by the public are, in fact, instrumental in the teaching of religion.” *Id.* at 248.
 12. 397 U.S. 664 (1970).
 13. *Id.* at 668-70.

The Court further asserted that adhering to the “policy of neutrality” derived from balancing the Establishment and Free Exercise Clauses has prevented government involvement that might “tip the balance toward government control of churches or governmental restraint on religious practice.”¹⁴ In upholding the tax exemption, the Court found the legislative purpose was neither advancement nor inhibition of religion.¹⁵ The Court further found that the tax exemption was granted to a broad class of non-profit entities, including hospitals, libraries, and scientific and professional groups, as well as religious organizations. Finally the Court concluded that, because the granting of the tax exemption created “only a minimal and remote involvement between church and state and far less than taxation of churches,” there was no danger of entanglement.¹⁶

The *Lemon* Test

In *Lemon v. Kurtzman*,¹⁷ and its companion case *Earley v. Dicenso*, the Court struck down two state statutes providing assistance to sectarian schools.¹⁸ The first was a Pennsylvania statute that reimbursed sectarian schools for actual expenses relating to textbooks, instructional materials and teachers’ salaries for secular courses, and the second was a Rhode Island statute that supplemented salaries of teachers of secular subjects in nonpublic schools. Building upon the test used in *Allen*, the Court pronounced a three-prong test to weigh the constitutionality of any law providing aid to religious schools. To pass muster, a statute must:

- (1) Have a secular legislative purpose;
- (2) Have a principal or primary effect that neither advances or inhibits religion; and
- (3) Not foster “an excessive entanglement between government and religion.”¹⁹

Although the Court ruled that each of the statutes had a secular purpose,²⁰ it found that both statutes fostered “excessive entanglement” between government and religion, thus violating

14. *Id.*

15. *Id.* at 672.

16. *Id.* at 676.

17. 403 U.S. 602 (1971).

18. These two appeals raised questions as to Pennsylvania and Rhode Island statutes providing state aid to church-related elementary and secondary schools. Both statutes were challenged as violative of the Establishment and Free Exercise Clauses of the First Amendment and the Due Process Clause of the Fourteenth Amendment.

Pennsylvania adopted a statutory program that provides financial support to nonpublic elementary and secondary schools by way of reimbursement for the cost of teachers’ salaries, textbooks, and instructional materials in specified secular subjects. Rhode Island adopted a statute under which the State pays directly to teachers in nonpublic elementary schools a supplement of 15% of their annual salary. *Id.* at 607.

19. *Id.* at 612-613.

20. The Court stated: “Inquiry into the legislative purposes of the Pennsylvania and Rhode Island statutes affords no basis for a conclusion that the legislative intent was to advance religion. On the contrary, the

the Establishment Clause.²¹ Given its holding, the Court found it unnecessary to determine whether the principal or primary effect of the programs was to advance or inhibit religion.²²

Tilton and Hunt

In *Tilton v. Richardson*,²³ a case decided at the same time as *Lemon*, the Court reached the opposite conclusion. The aid challenged in *Tilton* was in the form of federal grants for the construction of academic facilities at four private, church-related colleges. The grant contained a restriction that the facilities constructed not be used for any sectarian purpose. Relying upon *Lemon's* three-part test, the Court found the purpose of the federal aid program to be secular. With respect to whether the primary effect of the challenged act was to aid the religious purposes of church-related colleges and universities, the Court stated:

Construction grants surely aid these institutions in the sense that the construction of buildings will assist them to perform their various functions. But bus transportation, textbooks, and tax exemptions all gave aid in the sense that religious bodies would otherwise have been forced to find other sources from which to finance these services. Yet all of these forms of governmental assistance have been upheld. The crucial question is not whether some benefit accrues to a religious institution as a consequence of the legislative program, but whether its principal or primary effect advances religion.²⁴

In response to the argument that the “government may not subsidize any activities of an institution of higher learning that is some of its programs teaches religious doctrines,” the Court indicated there was no basis in the record to assume that “religion so permeate[d] the secular education” provided by the colleges that their religious and secular functions were inseparable.²⁵ Examining the nature of the church-related colleges, the Court concluded that “the evidence shows institutions with admittedly religious functions but whose predominant higher education mission is to provide their students with a secular education.”²⁶ Noting that the federal statute

statutes themselves clearly state that they are intended to enhance the quality of the secular education in all schools covered by the compulsory attendance laws.” *Id.* at 613.

21. *Id.* at 614 (“the cumulative impact of the entire relationship arising under the statutes in each State involves excessive entanglement between government and religion”). For Court’s discussion of entanglement concerns relating to the specific programs *see id.* at 615-21. The Court also expressed concern over the “divisive political potential” of both programs. *See id.* at 622-24.
22. “We need not decide whether these legislative precautions restrict the principal or primary effect of the programs to the point where they do not offend the Religion Clauses, ...” *Id.* at 613-14.
23. 403 U.S. 672 (1971).
24. *Id.* at 679 (citations omitted). The Court noted that the “simplistic argument that every form of financial aid to church-sponsored activity violates the Religion Clauses was rejected long ago in *Bradfield v. Roberts*, 175 U.S. 291 (1899).” *Id.*
25. 403 U.S. at 680.
26. *Id.* at 687. The Court noted that: all four schools were governed by Catholic religious organizations and the faculties and student bodies at each were predominantly Catholic, but that non-Catholics were admitted as students and given faculty appointments; none of the four schools required students to attend religious services; although students were required to take theology courses, these were taught according to

authorized grants and loans only for academic facilities to be used for defined secular purposes and prohibited any sectarian use of the facilities, the Court contended that the evidence fully supported finding there had been no violations of these restrictions.²⁷ However, the Court did find an aspect of the statute's enforcement provisions "inadequate to ensure the impact of the federal aid will not advance religion."²⁸ Consequently, the Court invalidated a portion of the statute that, in effect, limited a recipient institution's obligation not to use the funded facility for sectarian instruction or religious worship to only a twenty-year period. The Court found this limitation violated the Establishment Clause because the unrestricted use of valuable property after twenty-year period would constitute a contribution to a religious body.²⁹

Turning to the issue of excessive entanglement, the Court first stressed the character of the aided institutions that distinguished them for elementary and secondary schools, noting that: college students are less impressionable and thus less susceptible to religious indoctrination; college courses, by their nature, inherently limit the opportunities for sectarian influence; and a high degree of academic freedom tends to prevail at the college level.³⁰ The Court concluded that, because religious indoctrination was not a "substantial purpose or activity" of the church-related colleges and universities, there was less probability than in primary and secondary schools that religion would seep into the teaching of secular subjects.³¹ Concomitantly, the Court found that the intensive state surveillance necessary in *Lemon* was diminished and the ensuing entanglements between government and religion lessened.³² Looking at the type of aid provided, the Court found that its neutral or nonideological nature also lessened possible entanglement between church and state. The Court reasoned that, like the textbooks and bus transportation in *Allen* and *Everson*, but unlike the teachers' services in *Lemon*, physical facilities were religiously neutral and thus capable of being restricted to secular purposes.³³

academic requirements and professional standards and covered a range of human religious experiences; there was no attempt to indoctrinate or proselytize students; and all four schools subscribed to a well-established set of principles of academic freedom. *Id.* at 686-87.

27. *See id.* at 679-81. On the contrary, the Court found there was no evidence that religious activities took place in the funded facilities: courses at the colleges were "taught according to the academic requirements intrinsic to the subject matter," and "an atmosphere of academic freedom rather than religious indoctrination" was maintained. *Id.* at 680-682 (plurality opinion).

28. *Id.* at 682.

29. *Id.* at 683.

30. *Id.* at 686.

31. *Id.* at 687.

32. *Id.* at 687. The Court observed that the inspection necessary to verify that the facilities were devoted to secular education would be "minimal and indeed hardly more" than those the state might impose on all public schools under its compulsory education laws. *Id.* at 687.

33. *Id.* at 688. The Court wrote:

The entanglement between church and state is also lessened here by the nonideological character of the aid that the Government provides. Our cases from *Everson* to *Allen* have permitted church-related schools to receive government aid in the form of secular, neutral, or non-ideological services, facilities, or materials that are supplied to all students regardless of the affiliation of the school that they attend. In *Lemon* and *DiCenso*, however, the state programs subsidized teachers, either directly or indirectly. Since teachers are not necessarily religiously neutral, greater governmental surveillance would be required to guarantee that state salary aid would not in fact subsidize religious instruction.

Finally, the Court observed that the construction grant was a one-time payment, not involving continuing financial relationships, annual audits and appropriations, or government analysis of an institution's expenditures on secular, as distinguished from religious, activities.³⁴ Considered cumulatively, these factors persuaded the Court that church-state entanglement was not excessive.³⁵

The Court's reasoning in *Hunt v. McNair*,³⁶ was similar to that employed in *Tilton*. *Hunt* concerned an Establishment Clause challenge to the issuance of revenue bonds for the benefit of the Baptist College at Charleston, under a South Carolina law designed to assist higher educational institutions in the financing and construction of secular facilities, using revenue bonds issued by Educational Facilities Authority, a state entity.³⁷ The Court emphasized that the law explicitly stated that the revenue bonds were not direct or indirect obligations of the State and that general revenues of the State could not be used to support the project.³⁸ The Authority could assist projects encompassing buildings, facilities, site preparation, and related items but was prohibited from including "any facility used or to be used for sectarian instruction or as a place of religious worship [or] any facility which is used or to be used primarily in connection with any part of the program of a school or department of divinity for any religious denomination."³⁹ Under the statutory scheme, the educational institution would convey the land upon which the project would be financed to the Authority, which would lease it back to the educational institution, with reconveyance to the institution upon full payment of the bonds. The statute required that any lease agreement and any reconveyance agreement between the Authority and educational institution contain a strict restrictive provision against use for sectarian purposes, which could be enforced through inspections by the government.⁴⁰

The Court considered the law in terms of the three prong test announced in *Lemon*: purpose, effect, and entanglement.⁴¹ With respect to the first prong, the Court found that the

There we found the resulting entanglement excessive. Here, on the other hand, the Government provides facilities that are themselves religiously neutral. The risks of Government aid to religion and the corresponding need for surveillance are therefore reduced.

Id. at 687-88.

34. *Id.* U.S. at 688 ("government entanglements with religion are reduced by the circumstance that, unlike the direct and continuing payments under the Pennsylvania program, and all the incidents of regulation and surveillance, the Government aid here is a one-time, single-purpose construction grant."). The Court again noted that inspection as to use was "a minimal contact." *Id.*
35. *Id.* U.S. at 684-689. As for political divisiveness, the Court noted that no "continuing religious aggravation" over the program had been shown.
36. 413 U.S. 734 (1973).
37. *Id.* at 736-37. The action sought injunctive and declaratory relief.
38. *Id.* at 737-38. The higher educational institutions were responsible for servicing and repaying the bonds, but at a lower cost because of the tax-free status of the interest payments.
39. *Id.* at 736-37, quoting S.C. Code Ann. 22-41.2(b) (Supp. 1971).
40. See 413 U.S. at 738-40 & n.4 (neither the leased land nor any facility located thereon shall be used for sectarian instruction, as a place of worship, or in connection with any part of the program of a school or department of divinity or any religious denomination).
41. *Id.* at 741.

purpose of the law was manifestly a secular one because the benefits were available to all institutions of higher education in the state, regardless of whether they had a religious affiliation.⁴² In applying the second prong of the *Lemon* three-part test concerning “primary effect,” the Court declared that it “has consistently ... rejected ... the recurrent argument that all aid is forbidden because aid to one aspect of an institution frees it to spend its other resources on religious ends.”⁴³ The Court refined the primary effect test, stating:

“Aid normally may be thought to have a primary effect of advancing religion when it flows to an institution in which religion is so pervasive that a substantial portion of its functions are subsumed in the religious mission or when it funds a specifically religious activity in an otherwise substantially secular setting.”⁴⁴

Examining the nature of the College, the Court concluded that there was “no evidence” to place the College in the pervasive sectarian category.⁴⁵ The Court acknowledged that the members of the College board of trustees were elected by the South Carolina Baptist Convention, the Convention’s approval was required for certain financial transitions, and the College charter could only be amended by the Convention. However, the Court noted that it was likewise true that institutions involved in *Tilton* were governed by Catholic religious organizations.⁴⁶ Moreover, the Court found that the College imposed no religious qualifications for faculty membership or student admission and that “only 60% of the College student body [was] Baptist, percentage roughly equivalent to the percentage of Baptists” in that area of the state.⁴⁷ The Court stated that there was “no basis to conclude that the College’s operations [were] oriented significantly towards sectarian rather than secular education.”⁴⁸

The Court also found that the state aid was restricted to secular activities of the College and thus was not in danger of being used for a religious activity.⁴⁹ Specifically, the Court noted that the scope of the Authority’s power to assist institutions extended only to secular projects and that each lease agreement was required to contain clauses forbidding religious use and allowing inspections to enforce the agreement.

In concluding that it was “satisfied” that issuance of the bonds to the College would not have the primary effect of advancing or inhibiting religion,⁵⁰ the Court, in dictum, again emphasized the “special sort” of state aid involved in this case:

42. *Id.* at 741.

43. *Id.* at 742-43, citing *Tilton v. Richardson*, 403 U.S. 672 (1971); *Walz v. Tax Comm’n.*, 397 U.S. 664 (1970); *Bradfield v. Roberts*, 175 U.S. 291 (1899).

44. 413 U.S. at 743.

45. *Id.*

46. *Id.*, citing *Tilton*, 403, U.S. at 686. *See* note 26 *supra* and accompanying text.

47. *Id.* at 743-44.

48. *Id.* at 744.

49. *See id.* at 744.

50. *Id.* The Court further noted that because it had concluded that “the primary effect of the assistance afforded here is neither to advance nor to inhibit religion under *Lemon* and *Tilton*, we need not decide whether, as

We have here no expenditure of public funds, either by grant or loan, no reimbursement by a State for expenditures made by a parochial school or college, and no extending or committing of a State's credit. Rather, the only state aid consists, not of financial assistance directly or indirectly which would implicate public funds or credit, but the creation of an instrumentality (the Authority) through which educational institutions may borrow funds on the basis of their own credit and the security of their own property upon more favorable interest terms than otherwise would be available. The Supreme Court of New Jersey characterized the assistance rendered an educational institution under an act generally similar to the South Carolina Act as merely being a "governmental service." *Clayton v. Kervick*, 56 N.J. 523, 530-531, 267 A. 2d 503, 506-507 (1970). The South Carolina Supreme Court, in the opinion below, described the role of the State as that of a "mere conduit." 258 S.C., at 107, 187 S.E. 2d, at 650.⁵¹

With respect to *Lemon's* third prong of excessive entanglement, the Court noted that both *Lemon* and *Tilton* were "grounded on the proposition that the degree of entanglement ... varies in large measure with the extent to which religion permeates the institution." For example, the Court pointed out that, in finding excessive entanglement, the Court in *Lemon* had relied upon the "substantial religious character of [the] church-related' elementary schools."⁵² On the other hand, the Court in *Tilton*, had emphasized that because religious indoctrination was not a "substantial purpose or activity" of the colleges and universities to which the aid was directed, there was "less likelihood than in primary and secondary schools that religion will permeate the area of secular education."⁵³ Relying upon the similarity of the college with those in *Tilton* and the restricted scope of assistance to the secular aspects of the college, the Court concluded that the proposed aid project did not "foreshadow excessive entanglement" between government and religion.⁵⁴

appellees argue (Brief for Appellees 14), the importance of the tax exemption in the South Carolina scheme brings the present case under *Walz v. Tax Comm'n*, 397 U.S. 664 (1970), where this Court upheld a local property tax exemption which included religious institutions." 413 U.S. at 745 n.7.

51. 413 U.S. at 745 n.7.
52. 413 U.S. at 746, quoting *Lemon v. Kurtzman*, 403 U.S. 602, 616 (1971).
53. 413 U.S. at 746, quoting *Tilton v. Richardson*, 403 U.S. 672 at 687 (1971) (plurality opinion). The Court noted that, although Justice White "saw no such clear distinction [between lower schools and institutions of higher learning], he concurred in the judgment, stating: 'It is enough for me that ... the Federal Government [is] financing a separable secular function of overriding importance in order to sustain the legislation here challenged.'" 413 U.S. at 746, quoting *Tilton v. Richardson*, 403 U.S. 672 at 664 (1971) (concurring opinion).
54. See 413 U.S. at 746-49. The Court acknowledged that under the broad powers granted to the Authority under the statute, the Authority could become deeply involved with the day-to-day financial and policy decisions of the college. However, in upholding the statute, the Court relied upon the South Carolina Supreme Court's narrow interpretation of the practical operation of these powers and its conclusion that, under the Authority's rules and the colleges' proposed lease agreement with the Authority, the latter would be justified in taking action only if the college defaulted on its obligations to make payments. The Court also noted that the case came before it as an action for injunctive and declaratory relief to test the constitutionality of the Act as applied to a proposed, rather than an actual, issuance of revenue bonds. *Id.* at 747-49.

Lemon's Progeny

*Committee for Public Education and Religious Liberty v. Nyquist*⁵⁵ concerned aid to elementary and secondary schools and followed in *Lemon's* wake much as *Hunt* followed in *Tilton's*. The aid took three forms: direct subsidies for the maintenance and repair of buildings; reimbursement of parents for a percentage of tuition paid; and certain tax benefits for parents. The Court, noting that the lower court had found that the recipient elementary and secondary schools had generally conformed to the "profile" of a sectarian or substantially religious school, ruled that all three forms of aid, while having a secular purpose, had an impermissible primary effect. The Court found that, because no attempt had been made to impose restrictions on the aid payments, maintenance and repair subsidies could be used for the upkeep of a chapel or classrooms used for religious instruction.⁵⁶ The Court also emphasized that the reimbursements and tax benefits to parents also could be used to support wholly religious activities.⁵⁷

In *Levitt v. Committee for Public Education*,⁵⁸ the Court also invalidated a public aid program for church-affiliated elementary and secondary schools, in the form of reimbursements for the schools' testing and recordkeeping expenses. The money was allocated on a lump sum basis per student, and the beneficiary schools were not required to account for the money received or specify how it was used. Most of the schools met the same sectarian profile as did those in *Nyquist*. The Court found that the program constituted an impermissible state support of religion because the funds were allocated directly to the schools and the use of the funds was not limited to secular functions.

Meek v. Pittenger,⁵⁹ also involved state aid to church-related elementary and secondary schools. The Pennsylvania statute provided three types of aid:

- (1) Loan of textbooks to the schools;
- (2) Loan of instructional materials and equipment; and
- (3) Provision on nonpublic school premises, by public school teachers, of "auxiliary" educational services, including remedial instruction, counseling, testing, psychological services, and speech and hearing therapy, for the benefit of exceptional, remedial, or educationally disadvantaged students.⁶⁰

55. 413 U.S. 756 (1973).

56. *Id.* at 774.

57. *Id.* at 794 (distinguish *Walz*, involving property tax exemption that "covered all property devoted to religious, educational, or charitable purposes").

58. *Id.* at 472.

59. 421 U.S. 349 (1975).

60. *Id.* at 352-53.

Relying upon the authority of *Allen*, the Court upheld the textbook loan provision, stating that it “merely makes available to all children the benefits of a general program to lend school books free of charge.”⁶¹

It found, however, that *Lemon* required the invalidation of the other two forms of aid to the private schools. The first was the loan of instructional materials and equipment. The Court acknowledged that “indirect and incidental benefits” to sectarian schools may be constitutionally permissible; however, it found that the “massive aid” provided by the Pennsylvania statute to the sectarian schools was “neither indirect nor incidental.”⁶² The Court also conceded that, like the textbooks, the materials and equipment were “self-polic[ing], in that starting as secular, nonideological and neutral, they will not change in use.”⁶³ Nevertheless, the Court contended that, given the substantial amounts of direct support authorized by the statute, it would “simply ignore reality to attempt to separate secular educational functions from the predominantly religious role” of the sectarian schools and to characterize the statute as “channeling aid to the secular without providing direct aid to the sectarian.” Quoting *Hunt*, the Court concluded: “Even though earmarked for secular purposes, ‘when it flows to an institution in which religion is so pervasive that a substantial portion of its functions are subsumed in the religious mission,’ state aid has the impermissible primary effect of advancing religion.”⁶⁴ Therefore, the Court held that direct loan of the materials and equipment had the “unconstitutional primary effect of advancing religion because of the predominately religious character” of the beneficiary schools.⁶⁵

Addressing the “auxiliary” educational services, the Court observed that these were to be provided directly to the students involved and were intended to be secular, neutral and nonideological.⁶⁶ However, the Court believed that the provision of these services on the sectarian schools’ premises raised the “potential for impermissible fostering of religion.”⁶⁷ To guard against such potential, the State, in the Court’s view, would be forced to impose restrictions on the auxiliary teachers to ensure they remained religiously neutral.⁶⁸ Moreover, to make certain the teachers followed the restrictions, the state would have to engage in

61. *Id.* at 362, quoting *Board. of Educ. v. Allen*, 392 U.S. 236, 243 (1968).

62. *Id.* at 365.

63. *Id.* at 365, quoting the lower court decision at 374 F.Supp. 639, 660.

64. *Id.* at 365-66, quoting *Hunt v. McNair*, 413 U.S. 734, 743 (1973).

65. *Id.* at 363. The Court found that the primary beneficiaries of the aid, like those schools in *Lemon*, were “religion-pervasive institutions” whose very purpose was to provide an integrated secular and religious education and whose teaching process is largely “devoted to the inculcation of religious values and belief.” Furthermore, “[s]ubstantial aid to the educational function” of such schools “necessarily results in aid to the sectarian school enterprise as a whole.” *Id.* at 366.

66. *Id.* at 368.

67. *Id.* at 372.

68. *Id.* at 370. The Court maintained that the fact that these were public employees, rather than of the sectarian schools, made little difference in the need for continuing surveillance. *Id.* Moreover, the Court indicated that its earlier decisions have made clear that the lower court had “erred in relying entirely on the good faith and professionalism of the secular teachers and counselors functioning in church-related schools to ensure that a strictly nonideological posture is maintained.” *Id.* at 369.

“comprehensive, discriminating, and continuing state surveillance.”⁶⁹ The Court concluded that such steps would result in excessive entanglement between church and state.⁷⁰ The Court also echoed a concern, likewise raised in *Lemon* and *Nyquist*, that the necessity of annual legislative reconsideration of the aid appropriation would create “a serious potential for divisive conflict over the issue of aid to religion.”⁷¹

In *Roemer v. Board of Pub. Works of Maryland*,⁷² the Court again considered a challenge involving aid, in the form of annual noncategorical grants, to eligible colleges and universities, including religiously affiliated institutions. In considering the relationship between church and state, the Court asserted:

And religious institutions need not be quarantined from public benefits that are neutrally available to all. ... Everson and Allen put to rest any argument that the State may never act in such a way that has the incidental effect of facilitating religious activity. The Court has not been blind to the fact that in aiding a religious institution to perform a secular task, the State frees the institution’s resources to be put to sectarian ends. If this were impermissible, however, a church could not be protected by the police and fire departments, or have its public sidewalk kept in repair. The Court never has held that religious activities must be discriminated against in this way.

Neutrality is what is required. The State must confine itself to secular objectives, and neither advance nor impede religious activity.⁷³

In considering, as part of the “primary effects” inquiry, what private educational activities may be supported by state funds, the court noted that “*Hunt* requires: (1) that no state aid at all go to institutions that are so ‘pervasively sectarian’ that secular activities cannot be separated from sectarian ones, and (2) that if secular activities can be separated out, they alone may be funded.”⁷⁴ The Court indicated that, in determining whether an educational institution is “so ‘pervasively sectarian’ that it may receive no direct state aid of any kind, it is necessary to paint a general picture of the institution, composed of many elements.”⁷⁵ The Court agreed with the lower court’s finding that the higher educational institutions in question were not persuasively sectarian because they were not “so permeated by religion that the secular side could not be

69. *Id.* at 369-72, quoting from the companion case to *Lemon*, *Earley v. DiCenso*, see note 17 *supra* and accompanying text. The Court described the sectarian school as a setting in which “an atmosphere dedicated to the advancement of religious belief is constantly maintained.” 421 U.S. at 371.

70. *Id.* at 370.

71. *Id.* at 372. See also notes 21 & 35 and accompanying text.

72. 426 U.S. 736, 739, (1976). Excluded were institutions that award only seminarian or theological degrees. The grants were subject to the restriction that the funds be kept in a separate account and not be used for sectarian purposes and that records be kept of their expenditures.

73. *Id.* at 746-47, citing *Hunt*, 413 U.S., at 743 (“the Court has not accepted the recurrent argument that all aid is forbidden because aid to one aspect of an institution frees it to spend its other resources on religious ends”) (remainder of footnote omitted).

74. 426 U.S. at 755.

75. *Id.* at 758-59.

separated from the sectarian.”⁷⁶ The Court noted with approval that the general picture painted by the federal district court of the institutions in question was “similar in almost all respects to that of the church-affiliated colleges considered in *Tilton* and *Hunt*.”⁷⁷

The Court next considered the constitutional requirement in *Hunt* that aid “[extend] only to ‘the secular side.’” The Court reasoned that requirement was satisfied by the statutory restriction on sectarian use of the funds and the administrative procedures for enforcing that restriction.⁷⁸ Looking at the character of the aided institutions, the Court found they performed “essentially secular educational functions,” thus reducing both the danger that aid will be used to support religious activities and the need for “close surveillance of purportedly secular activities.”⁷⁹ The Court also ruled that the annual subsidy, involving occasional “quick and nonjudgmental” audits, would not involve excessive entanglement.⁸⁰

In *Wolman v. Walter*,⁸¹ the Establishment Clause challenge concerned an Ohio statute that authorized the State to provide nonpublic school students with books, instructional materials and equipment, standardized testing and scoring, speech, hearing and psychological diagnostic services, therapeutic services and field trip transportation. The Court found that the provision of textbooks, testing and scoring,⁸² diagnostic services,⁸³ therapeutic guidance and remedial

76. *Id.* at 758-59.

77. *Id.* The Court stated: “We find no constitutionally significant distinction between them, at least for purposes of the ‘pervasive sectarianism’ test.” *Id.*

78. *Id.* at 759-60. Again, the Court upheld the district court’s finding that aid was extended only to “‘the secular side,’” stating: “*Hunt* requires only that state funds not be used to support ‘specifically religious activity.’ It is clear that funds uses exist that meet this requirement... The statute in terms forbids the use of funds for ‘sectarian purposes.’ And this prohibition appears to be at least as broad as *Hunt*’s prohibition of the public funding of ‘specifically religious activity.’ We must assume that the colleges, and the [Maryland Council for Higher Education], will exercise their delegated control over use of the funds in compliance with the statutory, and therefore the constitutional, mandate.... It has not been the Court’s practice, in considering facial challenges to statutes of this kind, to strike them down in anticipation that particular applications may result in unconstitutional use of funds.” *Id.* at 759-61 (footnotes omitted).

79. *Id.* at 762.

80. *Id.* at 763-764. The Court maintained that the contacts occasioned by the aid were unlikely to be “any more entangling than the inspections and audits incident to the normal process of the colleges’ accreditations by the State.” *Id.* at 764. The Court also accepted the lower court’s finding that the program did not “create a substantial danger of political entanglement.” *Id.* at 765.

81. 433 U.S. 229 (1977).

82. The Court emphasized that the nonpublic school, unlike in *Levitt*, could not control the content of the test or its results, thus preventing the use of the test for religious teaching and avoiding the need for supervision that gives rise to excessive entanglement. Furthermore, the statute did not authorize payment to private school personnel for the costs of administering the tests. *Id.* at 239. *Cf.* *Levitt v. Committee for Pub. Educ.*, 413 U.S. 472 (1973) (invalidated New York law reimbursing sectarian schools for expenses of teacher-prepared testing).

83. The Court pointed out that its decisions have contained “a common thread to the effect that the provision of health services to all schoolchildren – public and nonpublic – does not have the primary effect of aiding religion.” 433 U.S. at 242. The Court distinguished the speech and hearing diagnostic services from remedial and accelerated teaching and counseling which made up the bulk of the “auxiliary services” invalidated in *Meek*. Moreover, the Court noted that the speech and hearing services in *Meek* were

services performed by public school personnel at a religiously neutral site were constitutional.⁸⁴ However, the Court ruled unconstitutional the expenditure of funds for the purchase and loan to students or their parents, upon request, of ostensibly neutral and secular instructional materials and equipment. The Court relied upon *Meeks* and its holding that the secular education and the religious mission in the sectarian schools “are inextricably intertwined.”⁸⁵ Because of the *impossibility* of separating the secular educational function from the sectarian, the Court ruled that the aid *inevitably* provided support for the schools religious role.⁸⁶ The Court also invalidated the field trip funding, holding that, because the sectarian schools were the true recipients of the aid and because field trips were an integral part of the sectarian schools’ educational experience, the “inevitable byproduct” of such aid was the “unacceptable risk” of fostering of religion.⁸⁷ The Court further held that excessive entanglement would result from the “close supervision” necessary to ensure secular use of the field trip funding.⁸⁸

*Mueller v. Allen*⁸⁹ dealt with a Minnesota statute permitting a state tax deduction to parents for amounts incurred for tuition, textbooks and transportation in connection with sending

invalidated only because they were found to be unseverable from the unconstitutional portions of the statute. *Id.* at 243-44. See *Meek v. Pittenger*, 421 U.S. 349, 371 n.21 (1975) (speech and hearing services were only a small part of the auxiliary services at issue). Accordingly, the Court concluded that provision of diagnostic service’s on nonpublic school premises would not create an “impermissible risk of the fostering of ideological views” and thus there was no need for excessive surveillance, and no impermissible entanglement. 433 U.S. at 244.

84. See *id.* at 237-48. The Court again distinguished *Meek*, where similar services were provided, but in the “pervasively sectarian atmosphere of the church-related school.” The Court indicated that the dangers perceived in *Meek* would not arise if services were provided at “truly religiously neutral locations,” because the danger arose from the “nature of the institution,” not the nature of the students. *Id.* at 247-48. The Court stated: “We hold that providing therapeutic and remedial services at a neutral site off the premises of the nonpublic schools will not have the impermissible effect of advancing religion. Neither will there be any excessive entanglement arising from supervision of public employees to insure that they maintain a neutral stance. It can hardly be said that the supervision of public employees performing public functions on public property creates an excessive entanglement between church and state. Sections 3317.06 (G), (H), (I), and (K) are constitutional.” *Id.* at 248.
85. *Id.* at 250. Having noted that the character of the schools at issue had been found to be “substantially comparable” to those involved in *Lemon* (*id.* at 235), the Court reiterated: “The very purpose of many of those schools is to provide an integrated secular and religious education Substantial aid to the educational function of such schools, accordingly, necessarily results in aid to the sectarian school enterprise as a whole. [T]he secular education those schools provide goes hand in hand with the religious mission that is the only reason for the schools’ existence. Within the institution, the two are inextricably intertwined.” *Id.* at 249-50, quoting from *Meek v. Pittenger*, 421 U.S. 349, 366 (1975).
86. 433 U.S. at 250 (“inescapably had the primary effect of providing a direct and substantial advancement of the sectarian enterprise.”) The Court rejected the distinction, urged by the appellees, between the Ohio statute, under which materials and equipment were loaned to nonpublic school students or their parents, and the statute in *Meek*, under which materials and equipment were loaned directly to the nonpublic schools. *Id.* (“it would exalt form over substance if this distinction were found to justify a result different from that in *Meek*.”)
87. *Id.* at 253-54.
88. *Id.* at 254, citing *Lemon v. Kurtzman*, 403 U.S. 602, 619 (1971) (“These prophylactic contacts will involve excessive and enduring entanglement between the state and church”).
89. 463 U.S. 388 (1983).

their children to any elementary or secondary school. The Court wasted little time in finding that the statute had a clearly secular purpose.⁹⁰ The court distinguished this tax deduction from the public aid provided in *Nyquist*, pointing out that, in the latter's case, the aid amounted to tuition grants provided solely to parents of nonpublic school children. In ruling that the Minnesota statute's primary effect was not to advance religion, the Court found several features of the tax deduction significant:

- (1) The deduction was only one among many allowed under Minnesota's tax code⁹¹;
- (2) The deduction was available for educational expenses incurred by all parents, regardless of whether their children attended public school, private nonsectarian school, or private sectarian school⁹²; and
- (3) Any economic benefit derived by the sectarian schools from the deduction was a "result of numerous private choices of individual parents of school-age children."⁹³

The Court concluded that a "program that neutrally provides state assistance to a broad spectrum of citizens is not readily subject to challenge under the Establishment Clause."⁹⁴ Finally, the Court had "no difficulty" in finding the Minnesota law did not "'excessively tangle' the State in religion."⁹⁵

Ball and Aguilar

*School District of Grand Rapids v. Ball*⁹⁶ and *Aguilar v. Felton*⁹⁷ were companion cases involving public aid to nonpublic school students, most of whom attended sectarian schools.

90. *See id.* at 395. (defraying educational expenses incurred by parents of public and private school students; ensuring the State's citizenry is well educated; and ensuring the continued financial health of sectarian and nonsectarian private schools).

91. *Id.* at 396. (legislatures have especially broad latitude in creating tax classifications and distinctions).

92. *Id.* at 397-98. (provision of benefits to broad spectrum an important index of secular effect); *accord*, *Widmar v. Vincent*, 454 U.S. 263, 274 (1981).

93. *Id.* at 399. Although the Court acknowledged that the financial assistance provided to parents ultimately has some economic benefit to the schools attended by their children, it stated: "Where ... aid to parochial schools is available only as a result of decisions of individual parents no 'imprimatur of state approval' can be deemed to have been conferred on any particular religion, or on religion generally." *Id.* (citation omitted). Moreover, after examining the historic purposes of the Establishment Clause prohibition, the Court concluded that such purposes "simply do not encompass the sort of attenuated financial benefit, ultimately controlled by the private choices of individual parents, that eventually flows to parochial schools from the neutrally available tax benefit at issue in this case." *Id.* at 400.

94. *Id.* at 398-99.

95. *Id.* at 403.

96. 473 U.S. 373 (1985).

97. 473 U.S. 402 (1985).

Ball concerned a challenge to two programs, Shared Time and Community Education,⁹⁸ which provided remedial and enrichment classes to nonpublic school students at public expense, in classrooms located in and leased from the nonpublic schools. Having concluded that the nonpublic schools at issue were “pervasively sectarian,”⁹⁹ the Court found that these programs had the effect of impermissibly promoting religion in three ways. First, much like in *Meek*, there existed a “substantial risk” that the state-paid teachers, influenced by the “pervasively sectarian” environment in which they worked, might “subtly or overtly indoctrinate the students in particular religious tenets at public expense.”¹⁰⁰ Second, the provision of state-funded, secular instruction on religious premises inherently created a “symbolic union” of church and state that “threaten[ed] to convey a message” of government support of religion to the students and to the public generally.¹⁰¹ Finally, the challenged programs, by taking over a substantial portion of the responsibility for teaching secular subjects, effectively subsidized the religious functions of the sectarian schools.¹⁰² Accordingly, the Court held that the provision of “instructional materials [and] of instructional services by teachers in the parochial school building ‘inescapably [has] the primary effect of providing a direct and substantial advancement of the sectarian enterprise.’”¹⁰³

In *Aguilar*, the Court struck down a New York City Title I program¹⁰⁴ that closely resembled the Share Time program found unconstitutional in *Ball*. The appellants attempted to distinguish the aid program from *Ball* on the ground that New York City, unlike the school district in *Ball*, had adopted a system for monitoring the religious content of the publicly funded

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98. The Shared Time program involved remedial and enrichment type classes that were taught by public employed teachers during the school day to supplement the core curriculum courses required by the state. The teachers used materials purchased with public funds. The Community Education program involved voluntary courses offered at the end of the school day and taught by part-time public school employees, who generally were also full-time employees of the same nonpublic school at which the Community Education courses were being offered. These Community Education courses are also offered at the public schools either on a Community Education basis or as part of the public schools’ “more extensive regular curriculum.” 473 U.S. at 375-77.
99. After considering the nature of the institutions in which the programs operate, the Court found that forty of the forty-one schools were “pervasively sectarian.” *Id.* at 384-85.
100. *See id.* at 386-88 & 397.
101. *See id.* at 389-92 & 397. The Court contended that the “symbolism of a union between church and state is most likely to influence children of tender years, whose experience is limited and whose beliefs consequently are the function of environment as much as of free and voluntary choice.” *Id.* at 390.
102. *See id.* at 396-97.
103. *Id.* at 395-96, quoting *Wolman v. Walter*, 433 U.S. 229, 250 (1977). In its reasoning, the Court distinguished between its prior cases involving indirect, incidental aid and those providing direct, substantial aid. Relying upon *Meek* and *Wolman*, the Court contended that the provision of teachers, in addition to instructional equipment and materials, constituted “direct aid to the educational function” of the sectarian schools and, as such, was “indistinguishable” from a direct cash subsidy, which would be “most clearly prohibited under the Establishment Clause.” 473 U.S. at 395.
104. The program, which focused on special educational needs of children of low-income families, was originally enacted as Title I of the Elementary and Secondary Education Act of 1965, 92 Stat. 2153, (codified at 20 U.S.C. §2701, et. seq.). Although Title I was superseded by Chapter I of the Education Consolidation and Improvement Act of 1981, 95 Stat. 464, (codified at 20 U.S.C. §3801, et. seq.), the Court continued to refer to the program as “Title I” for the sake of convenience. 473 U.S. at 404 & n.1.

Title I classes in the religious schools.¹⁰⁵ The Court rejected this argument, finding that the monitoring system “inevitably result[ed] in the excessive entanglement of church and state,” thus running afoul of the third part of the *Lemon* test.¹⁰⁶ The Court found that the “critical elements of the entanglement proscribed in *Lemon* and *Meek*” were present in New York City’s Title I program: the aid was provided in a pervasively sectarian environment; ongoing inspection was required to ensure the absence of a religious message, because the aid consisted teachers; and the scope and duration of the program would require a “permanent and pervasive state presence” in the religious schools. The Court also found the program objectionable because of the administrative cooperation required between the public and parochial school systems and the frequent contacts necessitated between the regular parochial school teachers and the remedial teachers.¹⁰⁷ Finally, the Court expressed concern that the detailed monitoring by government agents and close administrative contact required might increase the “dangers of political divisiveness along religious lines.”¹⁰⁸

Witters and Zobrest

In *Witters v. Washington Department of Services for the Blind*,¹⁰⁹ the Court considered whether a grant from Washington’s vocational rehabilitation program to finance a blind person’s religious training at a Christian college would advance religion in a manner inconsistent with the Establishment Clause.¹¹⁰ The Court pointed out the well-settled view that “the Establishment Clause is not violated every time money previously in the possession of a State is conveyed to a religious institution.”¹¹¹ As an example, the Court indicated there is no constitutional barrier to the state issuing a paycheck to its employee who, in turn, donates, even with the state’s foreknowledge, all or a portion of the check to a religious institution.¹¹² According to the Court, the issue was whether the grant of aid to the petitioner and the petitioner’s use of that aid to support his religious education was a permissible transfer similar to the hypothetical salary donation articulated by the Court or an “impermissible direct subsidy.”¹¹³ Observing that the grants under the program were “‘made available generally without regard to the sectarian-nonsectarian, or public-nonpublic nature of the institution benefited’ and [were] in no way

105. The Court maintained that the monitoring “at best” would have assisted in preventing the program from being used, “intentionally or unwittingly,” to inculcate the religious beliefs of the parochial school. *Id.* at 409.

106. *Id.* at 409. The Court cautioned that, even when state aid to sectarian institutions does not have the primary effect of advancing religion, the aid nevertheless might violate the Establishment Clause because of the nature of the interaction of church and state in administering the aid.

107. *Id.* at 413.

108. *Id.* at 414.

109. 474 U.S. 481 (1986).

110. *Witters* was studying the Bible, ethics, speech, and church administration to prepare himself for a career as a pastor, missionary or youth director. *Id.* at 483.

111. *Id.* at 486.

112. *Id.* at 486-87.

113. *Id.* at 487.

skewed towards religion,”¹¹⁴ the Court found that the aid program created “no financial incentive for students to undertake sectarian education.”¹¹⁵ The Court reasoned that, because grants were paid directly to the students who then transmitted them to the educational institution of the students’ choice, any program aid that “ultimately” flowed to a religious educational institution did so “only as a result of the genuinely independent and private choices of aid recipients.”¹¹⁶ Concluding that the “decision to support religious education” is thus made by the student and is not attributable to the State, the Court stated that, based upon the facts presented:

“[I]t does not seem appropriate to view any aid ultimately flowing to the Inland Empire School of the Bible as resulting from a state action sponsoring or subsidizing religion. Nor does the mere circumstance that petitioner has chosen to use neutrally available state aid to help pay for his religious education confer any message of state endorsement of religion.... On the facts present here, we think the Washington program works no state support of religion prohibited by the Establishment Clause.”¹¹⁷

*Zobrest v. Catalina Foothills School District*¹¹⁸ considered whether the provision, under the Individuals with Disabilities Education Act (IDEA),¹¹⁹ of a sign language interpreter for a deaf student attending a sectarian school had the primary effect of advancing religion.¹²⁰ Relying upon *Mueller* and *Witters*, the Court stated that: “[W]e have consistently held that government programs that neutrally provide benefits to a broad class of citizens defined without reference to religion are not readily subject to an Establishment Clause challenge just because sectarian institutions may also receive an attenuated financial benefit.”¹²¹ The Court found that the provision of the interpreter was part of a general government program that neutrally distributed benefits to any child that qualified as disabled under the IDEA, “without regard to the ‘sectarian-nonsectarian, or public-nonpublic nature’ of the school” attended by the child.¹²² Furthermore, by allowing parents to choose the school, the statute ensured that a government-paid interpreter would be present at a sectarian school “only as a result of the private decision of individual parents.”¹²³ The Court held that:

[B]ecause the IDEA creates no financial incentive for parents to choose a sectarian school, an interpreter’s presence there cannot be attributed to state decisionmaking.... When the government offers a neutral service on the premises of a sectarian school as part of a general program that ‘is in no way skewed towards religion,’ it follows under

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114. *Id.* at 487-88, quoting from *Committee for Public Education and Religious Liberty v. Nyquist*, 413 U.S.756, 782-83, n.38.
115. 474 U.S. at 488 (citation omitted).
116. *Id.* (footnote omitted).
117. *Id.* at 488-89 (citation omitted).
118. 509 U.S. 1 (1993).
119. 20 U.S.C. 1400 *et seq.*; see also *Ariz. Rev. Stat. Ann. §15-761 et seq.*
120. *See* 509 U.S. at 8-10.
121. *Id.* at 8 (“Nowhere have we stated this principle more clearly than in [*Mueller* and *Witters*]”).
122. *Id.* at 10, quoting from *Witters*, 474 U.S. 481, 487.
123. 509 U.S. at 10.

our prior decisions that provision of that service does not offend the Establishment Clause.”¹²⁴

The Court noted two reasons why the Respondent’s argument that *Meek* and *Ball* should control was “misplaced.” First, unlike the programs involved in those cases, the aid did not amount to “an impermissible ‘direct subsidy’” of the sectarian school because the aid did not relieve the school of an expense it otherwise would have incurred in educating the student.¹²⁵ The Court reiterated that:

[A]ny attenuated financial benefit that parochial schools do ultimately receive from the IDEA is attributable to ‘the private choice of individual parents.’ Disabled children, not sectarian schools, are the primary beneficiaries of the IDEA; to the extent sectarian schools benefit at all from the IDEA, they are only incidental beneficiaries.¹²⁶

Second, the Court, maintaining that the task of a sign-language interpreter was “quite different” from that performed by a teacher or guidance counselor, stated:

[T]he Establishment Clause lays down no absolute bar to the placing of a public employee in a sectarian school. Such a flat rule, smacking of antiquated notions of ‘taint,’ would indeed exalt form over substance. Nothing in this record suggests that a sign-language interpreter would do more than accurately interpret whatever material is presented to the class as a whole.¹²⁷

Old Presumptions Overturned: *Agostini v. Felton*

Twelve years after *Aquilar v. Felton*,¹²⁸ the Court had occasion to revisit that decision in *Agostini v. Felton*¹²⁹ when the New York City school board had sought relief from a permanent injunction that prohibited the board from using any Title I funds to provide teaching or counseling services by public school teachers or guidance counselors on the premises of sectarian schools.¹³⁰ After reviewing *Aquilar* and its companion case *Ball*, the Court summarized the rationale upon which they were decided.

124. *Id.* at 10. The Court maintained that this case was easier to decide than either *Mueller* or *Witters* because, “under the IDEA, no funds traceable to the government ever find their way into sectarian coffers.” *Id.*

125. *Id.* at 12.

126. *Id.* at 12.

127. *Id.* at 13.

128. 473 U.S. 402 (1985). See *supra* notes 96-108 and accompanying text.

129. 521 U.S. 203 (1997).

130. *Id.* at 203. In *Aquilar*, the Court had remanded the case back to the U.S. District Court for the Eastern District of New York, which had entered a permanent injunction prohibiting the New York City school board from using any Title I funds for public school teachers or guidance counselors to provide teaching or counseling services on the premises of sectarian schools. To continue offering Title I services to students at private religious schools, the school board modified its program by providing instruction and counseling at public school sites, leased sites, and in mobile instructional units parked near the sectarian schools. The

Distilled to essentials, the Court’s conclusion that the Shared Time program in *Ball* had the impermissible effect of advancing religion rested on three assumptions: (i) any public employee who works on the premises of a religious school is presumed to inculcate religion in her work; (ii) the presence of public employees on private school premises creates a symbolic union between church and state; and (iii) any and all public aid that directly aids the educational function of religious schools impermissibly finances religious indoctrination, even if the aid reaches such schools as a consequence of private decisionmaking. Additionally, in *Aguilar* there was a fourth assumption: that New York City’s Title I program necessitated an excessive government entanglement with religion because public employees who teach on the premises of religious schools must be closely monitored to ensure that they do not inculcate religion.¹³¹

The Court acknowledged that its more recent cases had undermined the assumptions upon which *Ball* and *Aguilar* had relied.¹³² Although the Court stated that the “general principles” used to evaluate whether government aid violates the Establishment Clause (i.e., whether the government acted with the purpose of advancing or inhibiting religion and whether the aid has the effect of advancing or inhibiting religion) have remained unchanged since *Aguilar*, it nonetheless conceded that its “understanding of the criteria” used to determine whether the aid has an impermissible effect had changed.¹³³ The Court explained that, although it has repeatedly recognized that government indoctrination of religious beliefs has the impermissible effect of advancing religion, its cases subsequent to *Aguilar* had modified the approach used to assess indoctrination in two significant respects.

First, the Court noted that *Zobrest*¹³⁴ it had “abandoned the presumption,” erected in *Meek*¹³⁵ and relied upon in *Ball* and *Aguilar*, that the presence of public employees on parochial school premises will inevitably result in the impermissible effect of state sponsored indoctrination or constitute an impermissible symbolic union between government and

resulting costs were significant and, because they were deducted from the federal grant before Title I funds were distributed, they reduced the amount of Title I funds available for remedial education. As a result, the school board had to reduce the number of students who received Title I benefits. This scenario was played out in school districts across the country. In 1995, the New York City school board filed a motion with the U.S. District Court for relief from the permanent injunction on the basis of three changes in the factual and legal landscape: the exorbitant costs of complying with the injunction; a majority of Justices on the United States Supreme Court had since expressed their views that *Aguilar* should be reconsidered or overruled; and subsequent Establishment Clause decisions had undermined *Aguilar*. The District Court denied the school board’s motion and the Court of Appeals for the Second Circuit affirmed. The Supreme Court granted certiorari. *See id.* at 208-215.

131. *Id.* at 222.

132. In doing do, the court agreed with one of the Petitioner school board’s argument justifying its claim for relief from the permanent injunction. *See id.* at 215-16 & 237.

133. 521 U.S. at 223.

134. *Zobrest v. Catalina Foothills School Dist.*, 509 U.S. 1 (1993). See discussion of case *supra* at notes 118-127 and accompanying text.

135. *Meek v. Pittenger*, 421 U.S. 349 (1975). See discussion of case *supra* at notes 59-71 and accompanying text.

religion.¹³⁶ The Court pointed to *Zobrest*¹³⁷ as having “expressly rejected the notion -- relied on in *Ball* and *Aguilar* -- that, solely because of her presence on private school property, a public employee will be presumed to inculcate religion in the students.”¹³⁸ Furthermore, the Court contended that *Zobrest* “implicitly repudiated” another premise upon which *Ball* and *Aguilar* stood: “that the presence of a public employee on private school property creates an impermissible ‘symbolic link’ between government and religion.”¹³⁹

The Court explained that the second significant modification in its approach was its departure, in *Witters*¹⁴⁰ from the rule relied upon in *Ball* that “all government aid that directly aids the educational function of religious schools is invalid.”¹⁴¹ The Court reiterated that the tuition grants in *Witters* were “‘made available generally without regard to the sectarian nonsectarian, or public nonpublic nature of the institution benefited’” and were disbursed directly to the students who directed the money, as tuition, to the educational institution of their choice.¹⁴² Consequently, any public funds that “ultimately went to religious institutions did so ‘only as a result of the genuinely independent and private choices’ of individuals.”¹⁴³

The Court concluded that “*Zobrest* and *Witters* make clear” that the Shared Time program in *Ball* and New York City’s Title I program in *Aguilar*, viewed under current law, will not be considered, “as a matter of law, ... to have the effect of advancing religion through indoctrination.”¹⁴⁴ The Court elaborated:

Indeed, each of the premises upon which we relied in *Ball* to reach a contrary conclusion is no longer valid. First, there is no reason to presume that, simply because she enters a parochial school classroom, a full time public employee such as a Title I teacher will depart from her assigned duties and instructions and embark on religious indoctrination

....

... *Zobrest* also repudiates *Ball*’s assumption that the presence of Title I teachers in a parochial school classrooms will, without more, create the impression of a ‘symbolic union’ between church and state....

Nor under current law can we conclude that a program placing full time public employees on parochial campuses to provide Title I instruction would impermissibly finance religious indoctrination.¹⁴⁵

136. 521 U.S. at 223.

137. *Zobrest*, 509 U.S. at 13.

138. 521 U.S. at 224.

139. *Id.*

140. *Witters v. Washington Dept. of Servs. For Blind*, 474 U.S. 481 (1986). See discussion of case *supra* at notes 109-117 and accompanying text.

141. 521 U.S. at 225.

142. 521 U.S. at 225-226, quoting *Witters*, 474 U.S. at 487.

143. 521 U.S. at 226, quoting *Witters*, 474 U.S. at 487.

144. 521 U.S. at 226

145. *Id.* at 227-228. The Court found the instructional services under Title I to be “indistinguishable” in “all relevant respects” from the provision of sign language interpreters under the IDEA: both programs made aid available only to eligible recipients; the aid was provided to students at whatever school they chose to

Finally, the factor the Court found “most fatal” to the argument, supported by the dissent, that the Title I services provided on the premises of the sectarian schools directly subsidize religion was the fact that such argument should apply “with equal force” when those same services were provided off campus.¹⁴⁶ The Court pointed out, however, that *Aguilar* had “implied that providing Title I services off campus is entirely consistent with the Establishment Clause.”¹⁴⁷ The Court noted that the dissent had “resist[ed] the impulse to upset this implication” and, instead, contended that it could be justified on the grounds that a sectarian school would be less likely to “make patently significant cut backs” in its curriculum if the Title I services were offered off campus, rather than on campus. In rejecting this reasoning, the Court contended that any financial incentive to make such cut backs would be the same regardless of where the services were offered.¹⁴⁸ Accordingly, the Court found that there was “no logical basis” for concluding that Title I services were an “impermissible subsidy of religion when offered *on* campus, but not when offered *off* campus.”¹⁴⁹ The Court concluded that, contrary to *Aguilar*, the presence of full time public employees of sectarian school campuses “[did] not as a matter of law have the impermissible effect of advancing religion through indoctrination.”¹⁵⁰

In *Agostini*, the Court announced that examination of criteria by which an aid program identifies its beneficiaries was relevant in determining whether the “criteria might themselves have the effect of advancing religion by creating a financial incentive to undertake religious indoctrination.”¹⁵¹ Relying upon *Witters* and *Zobrest*, the Court concluded that such financial incentive is not present when aid is “allocated on the basis of neutral, secular criteria that neither favor nor disfavor religion and is made available to both religious and secular beneficiaries on a nondiscriminatory basis.”¹⁵² Although the decisions in *Ball* and *Aguilar* ignored this issue, the Court pointed out that, before and since these decisions, it had “sustained programs that provided aid to *all* eligible children regardless of where they attended school.”¹⁵³ Turning to New York City’s Title I program, the Court found that, because the Title I services were allocated on the basis of criteria that neither favor nor disfavor religion and were available to all children who met the Acts’ eligibility requirements, regardless of religious beliefs or which school they

attend; and neither “reliev[ed] the sectarian schools of costs they otherwise would have borne in educating their students.” *Id.* at 228 (quoting *Zobrest*, 509 U.S. at 12).

146. *See* 521 U.S. at 230.

147. *Id.*

148. *Id.*

149. *Id.* (emphasis added).

150. *Id.*

151. *Id.* at 230-231. The Court had previously examined such criteria, within the context of evaluating whether a program subsidizes religion; but had done so solely to assess whether any use of the aid to indoctrinate religion was attributable to the government. *Id.* at 230.

152. *Id.* at 231. *See Zobrest*, 509 U.S. at 10 (neutrally available IDEA aid creates no financial incentive for parents to choose a sectarian school); *Witters*, 474 U.S. at 488 (neutrally available program did not create financial incentive for students to undertake sectarian education).

153. 521 U.S. at 231 (emphasis supplied).

attended, the program did not give the aid recipients any incentive to modify their religious beliefs or practices in order to obtain the program's services.¹⁵⁴

The Court next addressed *Aguilar*'s conclusion that the Title I program resulted in excessive entanglement between church and state.¹⁵⁵ First, however, the Court concluded that, because the factors it has used to assess whether an entanglement is "excessive" are similar to those used to examine the issue of "effect,"¹⁵⁶ the "simplest" way to consider the entanglement issue is "as an aspect of the inquiry into a statute's effect."¹⁵⁷ The Court then reviewed the three grounds on which it had found "excessive" entanglement in *Aguilar*:

- (1) The program required pervasive monitoring to ensure Title I employees did not inculcate religion;
- (2) The program required administrative cooperation between the school authority and the parochial schools; and
- (3) The program might increase the dangers of political divisiveness.¹⁵⁸

The Court pointed out that these last two considerations would be present regardless of whether the Title I services were offered on or off the premises of a sectarian school. The Court emphasized that no court had ever ruled that such services would be unconstitutional if offered off the premises of a sectarian school. Therefore, the Court reasoned that these considerations were "insufficient by themselves to create an 'excessive' entanglement."¹⁵⁹ With respect to the first consideration, the Court noted that its underlying assumption has been "undermined."¹⁶⁰ The Court stated:

In *Aguilar*, the Court presumed that full time public employees on parochial school grounds would be tempted to inculcate religion, despite the ethical standards they were required to uphold. Because of this risk *pervasive* monitoring would be required. But after *Zobrest* we no longer presume that public employees will inculcate religion simply

154. *Id.* at 232.

155. The Court emphasized that not all entanglements have the effect of advancing or inhibiting religion and that, because interaction is "inevitable," it has "always tolerated some level of involvement" between church and state. The court stated that "[e]ntanglement must be 'excessive' before it runs afoul of the Establishment Clause." *Id.* at 233 (citations omitted).

156. *Id.* at 232. The court explained that, in assessing entanglement, it has looked to the character and purpose of the benefited institutions, the nature of the government aid, and the resulting relationship between the government and the religious authority, and in assessing a law's "effect", it has examined the character of the benefited institutions and the nature of the government aid provided. *Id.* (citations omitted).

157. *Id.* at 233. The Court pointed out that it has considered entanglement as part of its inquiry whether an aid program has an impermissible effect on advancing religion, in addition to as a "factor separate and apart from 'effect'" *Id.* at 232. (citations omitted).

158. *Id.* at 233.

159. *Id.* at 233-234 (citations omitted).

160. *Id.* at 234.

because they happen to be in a sectarian environment. Since we have abandoned the assumption that properly instructed public employees will fail to discharge their duties faithfully, we must also discard the assumption that *pervasive* monitoring of Title I teachers is required.¹⁶¹

The Court also observed that the record failed to indicate the insufficiency of the safeguards adopted by the Title I program to prevent or detect inculcation of religion by public employees. Moreover, the Court pointed out that it had declined to find excessive entanglement in cases involving “far more onerous burdens in religious institutions than the monitoring system” presently at issue.¹⁶²

The Court concluded that New York City’s Title I program did not “run afoul of any of the three primary criteria” presently used by the Court to evaluate whether government aid has the effect of advancing religion. The Title I program does not:

- (1) Result in governmental indoctrination;
- (2) Define its recipients by reference to religion; or
- (3) Create an excessive entanglement.¹⁶³

Having rejected the presumptions and reasoning underlying *Aguilar* and *Ball*, the Court announced:

We therefore hold that a federally funded program providing supplemental, remedial instruction to disadvantaged children on a neutral basis is not invalid under the Establishment Clause when such instruction is given on the premises of sectarian schools by government employees pursuant to a program containing safeguards such as those present here. The same considerations that justify this holding require us to conclude that this carefully constrained program also cannot reasonably be viewed as an endorsement of religion.¹⁶⁴

Acknowledging that its Establishment Clause law had “significantly changed” since the *Aguilar* and *Ball* decisions, the Court affirmatively overruled *Aguilar* and those parts of *Ball* concerning the Grand Rapid’s Shared Time program.¹⁶⁵

161. *Id.* at 234. (emphasis supplied).

162. *Id.*

163. *Id.*

164. *Id.* at 234-235. (citations omitted).

165. *See id.* at 235 and 237. (“[We] must acknowledge that *Aguilar*, as well as the portion of *Ball* addressing the Grand Rapid’s Shared Time program, are no longer good law.”) *Id.* at 235.

Agostini's Progeny: *Mitchell v. Helms*

The latest United States Supreme Court case concerning aid to religious schools confirmed a doctrinal shift in church-state law that, in recent years, has resulted in the authorization of more forms of public aid for religious schools. *Mitchell v. Helms*,¹⁶⁶ handed down during the last week of the Court's 1999-2000 term, upheld government aid to religious schools in the form of computers and library books. Although no opinion commanded a majority of the court, six of the justices agreed that the provision of computers and library books to religious schools under the federal Chapter 2 program (now known as Title VI) should be upheld.¹⁶⁷ In so doing, the six justices also agreed to overrule key holdings in two 1970s Supreme Court cases that had set a precedent for barring the government provision of equipment such as maps and slide projectors to religious schools.¹⁶⁸

Mitchell v. Helms involved the federal school aid program known as Chapter 2.¹⁶⁹ The Federal Government distributed funds to state and local educational agencies, which, in turn, lent educational materials and equipment to public and private nonprofit schools based upon enrollment numbers (size of enrollment determined amount of aid received). In Jefferson Parish, Louisiana, approximately thirty percent of these Chapter 2 funds were allocated for private schools, most of which were either Catholic schools or otherwise religiously affiliated. The Respondents in *Mitchell* had filed suit, alleging that Chapter 2, as applied in Jefferson Parish, violated the First Amendment's Establishment Clause.¹⁷⁰

Both the plurality and the concurring opinions indicated that *Agostini v. Felton*¹⁷¹ was controlling.¹⁷² Both also agreed that *Agostini* had modified *Lemon's* three prong test¹⁷³ to

166. 120 S. Ct. 2530 (2000).

167. The plurality opinion, written by Justice Clarence Thomas, not only upheld the government aid under Chapter 2, but also indicated approval of any government aid that was offered on a neutral basis and was secular in content. Justices Sandra Day O'Connor and Stephen G. Breyer concurred in the outcome but expressed concern over the plurality's expansive ruling. ("announces a rule of unprecedented breadth" for the evaluation of constitutional challenges to government aid programs as applied to religious schools (O'Connor, J. and Breyer, J., concurring in judgment, at 2556) and "foreshadows the approval of direct monetary subsidies to religious organizations, even when they use their money to advance their religious objectives." (*Id.* at 2560).

168. See *id.* at 2555 (plurality opinion) (overruling *Meek* and *Wolman* to the extent they conflict withholding in *Mitchell*), 2556 (concurring opinion)(to extent Court's decision in *Meek* and *Wolman* are inconsistent with Court's judgment in *Mitchell*, those decisions are overruled).

169. The school aid program, denominated at the time the suit was filed as Chapter 2 of the Education Consolidation and Improvement Act of 1981, 95 Stat. 469, as amended, 20 U.S.C. §§7301-7373, had its origins as Title II of the Elementary and Secondary Education Act of 1965, 79 Stat. 27. Title I of that Act and its subsequent reenactment were at issue in *Aguilar* and *Agostini*. See *supra* notes 97-108 and 128-165 and accompanying text. Chapter 2 was subsequently codified as Subchapter VI of Chapter 70 of 20 U.S.C. by the Improving America's Schools Act of 1994, 108 Stat. 3707. The parties, the lower courts and the U.S. Supreme Court all refer to the aid program as Chapter 2. See *Mitchell*, 120 U.S. at 2537, n.1 (plurality opinion), 2560 (concurring opinion). For a summary of the provisions of Chapter 2, see *id.* at 2536-2538 (plurality opinion).

170. For a summary of the case's 15 year "tortuous history", see *id.* at 2538-2540 (plurality opinion).

171. 521 U.S. 203 (1997).

determine whether a statute violates the Establishment Clause, by recasting *Lemon*'s third issue of entanglement as simply one criterion relevant to the statute's primary effect inquiry.¹⁷⁴ Thus under *Agostini*'s analysis, the constitutional inquiry must address whether a government school aid program:

- (1) Has a secular purpose; or
- (2) Has a principal or primary effect of advancing or inhibiting religion.¹⁷⁵

Agostini's criteria for assessing whether government aid has the "effect" of advancing religion are whether it:

- (1) Results in governmental indoctrination;
- (2) Defines its recipients by reference to religion; or
- (3) Creates an excessive entanglement.¹⁷⁶

The issue before the Court in *Mitchell* was limited to determining Chapter 2's effect in light of the first two "effects" criteria enunciated in *Agostini*, that is whether Chapter 2 aid, as applied in Jefferson Parish:

- (1) Resulted in governmental indoctrination; or
- (2) Defined its recipients by reference to religion.¹⁷⁷

In a split decision,¹⁷⁸ six of the justices concluded that Chapter 2 neither results in religious indoctrination by the government nor defines its recipients by reference to religion.¹⁷⁹

172. *Mitchell*, 120 S. Ct. at 2540 (plurality opinion), 2556 (concurring opinion).

173. See *Lemon v. Kurtzman*, 403 U.S. 602 (1971). Under *Lemon*, the Court had considered whether a statute:

- (1) Has a secular purpose;
- (2) Has a principal or primary effect of advancing or inhibiting religion; or
- (3) Creates an excessive entanglement between government and religion.

174. The Court in *Agostini* had noted that its previous cases discussing excessive entanglement and its cases discussing primary effect had applied many of the same considerations. It further noted that these cases had "pared somewhat" the factors justifying a finding of excessive entanglement. See *Mitchell*, 120 S. Ct. at 2540 (plurality opinion) citing *Agostini*, 521 U.S. at 232-234; accord 120 S. Ct. at 2556 (concurring opinion).

175. *Agostini*, 521 U.S. at 232-233. See also *supra* note 133-163 and accompanying text.

176. *Mitchell*, 120 S. Ct. at 2540 (plurality opinion), 2560 (concurring opinion); see *Agostini*, 521 U.S. at 234.

177. See *Mitchell*, 120 S. Ct. at 2540 (plurality opinion), 2560-2561 (concurring opinion). The Respondents in *Mitchell* did not challenge the lower court's holding that the Chapter 2 aid has a secular purpose or that Chapter 2 does not create an excessive entanglement.

Accordingly, the Court held that Chapter 2 does not have the impermissible effect of advancing religion and consequently, does not constitute a “law respecting an establishment of religion.”¹⁸⁰ In so holding, the plurality and the concurring opinions agreed that, to the extent *Meek* and *Wolman* were inconsistent with the Court’s judgment, they were overruled.¹⁸¹

Justice Sandra Day O’Connor, joined by Justice Stephen Breyer, concurred in the judgment, but felt compelled to write a separate opinion in which she expressed reservations over what she viewed as the plurality’s “expansive” ruling. In particular, she noted two concerns that prompted her separate opinion:

- (1) The plurality’s treatment of neutrality, which came “close to assigning that factor singular importance” in future evaluations of Establishment Clause challenges to government school-aid programs; and
- (2) Approval by the plurality of actual diversion of government aid to religious indoctrination, which Justice O’Connor found to be in tension with the Court’s precedents and, in any event, unnecessary to decide the instant case.¹⁸²

The Respondents had attempted to dismiss *Agostini* as factually distinguishable¹⁸³ and instead proposed two “rules” to govern the Court’s determination of whether Chapter 2 had the effect of advancing religion:

- (1) Direct, nonincidental aid to the primary educational mission of religious schools is always impermissible; and
- (2) Aid to religious schools that is divertible to religious use is similarly impermissible.¹⁸⁴

After discussing these contentions at length, both the plurality and the concurring opinions rejected them.¹⁸⁵ Because both the plurality and the concurring opinions relied upon *Agostini* as controlling, an attempt has been made to structure the discussion of the plurality and concurring

178. Justice Thomas was joined in the plurality opinion by Chief Justice Rehnquist and Justices Scalia and Kennedy. Justice O’Connor filed an opinion concurring in the judgment, in which Justice Breyer joined. Justice Souter filed a dissenting opinion in which Justices Stevens and Ginsburg joined.

179. *Mitchell*, 120 S. Ct. at 2540 (2000) at 9 (plurality opinion), 2561 and 2572 (O’Connor, J. and Breyer, J. concurring in judgment).

180. *Id.* at 2540 (plurality opinion), 2572 (concurring opinion).

181. See note 168 *supra* and accompanying text.

182. *Mitchell*, 120 S. Ct. at 2556 (concurring opinion).

183. Justice Thomas noted that the Respondents “*inexplicably* make no effort to address Chapter 2 under the *Agostini* test.” *Id.* at 2544 (plurality opinion) (emphasis added).

184. See *id.* (plurality opinion).

185. See *id.* at 2544-2549 (plurality opinion), 2562-2568 (concurring opinion).

opinions, including their addressing of the arguments made by the Respondents, primarily within the framework of the two “primary effect” criteria at issue in the case.

Does government aid result in religious indoctrination?

The plurality opinion

With respect to the indoctrination issue, the plurality contended that the answer ultimately depended, as the Court had indicated in *Agostini* and elsewhere, upon whether any religious indoctrination that occurs in the benefited schools could reasonably be attributed to governmental action.¹⁸⁶ Furthermore, in the plurality’s view, the answer to the indoctrination question also would resolve the question whether a government school aid program subsidizes religion.¹⁸⁷ In distinguishing between indoctrination that is attributable to the state and indoctrination that is not, the plurality maintained that the Court has consistently turned to the neutrality principle, upholding aid that is offered to a broad range of groups or persons without regard to their religion.¹⁸⁸ Moreover, as a way of assuring neutrality, the Court has repeatedly considered whether any governmental aid to a religious institution results from the genuinely independent and private choices of individual parents.¹⁸⁹ The plurality noted that, in cases such as *Zobrest* and *Witters*, “private choices helped to ensure neutrality, and neutrality and private choices together eliminated any possible attribution [of indoctrination] to the government.”¹⁹⁰

The plurality chose to characterize the per capita scheme by which Chapter 2 aid was allocated as private decisionmaking. Accordingly, the plurality concluded that “[b]ecause Chapter 2 aid is provided pursuant to private choice, it is not problematic that one could fairly describe Chapter 2 as providing ‘direct’ aid.”¹⁹¹

186. *Id.* at 2541 and cases cited therein (plurality opinion).

187. 120 S. Ct. at 2541. See notes 146-150 *supra* and accompanying text re issue of subsidization.

188. *Mitchell*, 120 S. Ct. at 2541 (plurality opinion).

189. *See id.* at 2541-2543 and cases cited therein (plurality opinion).

190. *See id.* at 2542 (plurality opinion); accord, *Witters*, 474 U.S. at 488-89 (any program aid ultimately flowing to the religious educational institution was a result of the genuinely independent and private choices of aid recipients and thus is not attributable to the State; nor does use of neutrally available state aid by student to help pay for his religious education confer any message of state endorsement of religion); *Zobrest*, 509 U.S. at 10 (by allowing parents to choose the school, the statute ensured that a government-paid interpreter’s presence at sectarian school was result of private decision of individual parents and could not be attributed to state decisionmaking).

191. 120 S. Ct. at 2553 (plurality opinion). Relying upon *Agostini*, *Zobrest*, and *Witters*, the plurality reasoned that:

“Chapter 2 aid ... reaches participating schools only ‘as a consequence of private decisionmaking.’ Private decisionmaking controls because of the per capita allocation scheme, and those decisions are independent because of the program’s neutrality. It is the students and their parents – not the government – who, through their choice of school, determine who receives Chapter 2 funds. The aid follows the child.”

120 S. Ct. at 2552-2553.

With this framework in mind, the plurality addressed the respondent's chief argument that direct, nonincidental aid to the primary mission of religious schools is always impermissible.¹⁹² The plurality pointed out that *Agostini* had "expressly rejected the absolute line" urged by the Respondents: "We there explained that 'we have departed from the rule relied on in *Ball* that all government aid that directly assists the educational function of religious schools is invalid.'"¹⁹³ The plurality asserted that:

If aid to schools, even "direct aid," is neutrally available and, before reaching or benefiting any religious school, first passes through the hands (literally or figuratively) of numerous private citizens who are free to direct the aid elsewhere, the government has not provided any "support of religion."¹⁹⁴

Stating that the purpose of the direct/indirect distinction had been "merely to prevent 'subsidization' of religion," the plurality explained that the Court's more recent cases have addressed this purpose through the principle of private choice as it relates to the issue of whether any indoctrination could be attributed to the government.¹⁹⁵ The Court recounted that it viewed the neutral aid program in *Witters*, in which the Inland Empire School of the Bible ultimately received government aid in the form of tuition to support *Witters*' religious education, as "no different" from a government issuing a paycheck to its employee who, in turn, donates the funds to a religious institution. The Court had indicated that, under both scenarios, any funds that "ultimately went to religious institutions [would do] so 'only as a result of the genuinely independent and private choices' of individuals."¹⁹⁶

The plurality pointed out that the Court in *Agostini* had maintained that the "same logic applied" in *Zobrest*, where the Court had reasoned that the aid program's neutral eligibility criteria ensured the publicly funded interpreter's presence at a sectarian school was the result of private choice and, therefore, any religious indoctrination that might occur through the interpreter could not be attributed to the government.¹⁹⁷ Finally in *Agostini*, the Court, relying upon the reasoning of *Witters* and *Zobrest*, had concluded that the Title I remedial classes

192. *Id.* at 2544 (plurality opinion). The purpose of the direct/indirect distinction has been to prevent "subsidization" of religion. The plurality noted that this argument is inconsistent with the Court's more recent cases, which have addressed this concern through the principle of private choice. *Id.*

193. *Id.* at 2545 (plurality opinion), quoting *Agostini*, 521 U.S. at 225.

194. 120 S. Ct. at 2544 (plurality opinion) quoting *Witters* 474 at 489. Although the plurality acknowledged that "the presence of private choice is easier to see when aid literally passes through the hands of individuals," it nevertheless maintained that the Establishment Clause does not require such a form and *Agostini* rejected the absolute line urged by the Respondents. 120 S. Ct. at 2545 (citations omitted).

195. *Id.* at 2544 (plurality opinion) (emphasis added). The plurality reiterated that *Agostini*, relying primarily upon *Witters*, had "made clear that private choice and neutrality would resolve the concerns formerly addressed by the rule in *Ball*." *Id.* at 2545.

196. *Id.*, quoting *Agostini*, 521 U.S. at 226, and *Witters*, 474 U.S. at 487.

197. 120 S. Ct. at 2545 (plurality opinion). The Court in *Zobrest* had noted that it saw no difference between the government hiring the interpreter directly and the government providing funds to the parents who would then hire the interpreter. *Id.*, citing *Zobrest*, 509 U.S. at 13, n.11.

provided by public employees did not impermissibly finance religious indoctrination. In so ruling, the plurality noted that the Court had found it “insignificant” that: students did not have to apply directly for such services; instruction was provided to students in groups as opposed to individually; and instruction took place within the private school facilities.¹⁹⁸

The plurality rejected the Respondents’ “formalistic view” under which aid must be “literally placed in the hands of school children rather than given directly to the school for teaching those same students.” Instead, the plurality pointed out that, because *Meek* and *Wolman*, the cases upon which the Respondents relied for their argument, reached the same result on programs that were indistinguishable except for the direct/indirect distinction, it showed that such distinction was irrelevant to the decision in *Meek*.¹⁹⁹ Moreover, the plurality maintained that the labeling of a program as “direct” or “indirect” is arbitrary and “does not further the constitutional analysis.”²⁰⁰

Accordingly, the plurality concluded that Chapter 2, as applied in Jefferson Parish, did not result in governmental indoctrination because the aid was made available to a broad array of schools based upon neutral and secular criteria, reached the participating schools via the per capita allocation scheme as a consequence of private decisionmaking, and did not have an impermissible content.²⁰¹ The plurality also asserted that, because the aid is provided pursuant to private choices, it was not “problematic” that Chapter 2 aid could be described as “direct.”²⁰²

198. 120 S. Ct. at 2545 (plurality opinion).

199. *Id.* at 2546 (plurality opinion).

200. *Id.*

201. *Id.* at 2552-2553 (plurality opinion). The plurality reasoned that:

Private decisionmaking controls because of the per capita allocation scheme, and those decisions are independent because of the program’s neutrality. It is the students and their parents—not the government—who, through their choice of school, determine who receives Chapter 2 funds. The aid follows the child.

Id., citing *Agostini*, 521 U.S. at 226.

202. 120 S. Ct. at 2553 (plurality opinion). Thus the plurality, relying upon *Agostini*, found the fact that the materials and equipment provided under Chapter 2 were presumably used from time to time by the entire classes rather than individual students, that the students themselves did not have to apply for Chapter 2 aid in order for their school to receive it, and that the schools themselves, rather than the students, were the bailees of the Chapter 2 aid, “not constitutionally significant or meaningful.” *Id.* (plurality opinion), citing *Agostini*, 521 U.S. at 229-29. The plurality concluded that:

The ultimate beneficiaries of Chapter 2 aid are the students who attend the schools that receive that aid, and this is so regardless of whether individual students lug computers to school each day or, as Jefferson Parish has more sensibly provided, the schools receive the computers. Like the Ninth Circuit, and unlike the dissent, we see little difference in loaning science kits to students who then bring the kits to school as opposed to loaning science kits to the school directly.

120 S. Ct. at 2553 (plurality opinion).

The concurring opinion

Justice O'Connor had agreed with the plurality that the *Mitchell* case should be decided applying the criteria set forth in *Agostini*.²⁰³ Thus, as to the question of whether the aid resulted in religious indoctrination, Justice O'Connor noted that the Chapter 2 aid program in Jefferson Parish possessed the same "hallmarks" as the Title I program upheld in *Agostini*:

- (1) Aid was allocated on the basis of neutral secular criteria;
- (2) Aid was supplemental to, and did not supplant, non-federal funds;
- (3) No Chapter 2 funds reached the coffers of the religious schools; and
- (4) The aid was secular.²⁰⁴

She further noted that these very factors had precluded the Court in *Agostini* from finding that Title I constituted an "impermissible financing of religious indoctrination."²⁰⁵

Despite her concurrence in the judgment, Justice O'Connor expressed reservations over the plurality's elevation of the issue of neutrality in determining Establishment Clause challenges to government school-aid programs. Although recognizing that neutrality is an important criterion in upholding government school-aid programs against Establishment Clause challenges, the concurring opinion maintained that it is only one of several factors the Court considers.²⁰⁶ Accordingly, Justice O'Connor found herself agreeing with the dissent that "neutrality is not alone sufficient to qualify the aid as constitutional."²⁰⁷ Justice O'Connor further asserted: "We have never held that a government-aid program passes constitutional muster *solely* because of the neutral criteria it employs as a basis for distributing aid."²⁰⁸

The issue of divertibility

The Respondents had argued that the Establishment Clause required that any aid to religious schools not be impermissibly religious in nature or content and not be divertible to religious use. The plurality agreed with the first part of the Respondents' contention, but not

203. *Id.* at 2560 (concurring opinion). ("*Agostini* represents our most recent attempt to devise a general framework for approaching questions concerning neutral school-aid programs. *Agostini* also concerned an Establishment Clause challenge to a school-aid program closely related to the one at issue here. For these reasons, as well as my disagreement with the plurality's approach, I would decide today's case by applying the criteria set forth in *Agostini*.")

204. *Id.* at 2562 (concurring opinion); see *Agostini*, 521 U.S. at 226-28.

205. *See* 120 S. Ct. at 2562.

206. *See id.* at 2557 (concurring opinion).

207. *Id.* (concurring opinion), citing *id.* at 2578-2582 (dissenting opinion).

208. *Id.* at 2557 (concurring opinion) (emphasis supplied).

with the second.²⁰⁹ The plurality viewed this “no divertibility rule” as “unworkable” and “inconsistent” with the Court’s more recent case law. The plurality asserted that:

So long as the governmental aid is not itself unsuitable for use in the public schools because of religious content, and eligibility for aid is determined in a constitutionally permissible manner, any use of that aid to indoctrinate cannot be attributed to the government and is thus not of constitutional concern. ... Our recent precedents, particularly *Zobrest*, require us to reject respondents’ argument. For *Zobrest* gave no consideration to divertibility or even to actual diversion. Had such things mattered to the Court in *Zobrest*, we would have found the case to be quite easy – for striking down rather than, as we did, upholding the program²¹⁰

According to the plurality, the Court in *Zobrest* clearly did not consider the *use* of governmental aid to further religious indoctrination as “synonymous” with religious indoctrination *by* the government.²¹¹ Similarly, the plurality pointed out that, if the Court had been concerned with divertibility or diversion, it would have “unhesitatingly, perhaps summarily, struck down” the tuition-reimbursement program in *Witters*, because diversion of the aid “was guaranteed.”²¹² Turning to the cases relied upon by the Respondents to establish their rule against divertible aid, the plurality contended that *Meek* and *Wolman* offer “little, if any, support” for Respondents because: divertibility was mentioned “only briefly” in a concluding footnote in *Meek* that was, “at most, peripheral to the Court’s reasoning” in the case; and a concern for divertibility could not have been part of the Court’s reasoning in *Wolman* because the aid program explicitly prohibited divertible aid.²¹³

The plurality maintained that the issue was not “divertibility” of Chapter 2 aid, but whether such aid had an impermissible content.²¹⁴ The plurality contended, moreover, that the prohibition on impermissible content resolves any Establishment Clause concerns that arise if aid is actually diverted to religious uses.²¹⁵ The plurality noted that *Agostini* had explained *Zobrest* by making just this distinction between the *content* of aid and the *use* of that aid: Because the only *government* aid was the interpreter who, *herself*, had no “inherent religious significance,” and was not inculcating any religious messages, “no *government* indoctrination took place ...

209. *Id.* at 2547 (plurality opinion).

210. *Id.* The plurality pointed out that the dissent in *Zobrest* had argued for striking down the case because of divertibility. See generally *Zobrest*, 509 U.S. at 18-23. The plurality concluded that: “As that dissent made clear, diversion is the use of government aid to further a religious message. By that definition, the government-provided interpreter in *Zobrest* was not only divertible, but actually diverted.” *Id.* at 2548 (plurality opinion) (citations omitted).

211. *Id.* at 2547 (plurality opinion). The plurality also observed that the Court in *Zobrest* had not considered the use of the government aid to further religious indoctrination as creating any improper incentives. *Id.*

212. *Id.* The plurality noted that it was “certain” that *Witters* sought to use the aid to obtain a religious education from a sectarian institution to further a religious career.

213. *Id.* at 2548 (plurality opinion).

214. *Id.* The plurality noted that the statute explicitly required that all Chapter 2 aid for the benefit of children in private school be “secular, neutral, and nonideological” in content and the record indicated that the requirement was faithfully enforced. *Id.* at 2553 (plurality opinion); citing §7372(a)(1).

215. *Id.* at 2548 (plurality opinion).

[, and therefore,] it did not matter (given the neutrality and private choice involved in the program) that she ‘would be a mouthpiece for religious instruction.’”²¹⁶ Accordingly, the plurality concluded that “just as a government interpreter does not herself inculcate a religious message—even when she is conveying one-- so also a government computer or overhead projector does not itself inculcate a religious message, even when it is conveying one.”²¹⁷

Furthermore, the plurality noted that the Court in *Agostini* itself approved the provision of public employees to teach secular remedial classes in sectarian schools “partly” on the basis that the Court had concluded “there was no reason to suspect that indoctrinating content would be part of such governmental aid. Relying on *Zobrest*, we refused to presume that the public teachers would ‘inject religious content’ into their classes, especially given certain safeguards that existed; we also saw no evidence that they had done so.”²¹⁸

In addition, the plurality argued that the divertibility rule is unworkable in that it is “boundless,” encompassing such things as government-provided chalk, crayons, pens and paper.²¹⁹ The plurality questioned how indoctrination by diversion of such aid could be attributed to the government. The plurality suggested that such a rule might require the courts to undertake “the task of distinguishing among the myriad kinds of possible aid based on the ease of diverting each kind.” Wondering how the courts “might coherently draw any such line,” the plurality concluded that:

It not only is far more workable, but also is actually related to real concerns about preventing advancement of religion by government, simply to require, as did *Zobrest*, *Agostini*, and *Allen*, that a program of aid to schools not provide improper content and that it determine eligibility and allocate the aid on a permissible basis.²²⁰

Addressing the specific aid at issue in *Mitchell*, the plurality observed that there was no evidence the computers had any impermissible pre-existing content or that the religious schools had received any software that had an impermissible content.²²¹ Although the plurality acknowledged there was evidence that the equipment had been, or at least easily could be,

216. *Id.* citing *Agostini*, 521 U.S. at 224-26.

217. 120 S. Ct. at 2548 (plurality opinion).

218. 120 S. Ct. at 2548-49 (plurality opinion), citing *Agostini*, 521 U.S. at 223-27 & 234-35. The plurality also noted that the Court in *Allen* similarly had focused on content, emphasizing that textbooks in question had been preapproved by public school authorities and were not considered “‘unsuitable for use in the public schools because of religious content.’” 120 S. Ct. at 2549 (plurality opinion), quoting *Allen*, 392 U.S. at 245.

219. 120 S. Ct. at 2549 (plurality opinion). The plurality also pointed out that, although any aid, regardless of content, is “‘divertible’” in the sense that it permits a school to “‘divert’” resources, the Court nevertheless has rejected the “‘recurrent argument that all aid is forbidden because aid to one aspect of an institution frees it to spend its other resources on religious ends.’” *Id.*, quoting *Regan*, 444 U.S. at 658 and *Hunt v. McNair*, 413 U.S. 734, 743 (1973).

220. 120 S. Ct. at 2549 (plurality opinion) (footnote omitted noting that J. O’Connor finds *actual* diversion “unproblematic if ‘true private-choice’ directs the aid” and that minimal actual diversion is tolerable).

221. *Id.* at 2553 (plurality opinion). The primary aid at issue was comprised of computers, computer software and library books. *Id.*

diverted for use in religious classes, it nevertheless contended that such evidence of diversion was not relevant to the constitutional analysis as long as the governmental aid did not have an impermissible content and eligibility for the aid was determined in a constitutionally permissible manner.²²²

Accordingly, the plurality concluded that the Jefferson Parish’s Chapter 2 program did not result in governmental indoctrination because it:

- (1) Had determined aid eligibility neutrally;
- (2) Had allocated aid based upon the private choices of the parents of the school children; and
- (3) Had not provided aid that had an impermissible content.²²³

The concurring opinion

Justice O’Connor rejected “the plurality’s approval of actual diversion of government aid to religious indoctrination,” finding it to be “in tension with [the Court’s] precedents and, in any event, unnecessary to decide the instant case.”²²⁴ She strenuously disagreed with the “plurality’s conclusion that actual diversion of government aid to religious indoctrination is consistent with the Establishment Clause,” pointing out that the Court’s focus, in *Allen* and *Agostini*, on the *lack of evidence* that aid had been diverted by recipients to advance their religious mission would have been “entirely unnecessary” if the Court had believed that such diversion was constitutionally permissible.²²⁵ In particular, Justice O’Connor took strong issue with the plurality’s reliance on its characterization of Chapter 2 as a private-choice program:

The plurality bases its holding that actual diversion is permissible on *Witters* and *Zobrest*. Those decisions, however, rested on a significant factual premise missing from this case, as well as from the majority of cases thus far considered by the Court involving Establishment Clause challenges to school-aid programs. Specifically, we decided *Witters* and *Zobrest* on the understanding that the aid was provided directly to the individual student who, in turn, made the choice of where to put that aid to use.

222. *Id.* at 2554 (plurality opinion).

223. *Id.* at 2552 (plurality opinion). The plurality noted its unwillingness to elevate “scattered *de minimis* statutory violations of the restrictions on content, discovered and remedied by the relevant authorities prior to any litigation, to such a level as to convert an otherwise unobjectionable parishwide program into a law that has the effect of advancing religion.” *Id.* at 2555 (plurality opinion).

224. *Id.* at 2556 (concurring opinion). *See id.* at 2547-48 (plurality opinion) (Respondents’ “no divertibility rule” is inconsistent with Court’s more recent case law and not of constitutional concern); moreover, the issue is “not divertibility of aid but rather whether the aid itself has an impermissible content.”)

225. *Id.* at 2558 (concurring opinion). *See Agostini*, 521 U.S. at 226-27 (no evidence ever shown that Title I instructor teaching on parochial school premises attempted to inculcate religion); *Allen*, 392 U.S. at 248 (nothing in record supports proposition that secular textbooks are used by parochial schools to teach religion).

Accordingly, our approval of the aid in both cases relied to a significant extent on the fact that '[a]ny aid ... that ultimately flows to religious institutions does so only as a result of the genuinely independent and private choices of aid recipients.' This characteristic of both programs made them less like a direct subsidy, which would be impermissible under the Establishment Clause, and more akin to the government issuing a paycheck to an employee who, in turn, donates a portion of that check to a religious institution.

Recognizing this distinction, the plurality nevertheless finds *Witters* and *Zobrest* – to the extent those decisions might permit the use of government aid for religious purposes – relevant in any case involving a neutral, per-capita-aid program. Like [the dissent], I do not believe that we should treat a per-capita-aid program the same as the true private-choice programs considered in *Witters* and *Zobrest*.²²⁶

Although Justice O'Connor mentions two additional reasons why she objects to this characterization of a per-capita-aid program as a true private-choice programs,²²⁷ the most compelling of her arguments for maintaining a distinction between a per-capita-aid program and a true private-choice program concerns government aid that consists of direct monetary subsidies. Justice O'Connor reasoned that, despite the Court having "recognized special Establishment Clause dangers" in situations in which the government makes direct money payments to sectarian institutions,²²⁸ the plurality's view (i.e., a per-capita-aid program is identical in relevant constitutional respects to a true private-choice program,) would permit the government to provide direct money payments to religious organizations, including churches, based upon the number of members of each organization.²²⁹ As a corollary, because actual diversion is permissible under the plurality's view, these organizations (including churches) could use that aid to support religious indoctrination.²³⁰ While noting that "the plurality does not actually hold that its theory extends to direct money payments," Justice O'Connor nevertheless asserted: "That omission, however, is of little comfort. In its logic – as well as its specific advisory language – the plurality opinion foreshadows the approval of direct monetary subsidies to religious organizations, even when they use the money to advance their religious objectives."²³¹

The gist of Justice O'Connor's other arguments seem to be that:

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226. 120 S. Ct. at 2558-59 (concurring opinion) (citations omitted).
227. See 120 S. Ct. at 2559 (concurring opinion).
228. *Id.* at 2560 (concurring opinion), quoting from *Rosenberger v. Rector & Visitors of Univ. of Va.*, 515 U.S. 819, 842 (1995).
229. 120 S. Ct. at 2560 (concurring opinion).
230. *Id.*
231. *Id.*, citing plurality opinion at 2546-47 & n.8 (recognizing that direct money payments create special risks that governmental aid will have the effect of advancing religion (and that an indirect form of payment reduces these risks), but stating that it is "arguable, ... at least after *Witters*, that the principles of neutrality and private choice would be adequate to address those special risks, for it is hard to see the basis for deciding *Witters* differently simply if the State had sent the tuition check directly to whichever school *Witters* chose to attend.")

- (1) In a true private choice program, as opposed to a per capita aid program, the aid that flows to the religious school, and consequently is used to advance religion, is wholly dependent upon private decisionmaking²³²; and
- (2) The distinction between the two programs is significant in terms of public perception of endorsement by the government. For example, if a religious school receiving aid from a government program that provides direct aid to schools based upon the number of attending students uses that aid to inculcate religion in its students, a “reasonable observer would naturally perceive the aid program as *government* support for the advancement of religion.” On the other hand, no such inference is likely to be drawn when aid supports a religious school’s mission only as a result of individual, private decisionmaking.²³³

Justice O’Connor maintained that *Agostini* represents the Court’s “most recent attempt to devise a general framework” for examining neutral school-aid programs and, furthermore, that the school-aid program in *Agostini* was “closely related” to the one at issue in *Mitchell*.²³⁴ She concluded that “[f]or these reasons, as well as my disagreement with the plurality’s approach, I would decide today’s case by applying the criteria set forth in *Agostini*.”²³⁵

Meek, Wolman and the divertibility issue

The Respondents had contended that *Agostini* was distinguishable from the instant case because of the distinct character of its aid program and that, consequently, *Meek* and *Wolman*, in which aid programs similar to Chapter 2 had been held unconstitutional, must instead control.²³⁶ However, Justice O’Connor dismissed *Meek* and *Wolman* as having “created an inexplicable rift within our Establishment Clause jurisprudence concerning government aid to schools.”²³⁷ She noted that the Court, adhering to its prior holding in *Board of Education v. Allen*,²³⁸ had upheld the textbook lending programs at issue in each of these two cases,²³⁹ but had invalidated the lending of instruction materials and equipment to religious schools on the basis that “any

232. *Id.* at 2559 (concurring opinion).

233. *Id.* With respect to this latter issue, Justice O’Connor reasoned that the fact that the amount of aid to a school is based upon the school’s enrollment “does not separate the government from the endorsement of the religious message. The aid formula does not – and could not – indicate to a reasonable observer that the inculcation of religion is endorsed only by the individuals attending the religious school, who each affirmatively choose to direct the secular government aid to the school and its mission.” *Id.*

234. *Id.* at 2560 (concurring opinion). For Justice O’Connor’s discussion of the important similarities between the two school-aid programs, see *id.* at 2562 (concurring opinion).

235. *Id.* at 2560 (concurring opinion).

236. See *id.* at 2562-63 (concurring opinion). Justice O’Connor further notes that the dissent also relies upon *Meek* and *Wolman* in finding the “character of the Chapter 2 aid constitutionally problematic.” *Id.* at 2563.

237. *Id.*

238. 329 U.S. 236 (1968) (government lending of textbooks to students attending religious schools did not violate the Establishment Clause).

239. 120 S. Ct. at 2563 (concurring opinion), citing *Meek*, 421 U.S. at 359-62; *Wolman*, 433 U.S. at 236-38.

assistance in support” of the educational missions of pervasively sectarian schools would “inevitably have the impermissible effect of advancing religion.”²⁴⁰ Justice O’Connor pointed out that, although the Court was “willing to apply an irrebuttable presumption that secular instructional materials and equipment would be diverted to use for religious indoctrination,” it was unwilling to extend this “presumption of inevitable religious indoctrination” to school aid that consisted of loaned textbooks.²⁴¹ Thus, under *Meek* and *Wolman*, the Court would require clear evidence that religious schools were diverting secular textbooks to religious instruction, but would simply presume such diversion in the case of instructional materials and equipment.²⁴²

Justice O’Connor clearly rejected a constitutional test for school aid programs that turned on whether the aid took the form of equipment versus a textbook.²⁴³ She asserted that:

The irrationality of this distinction is patent. ... Indeed, technology’s advance since the *Allen*, *Meek* and *Wolman* decisions has only made the distinction between textbooks and instructional materials and equipment more suspect. In this case, for example we are asked to draw a constitutional line between lending textbooks and lending computers. Because computers constitute instructional equipment, adherence to *Meek* and *Wolman* would require the exclusion of computers from any government school aid program that includes religious schools. Yet, computers are as necessary now as were schoolbooks 30 years ago, and they play a somewhat similar role in the educational process. That *Allen*, *Meek* and *Wolman* would permit the constitutionality of a school-aid program to turn on whether the aid took the form of a computer rather than a book further reveals the inconsistency inherent in their logic.²⁴⁴

The Respondents, arguing that the Establishment Clause prohibits the government from giving or lending aid to religious schools if the aid is reasonably divertible to religious uses, had contended that the presumption that such schools will use instructional materials and equipment to inculcate religion was sound because the materials and equipment in question, unlike textbooks, were reasonably divertible to religious uses.²⁴⁵ Justice O’Connor rejected this contention, citing two reasons: the lack of direct precedential support for such a rule,²⁴⁶ and the

240. 120 S. Ct. at 2563 (concurring opinion), citing *Meek*, 421 U.S. at 362-66; *Wolman*, 433 U.S. at 248-51.

241. 120 S. Ct. at 2563-64 (concurring opinion).

242. Justice O’Connor observed that the inconsistency between the two strands of the Court’s jurisprudence was apparent at the time and quoted from various members of the Court on both sides of the *Meek* and *Wolman* decisions who had used the contradiction to support their respective arguments. *See id.* at 2564 (concurring opinion).

243. *Id.*

244. *Id.* at 2564 (concurring opinion); *accord* *Wallace v. Jaffree*, 472 U.S. 38, 110 (1985) (Rehnquist, J. dissenting) (state may lend textbooks containing maps of the United States to religious schools, but may not loan maps of the United States for use in their geography class.)

245. *See* 120 S. Ct. at 2564 (concurring opinion). Justice O’Connor noted that the dissent also found the divertibility of secular government aid to be “an important consideration” under the Establishment Clause, but did not assign to it the same “constitutionally determinative status” as did the Respondents. *Id.* (concurring opinion), citing *id.* at 2581, 2585-87. (dissenting opinion).

246. *Id.* at 2565 (concurring opinion) Justice O’Connor maintains that the only possible direct precedential support is a single sentence contained in a footnote from the *Wolman* decision, which “described *Allen* as

theory's failure to provide a "logical distinction" between the lending of textbooks and the lending of materials and equipment.²⁴⁷ While acknowledging the need for "continued recognition of the special dangers associated with direct money grants to religious institutions," she rejected the argument that such concern required that "any form of secular aid that might conceivably be diverted to a religious use" be treated as constitutionally suspect.²⁴⁸ Instead, Justice O'Connor maintained that the Court's "concern with direct monetary aid is based upon more than just diversion" and, in fact, is more akin to the founding fathers' concern over "sponsorship, financial support, and active involvement of the sovereign in religious activity."²⁴⁹ She concluded that the Court's statements relating to the constitutionally suspect status of direct cash aid "provide no justification for applying an absolute rule against divertibility when the aid consists instead of instructional materials and equipment."²⁵⁰

Justice O'Connor contended that, because divertibility fails to explain the distinction the Court's earlier cases have drawn between textbooks and instructional materials and equipment, there remained the issue of which of the "two irreconcilable strands of ... Establishment Clause jurisprudence," to follow.²⁵¹ In choosing between the two, Justice O'Connor stated:

I would adhere to the rule that we have applied in the context of textbook lending programs: To establish a First Amendment violation, the plaintiff must prove that the aid in question actually is, or has been, used for religious purposes. Just as we held in *Agostini* that our more recent cases had undermined the assumptions underlying *Ball* and *Aguilar*, I would now hold that *Agostini* and the cases on which it relied have undermined the assumptions underlying *Meek* and *Wolman*.²⁵²

Although acknowledging that *Agostini* had addressed only the specific presumption that public school employees teaching on sectarian school premises would inevitably inculcate religion, Justice O'Connor nevertheless indicated her belief that *Agostini*'s "definitive rejection of that presumption also stood for-- or at least strongly pointed to--the broader proposition that such presumptions of religious indoctrination are normally inappropriate when evaluating neutral

having been 'premised on the view that the educational content of textbooks is something that can be ascertained in advance and cannot be diverted to sectarian uses.'" Justice O'Connor contended that "[t]o the extent this simple description of *Allen* is even correct, it certainly does not constitute an actual holding that the Establishment Clause prohibits the government from lending any divertible aid to religious schools." *Id.*

247. *Id.* Justice O'Connor agreed with the plurality that virtually any instructional tool conceivably could be used to teach a religious message. Moreover, she pointed out that, under this divertibility rule, even a public financed lunch could be unconstitutional because religious school officials conceivably could lead students in a prayer over the food. Finally, she noted the dissent's attempt to justify a constitutional distinction between lending a textbook and lending a library book "only demonstrates the absurdity on which such a difference must rest." *Id.* at 2566 (concurring opinion).

248. *Id.*

249. *Id.*, quoting from *Waltz v. Tax Comm'n of City of New York*, 397 U.S. 664, 668 (1970).

250. 120 S. Ct. at 2566 (concurring opinion).

251. *Id.* at 2567 (concurring opinion).

252. *Id.*, citing *Meek*, 421 U.S. at 361-361; *Allen*, 392 U.S. at 248.

school-aid programs under the Establishment Clause.”²⁵³ She also pointed out the Court’s specific reliance in *Agostini* on the statement in *Zobrest* that “a presumption of indoctrination, because it constitutes an absolute bar to the aid in question regardless of the religious school’s ability to separate that aid from its religious mission, constitutes a ‘flat rule, smacking of antiquated notions of taint, [that] would indeed exalt form over substance.’”²⁵⁴ She concluded that this same reasoning would apply “with equal force” to the presumption concerning instructional materials and equipment.²⁵⁵ Accordingly, Justice O’Connor rejected Respondent’s contention that *Agostini* should be limited to its facts and that a presumption of religious inculcation for instructional materials should be retained.²⁵⁶

Respondents’ miscellaneous arguments

Finally, Justice O’Connor rejected the Respondents’ contention that the actual administration of Chapter 2 in Jefferson Parish violated the Establishment Clause. Justice O’Connor summarized the Respondents claims as follows: the program’s safeguards were insufficient to uncover instances of actual diversion; there was evidence that some religious schools may have actually diverted aid to support religious education; there was evidence of violations of Chapter 2’s content restrictions; and there were isolated examples of potential violations of Chapter 2’s supplantation restriction.²⁵⁷ Justice O’Connor notes her disagreement with both the plurality, which, relying upon evidence supporting the first two claims, “appears to contend that the Chapter 2 program can be upheld only if actual diversion of government aid to the advancement of religion is permissible under the Establishment Clause” and Justice Souter’s dissent, which, relying upon the evidence underlying all but the last of Respondent’s claims, would hold that the Chapter 2 program violated the Establishment Clause.²⁵⁸

253. 120 S. Ct. at 2567.

“In *Agostini*, we repeatedly emphasized that it would be inappropriate to presume inculcation of religion; rather, plaintiff’s raising an Establishment Clause challenge must present evidence that the government aid in question has resulted in religious indoctrination. ... As we explained in *Agostini*, ‘we have departed from the rule relied on in *Ball* that all government aid that directly assists the educational function of religious schools is invalid.’”

Id., quoting from *Agostini*. 521 U.S. at 225.

254. 120 S. Ct. at 2567 (concurring opinion).

255. *Id.*

256. *See id.* at 2567-68 (concurring opinion).

257. *Id.* at 2568-69 (concurring opinion).

258. *Id.* at 2569. She notes that both the plurality and Justice Souter focused the “primary thrust” of their arguments on the alleged inadequacy of the program’s safeguards. Moreover, they, with the Respondents, “appear to proceed from the premise that, so long as actual diversion presents a constitutional problem, the government must have a failsafe mechanism capable of detecting *any* instance of diversion.” *Id.* (emphasis supplied). In response, Justice O’Connor points out that the Court rejected that very assumption in *Agostini*:

There we explained that because we had “abandoned the assumption that properly instructed public employees will fail to discharge their duties faithfully, we must also discard the assumption that *pervasive* monitoring of Title I teachers is required.” [*Agostini*,] 521 U.S. at 234 (emphasis in

Justice O'Connor concluded that: the limited evidence of actual diversion was "at best *de minimis* and therefore insufficient to affect the constitutional inquiry";²⁵⁹ and the safeguards employed by the Chapter 2 program were constitutionally adequate.²⁶⁰ She also found the evidence of violations of Chapter 2's supplantation and secular-content restrictions equally insignificant to affect the constitutional inquiry.²⁶¹ Justice O'Connor concluded that, in view of the similarities between the Chapter 2 program and the Title I aid program in *Agostini*, the Establishment Clause challenge must fail.²⁶² Furthermore, she observed that, "[r]egardless of whether these factors are constitutional requirements, they are surely sufficient to find that the program at issue here does not have the impermissible effect of advancing religion. For the same reasons, 'this carefully constrained program also cannot reasonably be viewed as an endorsement of religion.'"²⁶³

Does the government-aid program define its recipients by reference to religion?

Agostini's second criteria for determining the effect of a governmental school-aid program requires consideration of whether an aid program defines its recipients by reference to religion. Justice O'Connor, in her concurring opinion, explained the relevance of this inquiry:

original). Because I believe the Court should abandon the presumption adopted in *Meek* and *Wolman* respecting the use of instructional materials and equipment by religious-school teachers. I see no constitutional need for *pervasive* monitoring under the Chapter 2 program.

Id. (emphasis supplied).

259. *Id.* Justice O'Connor asserted:

"The evidence proffered ... concerning actual diversion of Chapter 2 aid ... is *de minimis*. ...At most, it proves the possibility that, out of more than 40 nonpublic schools in Jefferson Parish participating in Chapter 2, aid may have been diverted in one school's second-grade class and another school's theology department.

The plurality's insistence that this evidence is somehow substantial flatly contradicts its willingness to disregard similarly insignificant evidence of violations of Chapter 2's supplantation and secular-content restrictions. ...

...

...I know of no case in which we have declared an entire aid program unconstitutional on Establishment Clause grounds solely because of violations on the minuscule scale of those at issue here. ...To the contrary, the presence of so few examples over a period of at least 4 years (15 years ago) tends to show not that the 'no-diversion' rules have failed, but that they have worked. Accordingly, I see no reason to ... declare a properly functioning aid program unconstitutional."

Id. at 2570-71 (concurring opinion).

260. *Id.* at 2569 (concurring opinion).

261. *Id.* at 2572 (concurring opinion).

262. *Id.* Justice O'Connor summarized that: aid was allocated on the basis of neutral secular criteria; the aid was required to be supplemental to, and not supplant, non-federal funds; no Chapter 2 funds ever reached the coffers of the religious schools; the aid was required to be secular; any evidence of actual diversion was *de minimis*; and the program included adequate safeguards. *Id.*

263. *Id.*, quoting *Agostini*, 521 U.S. at 235.

Scrutiny of the manner in which a government-aid program identifies its recipients is important because “the criteria might themselves have the effect of advancing religion by creating a financial incentive to undertake religious indoctrination.”²⁶⁴

The plurality and the concurring opinions agreed that *Agostini* set out the following rule for determining whether the criteria for identifying aid program recipients creates a financial incentive to undertake indoctrination: “This incentive is not present ...where the aid is allocated on the basis of neutral, secular criteria that neither favor nor disfavor religion, and is made available to both religious and secular beneficiaries on a nondiscriminatory basis.”²⁶⁵ Both the plurality and the concurring opinions also agreed that the statutory provisions governing Chapter 2 aid ensured that the aid was allocated on a nondiscriminatory basis, using wholly neutral and secular criteria, to students enrolled in both religious and secular schools.²⁶⁶ Accordingly, the plurality and the concurring opinions dispatched rather easily with this issue, concluding that the manner in which the Chapter 2 program identified its aid recipients did not create a financial incentive to undertake religious indoctrination.²⁶⁷

Recent Lower Court Cases Dealing With Issuance Of Tax Exempt Bonds

In the aftermath of *Agostini* and *Mitchell*, the question remains, does the issuance of tax-exempt bonds to assist private sectarian educational institutions offend the First Amendment’s Establishment Clause? Since *Agostini*, and in some cases since *Mitchell*, several lower courts have ruled on this precise issue. The following cases are instructive.

In *Johnson v. Economic Development Corporation*,²⁶⁸ decided one year before *Mitchell*, a federal district court in Michigan considered whether the issuance of tax-exempt bonds to finance parochial school improvements violated the Establishment Clause.²⁶⁹ The Oakland Economic Development Corporation (EDC) was authorized by statute to issue tax-exempt

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264. 120 S. Ct. at 2561 (concurring opinion), quoting *Agostini*, 521, U.S. at 231. The plurality noted that this criterion looks to the same facts as the neutrality inquiry, but uses those facts to answer a somewhat different question – whether the criteria for allocating the aid create a financial incentive to undertake religious indoctrination. *Mitchell*, 120 S. Ct. at 2543 (plurality opinion), citing *Agostini*, 521, U.S. at 231.
265. 120 S. Ct. at 2543 (plurality opinion), quoting *Agostini*, 521, U.S. at 231; *accord*, 120 S. Ct. at 2561 (concurring opinion), quoting *Agostini*, 521, U.S. at 231.
266. For a discussion of the statutory requirements of Chapter 2 allocation, see 120 S. Ct. at 2552 (plurality opinion), 2561 (concurring opinion).
267. *Id.* at 2552 (plurality opinion) (allocation criteria therefore created “no improper incentive”), 2561 (concurring opinion) (aid under Chapter 2 is allocated to students enrolled in religious and secular schools alike on the basis of neutral and secular criteria and, as a result, it creates no financial incentive to undertake religious indoctrination).
268. 64 F. Supp.2d 657 (E.D. Mich. 1999).
269. The school in question was an independent Roman Catholic School encompassing levels pre-school through grade 12. The project did not include any construction, renovation or improvements to the schools’ chapel. *Id.* at 658-59.

revenue bonds to finance building and improvement projects in an effort to alleviate and prevent conditions of unemployment and to foster and encourage economic development.²⁷⁰ The statute specifically provided that the municipality would not be liable on the notes or bonds of the Oakland EDC and the notes and bonds would not be a debt of the municipality.²⁷¹

The district court analyzed the case applying the three *Lemon* factors.²⁷² The district court found that Oakland EDC Act clearly had a secular purpose of alleviating unemployment. The district court also concluded that neither the EDC Act nor the instant bond issuance had the primary effect of promoting or inhibiting religion. In support of this conclusion, the court noted that any commercial or industrial enterprise may apply to the Oakland EDC for assistance and any religious affiliation of such applicant is completely irrelevant to the Oakland EDC's determination whether to issue the bonds.²⁷³ Perhaps because it found that the Oakland EDC acted without regard to the school's religious affiliation, the district court did not specifically address whether, as alleged by the plaintiff, the school was in fact "pervasively sectarian."²⁷⁴ Rather, the district court emphasized that:

The Supreme Court has repeatedly indicated that a general program which makes assistance available to a broad spectrum on a religiously neutral basis ordinarily is not subject to an Establishment Clause challenge. Reimbursement of bus fares, the loaning of textbooks, the granting of property tax exemptions, the provision of grants and bond revenue, and the allowance of tax deductions for school expenses, all have survived such a challenge because these forms of assistance were not directed specifically toward sectarian institutions. Rather in each case the assistance was directed toward a broader group. And sectarian institutions benefited only incidentally or on a neutral basis along with other beneficiaries of the state action.²⁷⁵

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270. *Id.* at 659. The court summarized the general process followed with respect to issuance of the bonds to the school: the EDC issued the bonds which were delivered to a bank to act as placement agent in marketing the bonds to private investors; the proceeds from the sale of the bonds were loaned by the EDC to the school pursuant to a loan agreement and the school made its loan payments directly to the bank. *Id.* at 659-60.
271. 64 F. Supp.2d at 659, quoting M.C.L. §125.1602.
272. 64 F. Supp.2d at 666. Interestingly, the district court relied upon *Lemon* and not *Agostini's* restatement of the test.
273. *Id.* at 666. Indeed, the court noted the parties stipulated that the EDC acted without regard to the religious affiliation of the school.
274. The court did recount the parties stipulated facts concerning the school, including that: there is no admission preference to Roman Catholics; there is no religious affiliation requirement or preference for teachers, nor is there any such inquiry of prospective faculty members; the school describes itself as a Christ-centered institution within the tradition of the Roman Catholic Church; and applicants for admission must support its "Goals and Criteria," the first being "to educate to ... a personal and active faith in God." *See id.* at 658.
275. *Id.*

The district court maintained that the bond issue “was precisely the kind of program at issue in this case” and reiterated that the United States Supreme Court has stated: ““religious institutions need not be quarantined from public benefits that are neutrally available to all.””²⁷⁶

The district court also found it “significant” that the funds involved in the case “did not take the form of a grant or loan of tax-raised money. Instead one hundred percent of the funds came from private investors.”²⁷⁷ The district court characterized the Oakland EDC as serving “merely as a conduit,” and concluded that it “simply provided a means by which private investors could finance the project.” Moreover, the district court emphasized that “[n]ot a single penny of the funds came from any state, county, or municipal source and no public entity has any obligation whatsoever in connection with the sale or purchase of these limited obligation bonds.”²⁷⁸ The district court also pointed out that the Oakland EDC incurred no expenses because the application fees paid by the school reimbursed the Oakland EDC for all administrative expenses and the school was responsible for repaying all of the principal and interest. The court further noted that such facts more closely resembled those in *Hunt*, which upheld similar funding for construction at a sectarian educational institution.²⁷⁹

More importantly, for purposes of this discussion, the district court rejected the plaintiff’s argument that the bond financing arrangement amounted to a direct subsidy because the state and federal government cannot collect income taxes on the interest paid on the bonds authorized by Oakland EDC.²⁸⁰ The district court maintained that this same argument had been raised and rejected in *Walz* and *Hunt*:

In both cases, the [United States] Supreme Court indicated that such “indirect costs”—whether occasioned by granting a property tax exemption or by funding a project through the sale of tax-exempt bonds – does not suffice to show a primary effect of advancing religion when the loss of revenue occurs as a result of providing a general benefit to a broad class of recipients under a religiously neutral government program. The same reasoning applies here.²⁸¹

Observing that no allegation of excessive entanglement between government and religion was made in the case, the district court contended that no such argument could have been made because the religious affiliation of the school played no part in the Oakland EDC’s review of the school’s application and the only contact the Oakland EDC had with the school was to process its application.²⁸²

276. *Id.* at 666-67, quoting *Roemer v. Board of Pub. Works of Maryland*, 426 U.S. 736, 747 (1976).

277. 64 F. Supp.2d at 667.

278. *Id.*

279. *Id.* The court also distinguished the instant case from the “‘maintenance and repair’ amendment found objectionable in *Nyquist*.” *Id.*

280. *Id.*

281. *Id.*

282. *Id.* The court further noted that the EDC does not monitor the school’s payments under the loan agreement and thus there is “no danger of ‘official and continuing surveillance leading to an impermissible degree of entanglement.’” *Id.*, quoting *Walz*, 397 U.S. 664, 675 (1970).

Accordingly, the district court concluded that the issuance of the bonds in this case had not violated the Establishment Clause because the statute and bond issuance had no religious purpose and did not have a primary effect of promoting religion and there was no danger of excessive entanglement between the state and religion.²⁸³ In so finding, the district court relied heavily upon its finding that: bond financing was available to a broad range of groups or persons based upon neutral, secular criteria without regard to religion; the bond financing arrangement did not constitute a direct subsidy to the religious school; no government funds were used and no public entity incurred any obligation whatsoever; and the EDC served merely a conduit for private investors.

Four months after *Mitchell* was decided, a federal district court in Tennessee declined to follow *Johnson* and ruled that issuance of the bonds to assist a religious educational institution violated the Establishment Clause. In *Steele v. Industrial Development Board*,²⁸⁴ the district court considered whether the issuance of tax-exempt bonds to finance a library and athletic facility at a religious educational institution had the primary effect of advancing or promoting religion. Specifically, the plaintiffs argued that the university was “so pervasively sectarian that the substantial tax benefit conferred directly on the school, in effect, was state sponsorship of the school’s Christian indoctrination.”²⁸⁵ In response, the defendant maintained that: the tax benefit promoted a legitimate, secular, legislative purpose; the pervasively sectarian test is no longer valid after *Mitchell*; and even if it were, the benefit conferred upon the university “is merely a tax exemption that has long been an acceptable indirect benefit to religious institutions.”²⁸⁶ As the secular purpose of the statute authorizing the issuance of bonds to finance construction projects at nonprofit educational institutions was not contested, the only issue before the court was whether the governmental aid had the primary effect of advancing or promoting religion. Considering *Agostini*’s three criteria for determining the “primary effect” of government school aid programs, the district court ruled that the issuance of the tax-exempt bonds fails two of the three criteria in that it results in governmental indoctrination and creates an excessive entanglement.²⁸⁷

In its decision, the district court relied upon three separate lines of analysis or approach. The first approach relied upon the line of United States Supreme Court cases considering aid given directly to colleges and universities that established that a government may not provide

283. 64 F. Supp.2d at 668. “As a matter of comity and federalism,” the federal district court declined to rule on the claim that the issuance of bonds violated the Michigan Constitution prohibiting the appropriation of public monies or the use to public credit to aid or maintain any private, denominational or other nonpublic lower or secondary school. The court asserted that it was “more appropriate for Michigan courts to interpret the Michigan statute and the Michigan constitutional provision at issue.” *See id.* at 668-669.

284. 117 F. Supp.2d 693 (M.D. Tenn. 2000).

285. 117 F. Supp.2d at 704.

286. 117 F. Supp.2d at 704.

287. *Id.* at 704. The three criteria, established in *Agostini* and affirmed in *Mitchell*, for determining whether governmental aid has the primary effect of advancing or promoting religion are whether the aid: (1) results in governmental indoctrination; (2) defines its recipients by reference to religion; or (3) creates an excessive entanglement. See notes 174-177 *supra* and accompanying text.

financial aid to a pervasively sectarian institution.²⁸⁸ While pointing out that this line of cases offer the “most directly controlling precedent to the case at hand” because they involved similar facts, including aid in the form of grants or proceeds of revenue bonds, the district court nevertheless acknowledged that these cases do not represent the United States Supreme Court’s most recent decisions concerning government aid to educational institutions.²⁸⁹ Therefore, the second approach relied upon the framework of analysis provided in the Supreme Court’s more recent cases, including *Agostini*, *Mitchell* and *Rosenberger*, that focused on specific aid program details such as the neutrality of the program, the role of the private individual in determining recipients of the aid, and the safeguards implemented to ensure that the aid supports only the secular functions of the religious educational institutions.²⁹⁰ The third approach relied upon the “endorsement test,” explained by the district court as follows: if the government action would be considered an endorsement of religion by the reasonable observer, then the action has the impermissible effect of advancing religion.²⁹¹

Under the first approach, the district court identified thirteen “pervasively sectarian” factors that it used to in its inquiry to find that Lipscomb University was “pervasively sectarian.”²⁹² The court rejected Justice Thomas’s statement in the plurality opinion in *Mitchell* that this test should no longer be used in evaluating Establishment Clause claims, because neither Justice in the concurring opinion joined in this view.²⁹³ The district court also rejected the defendants’ argument, in response to use of the “pervasively sectarian” test, that the bonds were not a direct benefit to the school from the government.²⁹⁴ The court appeared to put form over substance in insisting that the nature of the aid was a government loan rather than tax-exempt bond financing. The court maintained that the government chose to provide the University with

288. *Id.* at 704-05, citing *Tilton v. Richardson*, 403 U.S. 672 (1971); *Hunt v. McNair*, 413 U.S. 734 (1973); *Roemer v. Board of Pub. Works of Md.*, 426 U.S. 736 (1976).

289. 117 F. Supp.2d. at 705.

290. *Id.* at 705.

291. 117 F. Supp.2d at 705

292. *See id.* at 710. Noting that the “evidence of the pervasively sectarian nature of Lipscomb University is much stronger than that presented in *Hunt*, *Tilton*, *Roemer* or even *Columbia Union College*, 117 F. Supp.2d at 710, the court proceeds to painstakingly detail such evidence, *see id.* at 710-16, and concludes that the “pursuit of promoting a thoroughly Christian education makes Lipscomb an institution in which religion is so pervasive that a substantial portion of its functions are subsumed in religious mission. Worship as proscribed by the Church of Christ is so much a part of daily life on Lipscomb’s campus that it is completely intertwined and inseparable from the pursuit of academic excellence.” *Id.* at 721.

293. 117 F. Supp.2d at 706. *See Mitchell*, 120 S. Ct. at 2550-52. The district court noted that “It is well-settled that in a plurality opinion, “the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds. 117 F. Supp.2d at 706, quoting *Coe v. Bell*, 161 F. 3d 320, 354 (6th Cir. 1998) (quoting *Marks v. United States*, 430 U.S. 188, 193, 97 S. Ct. 990 (1977)).

294. Specifically, the court rejected the assertion that: the benefit did not come from the government; the benefit does not go to the school; and any benefit the university does receive is incidental. 117 F. Supp.2d at 716. The court observed that the form of aid provided to Lipscomb was a “substantial affirmative benefit” that allowed it to “dramatically improve” its academic and recreational facilities to make the school more attractive to potential students, who could “only take advantage of these benefits if they [agreed] to abide by the Churches of Christ aspects of the institution.” *Id.* at 718.

low-interest loan financing, that it obtained the funding for the loan through issuance of tax-exempt municipal bonds, and that, even though the loan was assigned to a bank, the loan still came from the government.²⁹⁵ The court specifically declined to follow the holding of *Johnson v. Economic Development Corporation*,²⁹⁶ concluding that the low-interest loan provided to the university by the government was a “direct and substantial benefit to the school.”²⁹⁷

295 *Id.* at 720.

296 *Id.* at 720 n.23 (decision of a fellow district court is not binding upon other district courts). *See also* notes 280-281 *supra* and accompanying text.

297. 117 F. Supp.2d at 721. The district court bases this conclusion in part on “precedent,” citing *Hunt*, in which it claims the United States Supreme Court “refrained from deciding whether the benefit was direct or indirect.” 117 F. Supp.2d at 719. Moreover, the district court contends that, in cases since *Hunt*, the Supreme Court “has implicitly recognized the bond proceed loan structure [in *Hunt*] as an example of direct state aid.” In support of this statement, the district court points to *Rosenberger* as citing *Hunt* as one of several cases “establishing the principle that [the United States Supreme Court has] recognized special Establishment Clause dangers where the government makes direct money payments to sectarian institutions” and also points to references to this same quoted material from *Rosenberger* by both the plurality and concurring opinions in *Mitchell*. *See* 117 F. Supp.2d at 720, quoting *Rosenberger*, 515 U.S. 819, 842 (1995); *Mitchell*, 120 S. Ct. 2530, 2546 (plurality opinion); *Mitchell*, 120 S. Ct. 2530, 2559-60 (concurring opinion). The Bureau is compelled to take issue with the federal district court’s contention that, in *Rosenberger* and *Mitchell*, the Supreme Court “has implicitly recognized the bond proceed loan structure [in *Hunt*] as an example of direct state aid.” The Supreme Court in *Rosenberger* states that: “The Court of Appeals (and the dissent) are correct to extract from our decisions the principle that we have recognized special Establishment Clause dangers where the government makes direct money payments to sectarian institutions, citing *Roemer v. Bd. of Pub. Works of Md.* 426 U.S. 736, 747 (1976); *Bowen v. Kendrick*, 487 U.S. 589, 614-15 (1988); *Hunt v. McNair*, 413 U.S., at 742; *Tilton*, 403 U.S. at 679-680; *Board of Ed. of Central School Dist. No. 1 v. Allen*, 392 U.S. 236 (1968).” 515 U.S., at 842. The Supreme Court’s acknowledgment that this principle may be extracted from these cases is a far cry from recognition, implicit or otherwise, that the bond financing structure in *Hunt* constitutes direct state aid. The *Rosenberger* dissent’s reference to these cases is as follows: “Even when the Court has upheld aid to an institution performing both secular and sectarian functions, it has always made a searching inquiry to ensure that the institution kept the secular activities separate from its sectarian ones, with any direct aid flowing only to the former and never the latter.” *Rosenberger*, 515 U.S., at 875-76 (citations omitted). If this was an acknowledgment that these cases all involved *direct* aid, as the district court suggests, this would mean that the *loan* of textbooks in *Allen* (one of the cases cited) constitutes *direct* aid. Rather, the specifically cited case references clearly are to the Court’s discussion of restricting government aid to *separable secular activities* of a sectarian institution. Again this could hardly be said to be recognition that the bond financing structure in *Hunt* constitutes direct state aid. Furthermore, the Court in *Rosenberger* stated: “The government usually acts by spending money. ...Even the provision of a meeting room, as in *Mergens* and *Widmar*, involved governmental expenditure, if only in the form of electricity and heating or cooling costs. The error made by the Court of Appeals, as well as by the dissent, lies in focusing on the money that is undoubtedly expended by the government, rather than on the nature of the benefit received by the recipient. If the expenditure of governmental funds is prohibited whenever those funds pay for a service that is, pursuant to a religion-neutral program, used by a group for sectarian purposes, then *Widmar*, *Mergens*, and *Lamb’s Chapel* would have to be overruled.... Any benefit to religion is incidental to the government’s provision of secular services for secular purposes on a religion-neutral basis.” *Rosenberger*, 515 U.S. at 843-44. The nature of the aid in *Rosenberger* (payment by the state university to a third-party printer for printing of student publications, including that of a religious student organization) is far different from tax-exempt bond financing. Nevertheless, it certainly is at least arguable that any benefit to religion is incidental to the government’s provision, on a religion-neutral basis, of bond proceeds, *raised not through the government’s taxing power but by private investors*, to a religiously affiliated educational institution for construction or improvement of secular projects that are restricted to secular use.

Under the second approach, the district court made the following determinations:

- (1) It could not find, as a matter of law, that the decision to provide financial assistance to the university was made on a neutral basis;²⁹⁸
- (2) The defendant’s argument that independent, private choice was involved in providing the benefit of the bond issue to the university was “without merit” because the Industrial Development Board, not the private investors, decided who would receive the benefit of the sale of the bonds;²⁹⁹ and
- (3) There were insufficient restrictions and inadequate monitoring and enforcement mechanisms attached to the aid to ensure that the government funds would be used to support only the secular functions of the institution.³⁰⁰

The district court apparently placed great emphasis on this latter determination, concluding that where the “government has not provided effective limitations on the use of government funds, the court must find that the government’s actions had the effect of advancing religion.”³⁰¹ The district court appeared to distinguish *Hunt v. McNair*, noting that the United States Supreme Court, in that case, had found the restrictive use and enforcement provisions “sufficient to ensure that the government aid would not be used to advance the religious purposes of the schools.”³⁰²

With respect to the third approach, the district court maintained that, because the endorsement test is concerned with the message conveyed by governmental action to average

298. 117 F. Supp.2d at 725. The district court maintained that facial neutrality alone is insufficient and that, in evaluating the neutrality of a government aid program, the court must look at both the facial neutrality of the statute and the manner in which it is applied in providing aid to specific recipients. The court contended that, in the instant case, this was “a nearly impossible task” because so little evidence was provided concerning the standards used to approve the Lipscomb bond issue. Consequently, the court concluded that it “must rely upon other factors” to decide whether the governmental entity’s actions advanced the university’s religious beliefs.

299. *Id.* at 724-25.

300. *Id.* at 725-30. Although noting that the language of the loan agreement restrictive use provision is similar to that found adequate by the United States Supreme Court in limiting the provision of government funds to secular activities, the district court asserted that restrictive language alone is insufficient in the absence of adequate enforcement of the restriction. The district court questioned whether the bank-trustee would adequately monitor and enforce the restriction provisions. Moreover, the court found the use restrictions would not extend for the useful life of the facilities constructed with government funds and thus they were insufficient to ensure that the school would never use such facilities for sectarian purposes. *See id.* at 728-29. *Compare*, *Tilton v. Richardson*, 403 U.S. 672, 683-84 (invalidating portion of statute that limits federal interest in facility to 20-year period as violating the Establishment Clause because the unrestricted use of valuable property after 20 years constitutes a contribution to a religious body).

301. 117 F. Supp.2d at 730.

302. *Id.* at 726, citing *Hunt*, 413 U.S. 734, 736-40. In *Hunt*, the statute required that any lease agreement and any reconveyance agreement between the Authority and educational institution contain a strict restrictive provision against use for sectarian purposes, which could be enforced through inspections by the government. *See* notes 39-40 & 49-50 *supra* and accompanying text.

citizens, the test “necessarily focuses upon the perception of a reasonable, informed observer.”³⁰³ Furthermore, the district court concluded that the Official Statement released by the Industrial Development Board in connection with the Bond Re-Issue was the “best source of information on which the reasonable observer may rely” in determining whether the bond issuance by the board was an endorsement of religion.³⁰⁴ The district court concluded that both the structure of the Official Statement, from which the reader would clearly connect the Board to the local government and both to the project benefiting the university, and the content of the Official Statement, which describes the university’s religious ties and affiliation “in significant detail,” indicate to the reasonable observer that the Board, as an instrumentality of the local government, “is endorsing the sectarian and religious beliefs” of the University.³⁰⁵ The district court also emphasized that the Official Statement contained no disclaimer “to indicate to the reasonable observer that the government is not entirely endorsing the religious views espoused by [the university] in the Official Statement.”³⁰⁶

The district court concluded that: the University was “pervasively sectarian and that its secular functions as an educational institution cannot be separated from its religious mission;” the financial aid lacked sufficient guarantees that the funds would be used solely to support secular functions of the University; and the aid created the perception of government endorsement of the University’s religious views and teachings.³⁰⁷ Accordingly, the issuance of tax-exempt bonds and the loan of the proceeds of those bonds to the University had the impermissible effect of advancing the religious beliefs of the University, in violation of the Establishment Clause of the First Amendment.

Just two weeks after the decision in *Steele*, the Virginia Supreme Court handed down its opinion in *Virginia College Building Authority v. Lynn*,³⁰⁸ wherein it determined that the issuance of revenue bonds for the benefit of a pervasively sectarian college violated neither the Establishment Clause of the federal constitution nor the section of the state constitution

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303. 117 F. Supp.2d at 732, quoting *Capitol Square Review and Advisory Bd. v. Pinette*, 515 U.S. 753, 773, 115 S. Ct. 2440,24529 (1995) (O’Connor, J. concurring in part and concurring in judgment). The district court emphasized that the Sixth circuit has specifically adopted the endorsement test for determining whether a governmental action has the impermissible effect of advancing religion. 117 F. Supp.2d at 731.
304. *Id.* at 733. In examining “all the relevant facts,” the district court also reviewed “the messages conveyed and the information provided to the general public by Lipscomb [University] regarding its religious beliefs and by the Board in considering and approving the Lipscomb bond issue.” The court noted that the University’s statements “regarding its overwhelming religious nature can be found in its brochures, catalogs, press releases, web sites and handbooks.” The court then proceeded to focus its attention on information provided by the Board that indicated the relationship between the Board and the University and “the degree to which the government does or does not support the religious view of Lipscomb [University].” *Id.* at 732-33.
305. *See id.* at 733-34.
306. *Id.* at 734. The district court cited *Rosenberger v. Rector and Visitors of the Univ. of Va.*, 515 U.S. 819, 841, in which a state funded university, through a disclaimer, “provided significant evidence that there was no government endorsement,” despite university funding to assist a religious organization on campus. See 117 F. Supp.2d at 734.
307. *Id.* at 734.
308. No. 992099 (Nov. 3, 2000); 2000 W.L. 1650111 (Va.).

concerning no establishment of religion.³⁰⁹ There was no contention that the Virginia College Building Authority (VCBA) acted with the purpose of advancing or inhibiting religion or that the bond program resulted in excessive entanglement.³¹⁰ Therefore, relying upon *Agostini* and *Mitchell*, the Virginia court indicated that it must consider whether the aid resulted in governmental indoctrination, whether recipients of the aid were defined by reference to religion, and whether the government aid program constituted an endorsement of religion.³¹¹

The court observed that in *Mitchell*, *Agostini*, *Zobrest*, *Witters*, *Mueller*, *Allen* and *Everson*, all of which involved government to pervasively sectarian schools, it was “the nature of the aid that was dispositive of the Establishment Clause question, not the nature of the institution.”³¹² The Virginia court therefore concluded that, in determining whether the Establishment Clause prohibits a particular school aid program, “both the nature of the aid and the nature of the institution receiving that aid must be appropriately considered and balanced.”³¹³ In proceeding with this consideration, the Virginia court found it helpful to examine *Hunt v. McNair*,³¹⁴ a case “remarkably similar” to the case at hand. After reviewing the facts in *Hunt*, the Virginia court noted that the United States Supreme Court had concluded that implementation of the bond financing proposal for sectarian colleges would not have the primary effect of advancing or inhibiting religion.³¹⁵ Moreover, the Virginia court observed that the Supreme Court had “suggested [in dictum] that even if an institution is pervasively sectarian, the aid in question may be so unique that the provision of the aid does not result in ‘the primary effect’ of advancing or inhibiting religion.”³¹⁶

Accordingly, the Virginia court indicated that it must first determine whether the college was pervasively sectarian and, if it found in the affirmative, then after considering *Agostini*, *Mitchell*, and other fact-specific cases, it must “determine whether the unique nature of the aid is nonetheless permitted without offending the Establishment Clause.”³¹⁷ Although noting that no one distinct formula has emerged for determining whether an institution is pervasively sectarian, the Virginia court identified several common factors previously relied upon by the United States Supreme Court in making this determination.³¹⁸ Based upon these factors, the Virginia court

309. *Id.* at 6-7. The case concerned Regent University, which was created under the auspices of the Christian Broadcasting Network, Inc. (CBN).

310. *Id.* at 16.

311. *Id.*

312. *Id.* at 14.

313. *Id.*

314. 413 U.S. 734, (1973).

315. 2000 W.L. 1650111 (Va.) at 14. *See* 413 U.S. at 745. The Virginia Court further noted that, appended to that discussion, the United States Supreme Court “specifically declined to address the very issue presented in the case before us today.” 2000 W.L. 1650111 (Va.) at 14. *See* 413 U.S. at 745 n.7.

316. 2000 W.L. 1650111 (Va.) at 15. *See* 413 U.S. at 745 n.7.

317. 2000 W.L. 1650111 (Va.) at 16.

318. These factors include: whether the institution has a formal affiliation with a church and the amount of autonomy enjoyed from the church; whether one of the purposes of the institution is the indoctrination of religion and whether its activities reflect such a purpose or exert a dominating religious influence over the

held that Regent University was pervasively sectarian and proceeded to determine whether it was “nonetheless ... permitted to participate in the VCBA bond program without offending the Establishment Clause.”³¹⁹

In addressing the remaining issues,³²⁰ the Virginia court emphasized the need to “distinguish at the outset the unique nature of the governmental aid” in the case:

Because the bond proceeds are the funds of private investors, the bond proceeds are not governmental aid received by the institution. No taxpayer dollars are transferred directly or indirectly to a participating institution. No taxpayer dollars are pledged or utilized as surety for bond obligations....

The aid does not involve usage of governmental funds and, in the traditional sense in which the terms have been used, the terms “direct aid” or “indirect aid” are simply inapplicable. The Court acknowledged this unique difference in footnote seven of its opinion in *Hunt*. The nature of this aid is properly defined as the granting of tax exempt status to the bonds which has the incidental result of permitting a qualifying institution to borrow funds at an interest rate lower than conventional private financing. The South Carolina Supreme Court in [the case below had] characterized the role of the state as a “mere conduit”, and the New Jersey Supreme Court in a similar case called the bond provisions a “governmental service.”³²¹

This characterization of the nature of the aid provided by tax exempt bonds by the Virginia court and its conclusion that the terms “direct aid” or “indirect aid” are “simply inapplicable” are at variance with the federal district court’s holding in *Steele* and more akin to the holding in *Johnson*.³²²

academic curriculum; whether the institution reflects an atmosphere of academic freedom; the institution’s policy on classroom prayer or other evidence of religion influencing the classroom instruction; the existence and use of religious qualifications for faculty hiring or student admission; and the religious makeup of the faculty and student population. *Id.* (footnotes omitted). The Virginia court apparently also took into consideration the categorization of factors as identified by both the majority and the dissenting opinions in *Columbia Union College v. Clarke*, 159 F.3d 151 (4th Cir. 1998) cert. denied, 527 U.S. 1013 (1999). See 2000 W.L. 1650111 (Va.) at 16 n.9.

319. 2000 W.L. 1650111 (Va.) at 17.

320. *Id.* at 17 (whether the aid resulted in governmental indoctrination, whether recipients of the aid were defined by reference to religion, and whether the government aid program constituted an endorsement of religion).

321. *Id.* at 17, citing *Hunt v. McNair*, 187 S.E.2d 645, 650 (S.C. 1972), aff’d, 413 U.S. 734 (1973). A number of other state high courts have relied upon *Hunt’s* “special sort” of state aid language in upholding the constitutionality of tax exempt bonds to assist sectarian educational institutions. See e.g., *California Educ. Facilities Auth. v. Priest*, 12 Cal. 3d 593, 526 P.2d 513, 116 Cal. Rptr. 361 (1974); *Nohr v. Brevard Cty. Educ. Fac. Auth.*, 247 So.2d 304 (Fla. 1971); *Cecrle v. Educational Facilities Auth.* 52 Ill.2d 312, 288 N.E.2d 399 (1972); *Opinion of the Justices*, 354 Mass. 779, 236 N.E.2d 523 (1968); *Minnesota Higher Educ. Auth. v. Hawk*, 305 Minn. 97, 232 N.W.2d 106 (1975); *Clayton v. Kervick*, 267 A.2d 503, 507 (N.J. 1970); *Vermont Educ. Bldg. Financ. Ag. v. Mann*, 127 Vt. 262, 247 A.2d 68 (1968).

322. See notes 295-297 & 299 *supra* and accompanying text.

Relying upon the decisions in *Agostini* and *Mitchell*, the Virginia court found that the recipients of the aid were not defined by reference to religion because the program was available to all qualifying higher education institutions in the State without regard to religious affiliation.³²³ The court concluded that, because of the neutral, secular allocation criteria, there was “no financial incentive to undertake religious indoctrination’ in the provision of this unique aid.”³²⁴ The court also asserted that it “cannot be disputed that an interest rate or tax exemption has exclusively secular content.”³²⁵ Furthermore, the court reasoned that because no government funds flow to the university, “it cannot be said that government funds are utilized for indoctrination of religious belief or that there is diversion of government funds for religious activity or that government funds are utilized for any programs, ‘supplemental’ or otherwise.”³²⁶ Finally, the court observed that the university receives the funds only as a result of the “genuinely independent choices of investors.”³²⁷ The court noted that no funds flow to the university unless private investors purchase bonds issued on its behalf and that such investment choices are “presumably based upon market factors and personal circumstances.”³²⁸ The court maintained that “[i]n any event, such a choice ‘cannot be attributed to state decision making.’”³²⁹

Once again, the conclusion of the Virginia court that the provision of the bond proceeds to Regent University involve no “government funds” and that any funds flowing to the University do so solely as a result of private investment decisions contradicts that of the federal district court in *Steele*.³³⁰

In conclusion, the Virginia court stated that:

The issuance of [revenue] bonds on behalf of [the university] does not result in governmental indoctrination because [the program] determines eligibility for aid neutrally. Any funds [the university] receives are from the private choices of investors.

323. 2000 W.L. 1650111 (Va.) at 17-18.

324. *Id.*, quoting from *Agostini*, 521 U.S. at 231 (“incentive is not present ... where the aid is allocated on the basis of neutral, secular criteria that neither favor nor disfavor religion, and is made available to both religious and secular beneficiaries on a nondiscriminatory basis”).

325. 2000 W.L. 1650111 (Va.) at 18.

326. *Id.*

327. *Id.*

328. *Id.*

329. *Id.*, quoting *Zobrest*, 509 U.S. at 10. The court quoted Justice O’Connor in *Mitchell*:

[W]hen government aid supports a school’s religious mission only because of independent decisions made by numerous individuals to guide their secular aid to that school, “no reasonable observer is likely to draw from the facts ... an inference that the State itself is endorsing a religious practice or belief.”

Witters, *supra*, at 493 (O’CONNOR, J., concurring in part and concurring in judgment). Rather, endorsement of the religious message is reasonably attributed to the individuals who select the path of the aid.

2000 W.L. 1650111 (Va.) at 18, quoting 120 S. Ct. at 2559 (O’Connor, J. concurring).

330. See notes 295 & 299 *supra* and accompanying text.

The aid has no impermissible content. No government funds ever reach Regent’s coffers. No government funds are used or pledged for any purpose and “this carefully constrained program also cannot reasonably be viewed as an endorsement of religion.” We hold that, with the exception of the School of Divinity, allowing [the university’s] participation in the VCBA bond financing program does not offend the Establishment Clause.³³¹

What Is Pervasively Sectarian?

Given the inquiry of these latter two cases into whether a particular educational institution is “pervasively sectarian,” *Columbia Union College v. Clarke*³³² may be instructive. Therein, the United States Court of Appeals for the Fourth Circuit considered an appeal from the lower district court’s ruling that annual noncategorical grants to a pervasively sectarian educational institution violated the Establishment Clause. The circuit court noted that the grant program at issue was the same one involved in *Roemer v. Board of Public Work of Maryland*,³³³ in which the United States Supreme Court “held that the state could provide direct government funds to support the general secular educational activities of the church-affiliated colleges because religion did not so permeate those colleges that their religious and sectarian roles were indivisible.”³³⁴ The Court in *Roemer* concluded that, even though the colleges “unquestionably were affiliated with a church,” they were not “pervasively sectarian,” and, therefore, “the direct grant of government funds to them did not violate the Establishment Clause.”³³⁵

The circuit court pointed out that the Court in *Roemer* took pains to distinguish a “pervasively sectarian” institution from a “religiously affiliated” one. In the former case, a “pervasively sectarian” college would be “unable to separate its secular, educational mission from sectarian indoctrination,” and therefore, no safeguard could “ensure that direct monetary aid, even if designated to fund the school’s secular functions, [would] not aid its religious mission.”³³⁶ On the other hand, an institution “not pervasively sectarian, but simply ‘affiliated’ with a religious organization could separate secular from religious activities and thus demonstrate that government funds would flow only to secular educational activities.”³³⁷ Accordingly, government assistance to such institution, “if directed only to those purely secular purposes, would not impermissibly advance religion.”³³⁸

Columbia Union had argued that the United States Supreme Court’s more recent cases had effectively overruled *Roemer*’s holding that the Establishment Clause allows “direct state

331. 2000 W.L. 1650111 (Va.) at 18, quoting *Agostini*, 521 U.S. at 235.
 332. 159 F.3d 151 (4th Cir. 1998), cert. denied, 527 U.S. 1013 (1999) (involving four-year liberal arts college affiliated with Seventh Day Adventist Church).
 333. 159 F.3d at 157. See *Roemer*, 426 U.S. 736 (1976). See also notes 72-80 *supra* and accompanying text.
 334. 159 F.3d. at 157, citing *Roemer*, 426 U.S. at 755-59.
 335. 159 F.3d. at 157-58, citing *Roemer*, 426 U.S. at 758-59.
 336. 159 F.3d at 158 quoting *Roemer*, 426 U.S. at 758-59.
 337. 159 F.3d at 158 citing *Roemer*, 426 U.S. at 762.
 338. 159 F.3d at 158.

money grants to the general secular educational programs of religious colleges *only if* those colleges are not pervasively sectarian.”³³⁹ The circuit court acknowledged that *Witters* and *Agostini* prohibit a court “from concluding that any and all state aid to a pervasively sectarian institution impermissibly advances religion” and therefore “unquestionably undermine” the broad “*Roemer* dicta that ‘no state aid at all’ is permissible to a pervasively sectarian institution.”³⁴⁰ Nevertheless, the circuit court concluded that nothing in those cases or any other Supreme Court precedent “eviscerates *Roemer*’s holding regarding direct money grants.”³⁴¹ The circuit court distinguished *Witters*, noting that the Supreme Court had refused to find that the aid involved was an “‘impermissible direct subsidy’” to a religious school because the state aid flowed to the school “only as a result of the genuinely independent and private choices of aid recipients.”³⁴² In contrast, the circuit court found that the aid to Columbia Union is not “an incidental benefit”; rather, the college is the “primary beneficiary of this direct aid,” and the students, to the extent they may benefit at all from the state grant, are “incidental beneficiar[ies].”³⁴³

In distinguishing the application of *Agostini* from the case before it,³⁴⁴ the federal circuit court concluded that:

Agostini ... holds that government aid flowing to even a pervasively sectarian institution does not impermissibly advance religion if it reaches the institution as a result of private

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339. *Id.* at 159 (emphasis added). In so arguing, Columbia Union relied principally upon *Witters*, *Agostini*, and *Rosenberger*. See discussion of cases at *id.* at 159-162.
340. 159 F.3d at 160, citing *Agostini*, 117 S. Ct. at 2010-11; *Roemer*, 426 U.S. at 747.
341. 159 F.3d at 159. (Establishment Clause permits the state to provide direct money payments (“noncategorical in nature”) to a church-affiliated college to fund its secular educational purposes only if the college is not so “pervasively sectarian that secular activities cannot be separated from sectarian ones.” (citing *Roemer*, 426 U.S. at 740).
342. 159 F.3d at 159, quoting *Witters*, 474 U.S. at 488.
343. 159 F.3d at 159-160; *cf.* *Zobrest*, 501 S. Ct. at 12 (disabled children are primary beneficiaries of IDEA services; sectarian schools are only incidental beneficiaries).
344. The circuit court pointed out that, in *Agostini* the Supreme Court:
- (1) In analogizing the remedial services in *Agostini* to the vocational grant in *Witters* and the sign-language interpreter in *Zobrest*, had reasoned that the remedial instruction provided to “eligible recipients” reached the school “‘only as a result of the genuinely independent and private choices of’ students or their parents” and therefore the aid, flowing to pervasively sectarian institutions “as a result of parents’ choice to send these qualifying students to such a school, did not impermissibly advance religion.” 159 F.3d at 160, (8) quoting *Agostini*, 117 S. Ct. at 2012, (quoting *Witters*, 474 U.S. at 487);
 - (2) Had emphasized that the aid in *Agostini* (unlike that in *Columbia Union* or *Roemer*) did not flow “directly to ‘the coffers of religious schools’ for services provided ‘on a school-wide basis,’” 159 F.3d at 160 quoting *Agostini*, 117 S. Ct. at 2013; and
 - (3) Had determined that the provision of remedial services to students at religious schools “did not impermissibly advance the schools’ religious educational mission because those services were ‘supplemental to the regular curricula’ taught to all students.” 159 F.3d at 160 quoting *Agostini*, 117 S. Ct. at 2013. “Title I aid did not ‘supplant’ or ‘reliev[e] sectarian schools of costs they otherwise would have borne in educating their students.’” 159 F.3d at 160, quoting *Agostini*, 117 S. Ct. at 2013 (quoting *Zobrest*, 509 U.S. at 12).

independent choices of the individual rather than state decisionmaking, and if it “supplements” rather than “supplant[s]” the college’s core educational functions. But *Agostini* does not hold that government funding that directly flows to “the coffers of [a pervasively sectarian] religious school[]” to fund the entire budget for many of the college’s core educational courses would survive an Establishment Clause challenge. *Agostini*, therefore, does not disturb the central teaching of *Roemer* that “when a college is so pervasively sectarian that its religious mission ‘permeates’ its educational functions, the government cannot provide direct money grants even to fund the college’s secular subjects because ‘religious and secular functions [a]re inseparable.’”³⁴⁵

Having “determined that direct state funding of the general education courses of a ‘pervasively sectarian’ institution would violate the Establishment Clause,” the circuit court turned to the issue of “whether the district court properly held that Columbia Union is, as a matter of law, a ‘pervasively sectarian’ institution.”³⁴⁶ Considering what constitutes a “pervasively sectarian,” institution, the circuit court observed that the elements of such an institution are “not clearly defined ‘absolutes of the physical sciences or mathematics,’ which can be applied like a ‘litmus-paper test,’ to produce a definitive, unassailable result.”³⁴⁷ However, the circuit court observed that, even though the Supreme Court had held that religiously affiliated colleges in *Roemer*, *Tilton* and *Hunt* were not pervasively sectarian, the Court nonetheless had identified several characteristics of a “pervasively sectarian” college that could be categorized into “four general areas of inquiry: (1) mandated religious worship; (2) dominance of religious influences over the academic curriculum; (3) religious preferences in the college’s faculty hiring and student admission processes; and (4) to degree of institutional autonomy the college enjoys apart from its affiliated church.”³⁴⁸ The circuit court contended, however, that no one of these factors, in isolation, was dispositive.³⁴⁹ Moreover, the circuit court cautioned that:

345. 159 F.3d at 160-61, quoting *Agostini*, 117 S. Ct. at 2013; *Roemer*, 426 U.S. at 750. The circuit court maintained that *Rosenberger* also was inapplicable, noting that the Supreme Court had “expressly found that *Roemer* did not apply in a case where the University provided an ‘incidental,’ indirect benefit (i.e., printing services) for all qualifying recipients, not ‘direct money payments’ as was provided to the colleges in *Roemer*.” 159 F.3d at 161, citing *Rosenberger v. Rector and Visitors of the Univ. of Va.*, 515 U.S. 819, 842, 844 (1995); see also *id.* at 840-41 (payments “to private contractors for the cost of printing” differs from a “tax levied for the direct support of a church,” which would be “contrary to” the Establishment Clause; “[o]ur decision ... cannot be read as addressing an expenditure from a general tax fund”).

346. 159 F.3d at 162-63.

347. *Id.* at 163 quoting *Tilton v. Richardson*, 403 U.S. 672, 678 (1971); *Roemer*, 426 U.S. at 758.

348. 159 F.3d at 163. See generally *Roemer*, 426 U.S. at 755 -58; *Hunt*, 413 U.S. at 743 -44; *Tilton*, 403 U.S. at 685-86.

349. 159 F.3d at 163. The court stated:

“For example, although ‘Catholic religious organizations ... governed’ all the colleges in *Tilton*, their lack of institutional autonomy simply constituted one factor in favor of finding them pervasively sectarian. *Tilton*, 403 U.S. at 686 -87. Similarly, the colleges at issue in *Roemer* required students to take certain religion courses, but this fact alone did not render them pervasively sectarian. *Roemer*, 426 U.S. at 756.”

159 F.3d at 163.

A careful reading of *Roemer*, *Tilton*, and *Hunt* leads to the inescapable conclusion that even colleges obviously and firmly devoted to the ideals and teachings of a given religion are not necessarily “so permeated by religion that the secular side cannot be separated from the sectarian.” Indeed, the Supreme Court has set the bar to finding an institution of higher learning pervasively sectarian quite high. We believe that to find religion pervades a college to such a degree that religious indoctrination thoroughly dominates secular instruction, the college must in fact possess a great many of the following characteristics: mandatory student worship services; an express preference in hiring and admissions for members of the affiliated church for the purpose of deepening the religious experience or furthering religious indoctrination; academic courses implemented with the primary goal of religious indoctrination; and church dominance over college affairs as illustrated by its control over the board of trustees and financial expenditures. These elements should not be read as a “pervasively sectarian” template that, when placed over every religiously affiliated college, precisely determines the degree of its religiosity. *Matters as difficult and important can never be so easily resolved. Rather, we set them out to provide some guidance and to clarify that the Supreme Court regards a “pervasively sectarian” college as a rarity, to be so designated only after a thorough and searching inquiry.*³⁵⁰

The circuit court ruled that the lower court had erred in granting summary judgment. Concluding that “[t]he criteria for assessing whether an institution is pervasively sectarian are complex, elusive, and heavily fact intensive,” the circuit court remanded the case to the district court to “make the requisite full and careful determinations necessary”³⁵¹

Summary: Putting It All Together

The United States Supreme Court has consistently rejected the proposition that the Establishment Clause prohibits any program that “in some manner aids an institution with a religious affiliation.”³⁵² Nor has the Court accepted “the recurrent argument that all aid is forbidden because aid to one aspect of an institution frees it to spend its other resources on religious ends.”³⁵³ *Tilton* and *Hunt* stood for the proposition that aid, in the form of construction grants and revenue bond proceeds, to religiously affiliated educational institutions was constitutionally permissible, provided the institutions were not “pervasively sectarian” and the

350. 159 F.3d at 163-64 (emphasis added) (other citations omitted). See generally *Roemer*, 426 U.S. at 755-58; *Hunt*, 413 U.S. at 743-44; *Tilton*, 403 U.S. at 685-86; see also *Ball*, 473 U.S. at 384 n.6; *MEEK v. Pittenger*, 421 U.S. 349, 356 (1975); *Nyquist*, 413 U.S. at 767-68; *Lemon*, 403 U.S. at 615 -18.

351. 159 F. 3d at 169. On remand, the federal district court issued a Memorandum of Decision finding that Columbia College was not “pervasively sectarian” because it possessed only two of the four characteristics identified by the circuit court.

352. *Hunt v. McNair*, 413 U.S. 734, 742-43, citing *Tilton v. Richardson*, 403 U.S. 672, 679 (1971). (The “simplistic argument that every form of financial aid to church-sponsored activity violates the Religion Clauses was rejected long ago in *Bradfield v. Roberts*, 175 U.S. 291 (1899).”)

353. *Hunt*, 413 U.S. at 742-43, citing *Tilton v. Richardson*, 403 U.S. 672 (1971); *Walz v. Tax Comm’n.*, 397 U.S. 664 (1970); *Bradfield v. Roberts*, 175 U.S. 291 (1899).

aid extended only to the secular side of the institutions.³⁵⁴ Furthermore, *Roemer* upheld even direct noncategorical grants to religiously affiliated colleges and universities, as long as the institutions were not pervasively sectarian and the aid was restricted to secular purposes or activities.³⁵⁵

More recently, the Court in *Agostini*, acknowledged that the landscape of its Establishment Clause law had significantly changed since the *Aguilar* and *Ball* decisions.³⁵⁶ Relying upon *Witters* and *Zobrest*, the Court rejected the presumptions and reasoning underlying *Aguilar* and *Ball* that all government aid “that directly assists the educational function of religious schools is invalid.”³⁵⁷ Accordingly, the Court affirmatively overruled *Aguilar* and those parts of *Ball* concerning the Grand Rapid’s Shared Time program.³⁵⁸

The Court in *Agostini* affirmed that, in evaluating whether a government school aid program violates the Establishment Clause, courts should inquire whether the program:

- (1) Has a secular purpose; or
- (2) Has a principal or primary effect of advancing or inhibiting religion.³⁵⁹

With respect to the first inquiry, the Court generally has had no problem finding that a particular aid program satisfies the “secular purpose” prong of the *Lemon* test.³⁶⁰

354. See *Hunt*, 413 U.S. at 743 (“Aid normally may be thought to have a primary effect of advancing religion when it flows to an institution in which religion is so pervasive that a substantial portion of its functions are subsumed in the religious mission or when it funds a specifically religious activity in an otherwise substantially secular setting.”) *Tilton v. Richardson*, 403 U.S. at 680 (“religion so permeates the secular education” provided by the colleges that their religious and secular functions were inseparable).

355. *Roemer v. Bd. of Pub. Wks. of Md.*, 426 U.S. 736, 758-60 (annual grants were noncategorical and unrestricted with one exception – use restriction for sectarian purposes).

356. *Agostini*, 521 U.S. at 222 (“Our more recent cases have undermined the assumptions upon which *Ball* and *Aguilar* relied.”).

357. *Mitchell v. Helm*, 120 S. Ct. 2530, 2545 (plurality opinion), 2567 (concurring opinion), quoting from *Agostini*, 521 U.S. at 225.

358. *Agostini*, 521 U.S. at 235. (“[We] must acknowledge that *Aguilar*, as well as the portion of *Ball* addressing the Grand Rapid’s Shared Time program, are no longer good law.) *Id.*

359. See *id.* at 222-23. See also notes 133-163 *supra* and accompanying text.

360. See e.g., *Mitchell v. Helm*, 120 S. Ct. 2530, 2540 (plurality opinion), 2560 (concurring opinion) (secular purpose of program not questioned); (*Zobrest v. Catalina Foothills School Dist.*, 509 U.S. 1, 5 (1993) (IDEA program has a clear secular purpose); *Witters v. Washington Dep’t of Services for the Blind*, 474 U.S. 481, 485-86 (1986) (all parties concede the “unmistakably secular purpose” of program); *School Dist. of Grand Rapids v. Ball*, 473 U.S. 373, 383 (1985) (Court noted that “[a]s has often been true in school aid cases, there is no dispute as to the first [Lemon] test” that the purpose of the aid is “manifestly secular”); *Roemer v. Bd. of Pub. Wks. of Md.*, 426 U.S. 736, 754 (1976) (secular purpose of program not challenged); *Hunt v. McNair*, 413 U.S. 734, 741 (1973) (purpose of statute is manifestly a secular one); *Tilton v. Richardson*, 403 U.S. 672, 679 (1971) (legitimate secular objective entirely appropriate for governmental action).

With respect to the second inquiry, the Court in *Agostini* indicated three primary criteria for determining if a government aid program has the effect of advancing religion. These are whether it:

- (1) Results in governmental indoctrination;
- (2) Defines its recipients by reference to religion; or
- (3) Creates an excessive entanglement.³⁶¹

The Court found that the Title I aid program in *Agostini* did not run afoul of any of these. It also stated that review of these same considerations justified its conclusion that the Title I program did not constitute an endorsement of religion.³⁶² In determining to treat the issue of excessive entanglement as an aspect of the inquiry into a program's effect, the Court recognized that it has used the same factors to assess both "entanglement" and "effect."³⁶³ Furthermore, the Court's consideration in *Agostini* of the heretofore traditional grounds for finding excessive entanglement indicate that many of the presumptions underlying these grounds also have been undermined and, consequently, the Court henceforth will likely require a showing of "far more onerous burdens" to support a finding of excessive entanglement.³⁶⁴

In *Mitchell*, decided during the Supreme Court's 2000 term, six of the nine justices affirmed that Establishment Clause challenges to government school aid programs should be examined by applying the criteria set forth in *Agostini*.³⁶⁵ They also indicated that review of these same criteria would determine whether a program constitutes an endorsement of religion.³⁶⁶ In addition, these same six justices agreed to overrule *Meek* and *Wolman*,³⁶⁷ thus rejecting the presumption established in those cases that any aid flowing to the educational mission of a pervasively sectarian school inevitably has the impermissible primary effect of advancing religion.³⁶⁸

361. *Agostini*, 521 U.S. at 234.

362. *Id.* at 235.

363. *Id.* at 232-33.

364. *Id.* at 234. See also notes 155-162 *supra* and accompanying text.

365. *Mitchell*, 120 S. Ct. at 2540, 2555 (plurality opinion), 2556 (concurring opinion).

366. *Id.* at 2555 (plurality opinion), 2560 (concurring opinion).

367. *Id.* at 2555 (plurality opinion) (to extent *Meek* and *Wolman* conflict with Court's holding, they are overruled), 2556 ("Today we simply acknowledge what has long been evident"); *see id.* at 2556 (concurring opinion) (*Meek* and *Wolman* overruled to extent inconsistent with Court's judgment in *Mitchell*), 2563 (*Meek* and *Wolman* created an inexplicable rift within our Establishment Clause jurisprudence), 2567 (concurring opinion) (*Agostini* and cases upon which it relied have undermined *Meek* and *Wolman*.)

368. *See Meek v. Pittenger*, 421 U.S. 349 (1975) (aid program ostensibly limited to wholly neutral, secular instructional material and equipment, "necessarily results in aid to the sectarian school enterprise as a whole" and "inescapably results in the direct and substantial advancement of religious activity." 421 U.S. at 366; *Wolman v. Walter*, 433 U.S. 229 (1977) ("In view of the impossibility of separating the secular

The *Mitchell* plurality opinion openly rejected the constitutional relevance of whether a recipient school is pervasively sectarian, noting that the period when this mattered, particularly if the school was a primary or secondary school, “is one that the Court should regret, and it is thankfully long past.”³⁶⁹

Justice O’Connor, joined by Justice Breyer in the concurring opinion in *Mitchell*, neither concurred with the plurality’s position nor registered an objection to it. While Justice O’Connor’s silence on the specific issue of the constitutional relevance of pervasively sectarian institutions appears curious, especially given her passionate disagreement with the plurality on other issues as well as the dissenter’s vociferous emphasis on the issue,³⁷⁰ such silence does not automatically translate into support for the demise of the pervasively sectarian inquiry. Moreover, her strenuous objection both to the plurality’s “conclusion that actual diversion of government aid to religious indoctrination is consistent with the Establishment Clause,” and to its characterization of the Chapter 2 aid as a “true private-choice program” indicates a continuing concern with government aid that consists of direct monetary subsidies to religious organizations that could then use that aid to “support religious indoctrination.”³⁷¹

Despite this concern, however, Justice O’Connor declined to accept the argument that direct, nonincidental aid to the educational function of religious schools is *always* impermissible.³⁷² Moreover, she stressed her belief that “presumptions of religious

education function from the sectarian, the state aid inevitably flows in part in support of the religious role of the schools.”) 433 U.S. at 250.

369. *Mitchell*, 120 S. Ct. at 2550 (plurality opinion). In support of its position, the plurality points out that the court has not struck down an aid program in reliance on this factor since *Aguilar* and *Ball*, which *Agostini* overruled in the former case in full and in the latter case in part. The plurality also relies on the fact that *Zobrest* and *Agostini* “upheld aid programs to children who attended schools that were not only pervasively sectarian but also were primary and secondary [schools].” *Id.* Finally the plurality gives weight to the fact that Justice O’Connor not only failed to mention that pervasively sectarian schools were at issue in her concurring opinion in *Mitchell*, but, in writing the opinion for the Court in *Agostini*, likewise failed to discuss the fact that pervasively sectarian schools were at issue in explaining why the Title I aid program was constitutional. See *id.* at 2551 & n.13.

370. See notes 182, 206-208, & 224-233 and accompanying text. See also *Mitchell*, 120 S. Ct. at 2581-83, 2586-87, 2589, 2591-93 (dissenting opinion).

371. *Id.* at 2559-60 (concurring opinion). Justice O’Connor wrote: “To be sure, the plurality does not actually hold that its theory extends to direct money payments. That omission, however, is of little comfort. In its logic – as well as its specific advisory language – the plurality opinion foreshadows the approval of direct monetary subsidies to religious organizations, even when they use the money to advance their religious objectives.” *Id.* at 2560 (concurring opinion), citing plurality opinion at 2546 & n.8 (recognizing that direct money payments create “special risks that governmental aid will have the effect of advancing religion” (and that an indirect form of payment reduces these risks), but stating that it is “arguable, ... at least after *Witters*, that the principles of neutrality and private choice would be adequate to address those special risks, ...”).

372. See notes 248-250 and accompanying text.

indoctrination are normally inappropriate when evaluating neutral school-aid programs” under the Establishment Clause³⁷³:

In *Agostini*, we repeatedly emphasized that it would be inappropriate to presume inculcation of religion; rather, plaintiffs raising an Establishment Clause challenge must present evidence that the government aid in question has resulted in religious indoctrination.... As we explained in *Agostini* “we have departed from the rule relied on in *Ball* that all government aid that directly assists the educational function of religious schools is invalid.”³⁷⁴

Justice O’Connor also pointed out the Court’s specific reliance in *Agostini* on its statement in *Zobrest* that “a presumption of indoctrination, because it constitutes an absolute bar to the aid in question regardless of the religious school’s ability to separate that aid from its religious mission, constitutes a ‘flat rule, smacking of antiquated notions of taint, [that] would indeed exalt form over substance.’”³⁷⁵ Thus Justice O’Connor clearly indicated that, in evaluating an Establishment Clause challenge to a neutral school-aid program, she would not presume religious indoctrination,³⁷⁶ but rather, would permit inquiry into a religious school’s ability to separate the government aid in question from the school’s religious mission and would require proof that such aid “actually is, or has been, used for religious purposes.”³⁷⁷

The Court in *Mitchell* addressed only the first two criteria for determining the primary effect of a governmental school-aid program.³⁷⁸ With respect to the second of these, both the plurality and the concurring opinions concluded that, because Chapter 2 aid was allocated on a nondiscriminatory basis, using wholly neutral and secular criteria, to students enrolled in both religious and secular schools, Chapter 2 does not define its recipients by reference to religion and thus its criteria for allocating aid does not create a financial incentive to undertake religious indoctrination.³⁷⁹

373. *Mitchell*, 120 S. Ct. at 2567 (concurring opinion). While acknowledging the need for “continued recognition of the special dangers associated with direct money grants to religious institutions,” Justice O’Connor nevertheless rejected the argument that such concern required that “any form of secular aid that might conceivably be diverted to a religious use” be treated as constitutionally suspect. *Id.* at 2566 (concurring opinion).

374. *Id.* at 2567 (concurring opinion), quoting from *Agostini*, 521 U.S. at 225.

375. *Mitchell*, 120 S. Ct. at 2567 (concurring opinion), citing *Zobrest*, 509 U.S. at 13.

376. *See Mitchell*, 120 S. Ct. at 2567-68 (concurring opinion).

377. “I would adhere to the rule that we have applied in the context of textbook lending programs: To establish a First Amendment violation, the plaintiff must prove that the aid in question actually is, or has been, used for religious purposes.” *Id.* at 2567 (concurring opinion).

378. *See id.* at 2540 (plurality opinion), 2560-61 (concurring opinion). The Respondents in *Mitchell* did not challenge the lower court’s holding that the Chapter 2 aid has a secular purpose or that Chapter 2 does not create an excessive entanglement.

379. *Id.* at 2543 (plurality opinion), 2561 (concurring opinion); *see Agostini*, 521 U.S. at 231. Justice O’Connor, in her concurring opinion, explained the relevance of this inquiry: Scrutiny of the manner in which a government-aid program identifies its recipients is important because “the criteria might themselves have the effect of advancing religion by creating a financial incentive to undertake religious indoctrination.” 120 S. Ct. at 2561 (concurring opinion). In *Agostini*, the Court set out the following rule for determining the

Under the *Mitchell* plurality, the first primary effect criteria, that is, whether governmental aid to religious schools results in religious indoctrination, ultimately depends on whether any indoctrination that occurs could reasonably be attributed to governmental action. In deciding this issue, the plurality maintained that the Court has consistently turned to the neutrality principle, upholding aid that is offered to a broad range of groups or persons without regard to their religion. The plurality chose to characterize the per capita scheme by which Chapter 2 aid was allocated as “private decisionmaking” and concluded that the neutrality and private choices together eliminated any possible attribution of indoctrination to the government.³⁸⁰ Furthermore, relying upon *Witters*, *Zobrest* and *Agostini*, the plurality maintained that the principle of private choice (within the context of attribution of indoctrination to governmental action) has replaced the distinction between direct and indirect aid, and consequently, it was irrelevant that Chapter 2 aid could be characterized as providing “direct” aid, because such aid was provided pursuant to private choice.³⁸¹ Therefore, the plurality concluded that the Jefferson Parish’s Chapter 2 program was not reasonably attributable to governmental action, and thus did not result in governmental indoctrination, because it:

- (1) Had determined aid eligibility neutrally;
- (2) Had allocated aid based upon the private choices of the parents of the school children; and
- (3) Had not provided aid that had an impermissible content.³⁸²

Justice O’Connor, troubled by the “expansive scope of the plurality’s rule,”³⁸³ was compelled to write separately because of her disagreement with the plurality’s “near – absolute position with respect to neutrality” and its approval of actual diversion of government aid to religious indoctrination.³⁸⁴ Although recognizing that neutrality is an important criterion in upholding government school-aid programs against Establishment Clause challenges, Justice

presence of such financial incentive: “This financial incentive is not present ...where the aid is allocated on the basis of neutral, secular criteria that neither favor nor disfavor religion, and is made available to both religious and secular beneficiaries on a nondiscriminatory basis.” *Id.* at 2543 (plurality opinion), quoting *Agostini*, 521, U.S. at 231; *accord*, 120 S. Ct. at 2561 (concurring opinion), quoting *Agostini*, 521, U.S. at 231.

380. See discussion at notes 191-197 *supra* and accompanying text.

381. See discussion at notes 199-202 *supra* and accompanying text.

382. See *Mitchell*, 120 S. Ct at 2552 (plurality opinion).

383. *Id.* at 2556 (concurring opinion). Justice O’Connor summarizes the “essentials” of the plurality’s ruling as stating that: government aid to religious schools does not have the effect of advancing religion provided aid is offered on a neutral basis and the aid is secular in content; the distinction between direct and indirect aid is rejected; and actual diversion of secular aid by a religious school to sectarian uses is permissible. *Id.*

384. *Id.* (“the plurality’s treatment of neutrality comes close to assigning that factor singular importance in the future adjudication of Establishment Clause challenges to government school-aid programs”).

O'Connor asserted: "We have never held that a government-aid program passes constitutional muster *solely* because of the neutral criteria it employs as a basis for distributing aid."³⁸⁵

Justice O'Connor acknowledged that "school-aid cases often pose difficult questions at the intersection of the neutrality and no-aid principles and therefore defy simple categorization under either rule."³⁸⁶ Justice O'Connor contended that resolution of such cases instead "depends on the hard task of judging--sifting through the details and determining whether the challenged program offends the Establishment Clause. Such judgment requires courts to draw lines, sometimes quite fine, based on the particular facts of each case."³⁸⁷

Noting *Agostini*'s similarities to the facts presented in *Mitchell*, Justice O'Connor also indicated that *Agostini* represented the Court's "most recent attempt to devise a general framework for approaching ...neutral school-aid programs."³⁸⁸ Accordingly, in applying the criteria set forth in *Agostini* to the facts in *Mitchell*, Justice O'Connor concluded that the Chapter 2 aid program "bears the same hallmarks" of the Title I aid program the Court found important in *Agostini*:

- (1) Aid was allocated on the basis of neutral, secular criteria without regard to religion;
- (2) Aid was supplemental to, and did not supplant, funds otherwise available to the schools;
- (3) No Chapter 2 funds reached the coffers of the religious schools;
- (4) Content of the aid was secular, neutral, and nonideological; and
- (5) Any evidence of actual diversion of aid to religious instruction was de minimis.³⁸⁹

Finally, Justice O'Connor rejected contentions that the actual administration of Chapter 2 in Jefferson Parish violated the Establishment Clause. Justice O'Connor summarized these claims as follows: the program's safeguards were insufficient to uncover instances of actual diversion; there was evidence that some religious schools may have actually diverted aid to support religious education; there was evidence of violations of Chapter 2's content restrictions; and there were isolated examples of potential violations of Chapter 2's supplantation restriction.³⁹⁰ Justice O'Connor concluded that: the limited evidence of actual diversion was "at

385. *Id.* at 2557 (concurring opinion) (emphasis supplied).

386. *Id.* at 2560 (concurring opinion).

387. *Id.*, quoting *Rosenberger*, 515 U.S. at 847.

388. *Mitchell*, 120 S. Ct. at 2560 (concurring opinion); *accord, id.* at 2540 (plurality opinion) (*Agostini* "brought some clarity to our case law").

389. *Id.* at 2562 (concurring opinion). See *Agostini*, 521 U.S. at 226-28.

390. See *Mitchell*, 120 S. Ct. at 2568-69 (concurring opinion).

best *de minimis* and therefore insufficient to affect the constitutional inquiry”³⁹¹; the safeguards employed by the Chapter 2 program were constitutionally adequate;³⁹² and the evidence of violations of Chapter 2’s supplantation and secular-content restrictions were equally insignificant to affect the constitutional inquiry.³⁹³

Justice O’Connor concluded that, because of the “important similarities” between the Chapter 2 program and the Title I aid program in *Agostini*, the “Establishment Clause challenge must fail.”³⁹⁴ Justice O’Connor summarized these similarities as follows: aid was allocated on the basis of neutral, secular criteria; the aid was required to be supplemental to, and not supplant, non-federal funds; no Chapter 2 funds ever reached the coffers of the religious schools; the aid was required to be secular; any evidence of actual diversion was *de minimis*; and the program included adequate safeguards.³⁹⁵ Furthermore, she concluded that, “[r]egardless of whether these factors are constitutional requirements, they are surely sufficient to find that the program at issue here does not have the impermissible effect of advancing religion. For the same reasons, ‘this carefully constrained program also cannot reasonably be viewed as an endorsement of religion.’”³⁹⁶

The plurality’s broad ruling would appear to sanction any government aid to religious schools, provided it is offered on a neutral, secular basis, is neutral and secular in content, and reaches the religious school as a result of independent private choice. Given that this was the gist of the Court’s ruling in *Witters* and *Zobrest*, it seems likely Justices O’Connor and Breyer might have joined in the plurality’s opinion if they had agreed with its characterization that Chapter 2’s per capita allocation was a true private-choice program. However, they believed that a true private-choice program was not present in *Mitchell*. In their view, therefore, the plurality’s holding that Chapter 2 aid did not have the effect of advancing religion was predicated almost

391. *Id.* at 2569 (concurring opinion). Justice O’Connor asserted:

“The evidence proffered ... concerning actual diversion of Chapter 2 aid ... is *de minimis*. ... At most, it proves the possibility that, out of more than 40 nonpublic schools in Jefferson Parish participating in Chapter 2, aid may have been diverted in one school’s second-grade class and another school’s theology department.

The plurality’s insistence that this evidence is somehow substantial flatly contradicts its willingness to disregard similarly insignificant evidence of violations of Chapter 2’s supplantation and secular-content restrictions. ...

... I know of no case in which we have declared an entire aid program unconstitutional on Establishment Clause grounds solely because of violations on the minuscule scale of those at issue here. ... To the contrary, the presence of so few examples over a period of at least 4 years (15 years ago) tends to show not that the ‘no-diversion’ rules have failed, but that they have worked. Accordingly, I see no reason to ... declare a properly functioning aid program unconstitutional.”

Id. at 2570-71.

392. *Id.* at 2569 (concurring opinion).

393. *See id.* at 2572 (concurring opinion).

394. *Id.* at 2572 (concurring opinion). *See id.* at 2562 (concurring opinion), citing *Agostini*, 521 U.S. at 226-28 (noting factors that precluded Court from finding an impermissible financing of religious indoctrination).

395. *Mitchell* 120 S. Ct. at 2572 (concurring opinion).

396. *Id.*, quoting *Agostini*, 521 U.S. at 235.

solely upon the fact that the aid was allocated on a neutral, secular basis and was neutral and secular in content.³⁹⁷ Justices O'Connor and Breyer clearly needed more than this “near-absolute” positioning with respect to neutrality. While acknowledging the importance of neutrality, private choice and secular content, Justice O'Connor indicates that other factors also are relevant in examining government school aid programs.³⁹⁸

Furthermore, in the aftermath of *Agostini* and *Mitchell* and the Court's rejection of the presumption that any aid flowing to the educational mission of a pervasively sectarian school inevitably has the impermissible primary effect of advancing religion,³⁹⁹ one may inquire whether determining that an institution is pervasive sectarian remains significant. Certainly the *Mitchell* plurality would accord it no significance whatever. However, the concurring justices appeared unwilling to go that far. Rather, Justice O'Connor indicated she would permit inquiry into whether a sectarian educational institution could separate its secular and sectarian activities and would require a showing of diversion of aid to sectarian uses.

It remains to be determined whether the issuance of tax-exempt special purpose revenue bonds for construction or improvement projects for the benefit of private educational institutions, including religious ones, is permissible under the Establishment Clause. The Supreme Court's decision in *Hunt* as well as those of a number of state high courts indicate that the issuance of such bonds to assist religious schools is permissible, provided the institutions are not pervasively sectarian and the aid is restricted to secular purposes.⁴⁰⁰ Moreover, *Roemer* made clear that even direct, unrestricted grants to religiously affiliated colleges and universities were permissible, as long as the institutions were not pervasively sectarian and the aid was restricted to secular purposes or activities.⁴⁰¹ Thus the issuance of special purpose revenue bonds or even direct grants to assist religiously affiliated schools, but not pervasively sectarian schools, would be permissible under the Establishment Clause. Furthermore, under *Witters*, *Zobrest* and *Agostini*, even the pervasively sectarian nature of an institution may be irrelevant if: eligibility for the government aid flowing to the institution was determined on the basis of neutral secular criteria without regard to religion; the aid reached the institution as a result of private independent choices of the individual rather than state decisionmaking; the aid supplements rather than

397. In the presence of these factors, the plurality had indicated no inquiry was necessary into whether the recipient school was pervasively sectarian, whether the aid was direct or indirect aid; or whether the aid was actually diverted by a religious school to sectarian uses. See note 383 *supra* and accompanying text.

398. See *Mitchell* 120 S. Ct. at 2558, 2562, 2572 (concurring opinion).

399. See *Meek v. Pittenger*, 421 U.S. 349 (1975) (aid program ostensibly limited to wholly neutral, secular instructional material and equipment, “necessarily results in aid to the sectarian school enterprise as a whole” and “inescapably results in the direct and substantial advancement of religious activity.” 421 U.S. at 366; *Wolman v. Walter*, 433 U.S. 229 (1977) (“In view of the impossibility of separating the secular education function from the sectarian, the state aid inevitably flows in part in support of the religious role of the schools.”) 433 U.S. at 250.

400. See note 321 *supra* and accompanying text. It is true that *Hunt*, as well as *Tilton* and *Roemer*, dealt only with colleges and universities; however, *Agostini* and *Mitchell*, both of which dealt with lower secondary schools, have made clear that the Court's rejection of a presumption of pervasive sectarian extends to elementary and secondary schools as well as institutions of higher learning.

401. *Roemer v. Bd. of Pub. Wks. of Md.*, 426 U.S. 736, 758-60 (annual grants were noncategorical and unrestricted with one exception – use restriction for sectarian purposes).

supplants the institution's core educational functions; and adequate safeguards are present to prevent actual diversion of aid to sectarian uses. Therefore, if tax-exempt special purpose revenue bonds financing is viewed as "indirect" or "incidental" aid, rather than direct aid, and the aid is deemed to reach the religious school as a result of private independent choices of the individual rather than state decisionmaking then such aid may be permissible to religious schools even if they are determined to be pervasively sectarian; provided the aid is allocated pursuant to a neutral government aid program with sufficient use restrictions and adequate safeguard to ensure the bond proceeds are not diverted to religious use.

The previously discussed lower court cases involving recent Establishment Clause challenges to the issuance of tax-exempt revenue bonds to assist sectarian schools considered these possibilities.

The federal district court in *Steele v. Industrial Development Board* rejected Lipscomb University's argument that the pervasively sectarian test was no longer viable after *Mitchell*. Instead, after reviewing thirteen relevant factors, the court concluded that the University was pervasively sectarian and thus could not separate its secular functions as an educational institution from its religious mission. Accordingly, the court ruled that the issuance of tax-exempt bonds to assist the University had the impermissible effect of advancing its religious beliefs. The district court in *Steele* also found that the bond financing constituted a direct benefit to Lipscomb University and that the aid was directed to the University, not through private investors who purchased the bonds, but as a result of government decisionmaking.⁴⁰² In this particular holding, the district court in *Steele* is at variance with its sister district court in *Johnson v. Economic Development Corporation* and the Virginia Supreme Court in *Virginia College Building Authority v. Lynn*.

In addition, the federal district court in *Steele*, in contrast to the courts in *Johnson* and *Virginia College Building Authority*, was unable to determine, as a matter of law, whether the bond financing was made available to Lipscomb University on the basis of neutral, secular criteria, without regard to religion. Furthermore, the court found that the use restrictions were insufficient and the monitoring and enforcement mechanisms were inadequate to ensure the bond proceeds (which the court viewed as government funds) would be used only to support secular functions of the University. Finally, the court concluded that the aid created the perception of government endorsement of the University. In so concluding, the court relied, in part, on the abundant information available to the public regarding the University's overwhelming religious nature and the failure of the Industrial Development Board to provide disclaimers in the Official Statement released in connection with the Bond Reissue.

Justice O'Connor has acknowledged the critical need to "sift through the details" and particular facts of each case to determine whether the challenged program offends the Establishment Clause. She has further acknowledged that this sometimes requires courts to draw quite fine lines."⁴⁰³ *Steele* may well be a case in which the particular details and facts necessitate

402. 117 F. Supp. at 724-25. See generally notes 284-307 *supra* and accompanying text.

403. *Mitchell*, 120 S. Ct. at 2560 (concurring opinion), quoting *Rosenberger*, 515 U.S. at 847.

a fine line to be drawn. Given a different fact pattern, however, the court may have drawn the line elsewhere.

Johnson and *Virginia College Building Authority* are in sharp contrast to *Steele*. In *Johnson v. Economic Development Corporation*, the district court did not specifically address whether the catholic grade school involved was in fact pervasively sectarian, but instead found that the bond issue was the kind of general program that makes assistance available to a broad spectrum on a religiously neutral basis and which the Supreme Court has indicated is not ordinarily subject to an Establishment Clause challenge. The court maintained that, because the assistance is directed toward a broader group, any benefit to sectarian institutions is only incidental or on a neutral basis along with other beneficiaries of the state action. Thus the court rejected the argument that the bond financing arrangement constituted a direct subsidy to a religious school.⁴⁰⁴

The Virginia Supreme Court in *Virginia College Building Authority v. Lynn* explicitly found that Regent University was pervasively sectarian. Nevertheless, in examining the nature of the aid, the court concluded that “the aid does not involve usage of governmental funds and, in the traditional sense in which the terms have been used, the terms ‘direct aid’ or ‘indirect aid’ are simply inapplicable.”⁴⁰⁵

The courts in *Johnson* and *Virginia College Building Authority* also noted the similarity of the cases before them with *Hunt*, wherein the United States Supreme Court had concluded that implementation of a tax-exempt bond financing proposal for sectarian colleges would not have the primary effect of advancing or inhibiting religion.⁴⁰⁶ Moreover, the Virginia court emphasized that the Court in *Hunt* had “suggested [in dictum] that even if an institution is pervasively sectarian, the aid in question may be so unique that the provision of the aid does not result in ‘the primary effect’ of advancing or inhibiting religion.”⁴⁰⁷

We have here no expenditure of public funds, either by grant or loan, no reimbursement by a State for expenditures made by a parochial school or college, and no extending or committing of a State’s credit. Rather, the only state aid consists, not of financial assistance directly or indirectly which would implicate public funds or credit, but the creation of an instrumentality (the Authority) through which educational institutions may borrow funds on the basis of their own credit and the security of their own property upon more favorable interest terms than otherwise would be available.⁴⁰⁸

404. See 64 F. Supp. 2d at 667. See generally notes 268-283 *supra* and accompanying text.

405. 2000 W.L. 1650111 (Va.) at 17. See notes 308-331 *supra* and accompanying text.

406. See 64 F. Supp. 2d at 667. 2000 W.L. 1650111 (Va.) at 14. See 413 U.S. at 745.

407. 2000 W.L. 1650111 (Va.) at 15. See 413 U.S. at 745 n.7.

408. 413 U.S. at 745 n.7. The Virginia Court further noted that, appended to that discussion, the United States Supreme Court “specifically declined to address the very issue presented in the case before us today.” 2000 W.L. 1650111 (Va.) at 14. See 413 U.S. at 745 n.7.

The Court in *Hunt* further noted that state supreme courts had variously characterized the assistance rendered an educational institution in this manner as being merely a “governmental service” or a “mere conduit.”⁴⁰⁹

As in *Hunt*, the courts in *Johnson* and *Virginia College Building Authority*, in considering the nature of the tax-exempt revenue bond financing scheme, also cited the fact that no tax-payer money is involved: there is no loan or grant of taxpayer dollars; no taxpayer dollars are transferred directly or indirectly to a participating institution; and no taxpayer dollars are pledged or utilized as surety for bond obligations. The bond proceeds are the funds of private investors, all money comes from private investors, no money comes from the government, and the government incurs no expenses and no obligation whatsoever in connection with the bonds. Moreover, the Virginia court, in contrast to *Steele*, pointed out that the nature of the aid provided by tax-exempt bond financing is not a loan of government money but, instead, “is properly defined as the granting of tax exempt status to the bonds which has the incidental result of permitting a qualifying institution to borrow funds at an interest rate lower than conventional private financing.”⁴¹⁰

If the tax-exempt bond financing scheme to assist religious schools is determined to be a true private choice program, *Witters*, *Zobrest* and *Agostini* indicate the sectarian nature of the institution will be of little relevance. Even if the program is not found to be a true private choice program, a court no longer may presume, after *Agostini* and *Mitchell*, that any aid flowing to the educational mission of a pervasively sectarian school inevitably has the impermissible primary effect of advancing religion. Instead, in a challenge to such a program, the court must inquire into the sectarian nature of an institution and require proof of actual diversion of aid to religious uses. This may not be an easy task. The court in *Columbia Union* recognized that even institutions “obviously and firmly devoted to the ideals and teachings of a given religion are not necessarily ‘so permeated by religion that the secular side cannot be separated from the sectarian.’” Moreover, as the court in *Columbia Union* cautioned, a designation of pervasively sectarian should be made only after a thorough and searching inquiry.⁴¹¹

It remains to be seen whether this type of tax-exempt bond financing scheme will be viewed by the Supreme Court as a “true private choice program.” Nevertheless, the rationale underlying *Hunt*, *Johnson*, and *Virginia College Building Authority* seems to indicate that this is a “special type of aid” that defies simple categorization as direct or indirect government aid. Regardless of how it ultimately may be categorized, however, it would appear that a carefully crafted tax-exempt bond financing program to assist religious schools could withstand an Establishment Clause challenge.

Given the Court’s recent rulings, the following factors, while not an exhaustive list, would appear to be significant in analyzing any future Establishment Clause challenge to

409. 413 U.S. at 745 n.7.

410. See note 321 *supra* and accompanying text.

411. See 159 F.3d at 163-64 (the Supreme Court has set the bar to finding an institution of higher learning pervasively sectarian quite high).

government school aid programs generally and thus may provide a road map of sorts through the maze of Establishment Clause jurisprudence:

- (1) Does the aid program (or the law creating the program) have a secular purpose;
- (2) Does the aid program result in governmental indoctrination;
- (3) Is eligibility for aid determined on the basis of neutral, secular criteria without regard to religion;
- (4) Is the content of the aid secular, neutral, and nonideological;
- (5) Is the aid allocated to the religious school on the basis of independent, private choice;
- (6) Does the aid program define its recipients by reference to religion;
- (7) Does the criteria for allocating aid create a financial incentive to undertake religious indoctrination;
- (8) Does the aid program create an excessive entanglement between religion and government;
- (9) Does the aid program constitute a government endorsement of religion;
- (10) Is the aid supplemental to, rather than supplanting of, funds otherwise available to the religious schools;
- (11) Do aid funds reach the coffers of the religious schools;
- (12) Are there adequate use restrictions, monitoring and other safeguards to prevent actual diversion of aid to religious uses; and
- (13) Is there evidence of actual diversion (more than *de minimis*).

Thus, for example, a tax-exempt bond financing program could be devised with the following characteristics: has a clear secular purpose; determines aid eligibility in a nondiscriminatory manner on the basis of neutral secular criteria; makes aid available to religious and nonreligious schools alike on the basis of neutral secular criteria; imposes sufficient use restrictions and other safeguards to ensure that neither the funds nor the facilities constructed or improved with the funds will be used only for sectarian purposes and yet avoids excessive entanglement; requires that aid be supplemental to funds otherwise available to the religious school; and contains sufficient disclaimers of any endorsement of the religious practices or beliefs of the school.

Surviving an Establishment Clause challenge is only one constitutional hurdle a tax-exempt bond financing program to assist religious schools would likely face, however. Such a program also would have to survive a state constitutional challenge. These are discussed in Chapter 7.

Chapter 7

HAWAII CONSTITUTIONAL ISSUES

Relevant Constitutional Provisions

Issuance of special purpose revenue bonds must be authorized by the Legislature pursuant to Article VII, section 12 of the Hawaii Constitution and chapter 39A, Hawaii Revised Statutes. These provisions permit the issuance of special purpose revenue bonds on behalf of special purpose entities to finance facilities of or for, or to loan the bond proceeds for, certain specified types of projects. These are limited to:

- (1) Manufacturing, processing, or industrial enterprises;
- (2) Utilities serving the general public;
- (3) Health care facilities provided to the general public not-for-profit corporations;
- (4) Early childhood education and care facilities provided to the general public not-for-profit corporations; and
- (5) Low and moderate income government housing programs.¹

Section 103 of the Internal Revenue Code provides that interest on special purpose revenue bonds is excluded from gross income for federal tax income purposes if the bonds are issued by a State or political subdivision.² State law also provides that special purpose revenue bonds and interest therefrom are exempt from all state, county and municipal taxation, except inheritance, transfer, and estate taxes.³ The tax exemption permits the bonds to be sold at a lower rate of interest, resulting in savings in interest cost to the special purpose entity. In Hawaii, the special purpose revenue bonds are issued not in the name of the State of Hawaii, but in the name of the department of budget and finance.⁴

The Hawaii Constitution and state statutory law make clear, however, that special purpose revenue bonds, despite being issued by the department of budget and finance, are not general obligations of the State, and the State is prohibited from using public funds to pay the

1. Haw. Const. art. VII, §12(9).

2. Section 103, Internal Revenue Code of 1986, as amended. See Haw. Rev. Stat. §§ 39A-44.5, 39A-84.5, 39A-124.5, 39A-164.5, and 39A-204.5.

3. See Haw. Rev. Stat. §§ 39A-44, 39A-84, 39A-124, 39A-164, 39A-204, 39A-234 and 235-7(a)(6).

4. To qualify for tax exempt status under section 103 of the Internal Revenue Code of 1986, as amended, special purpose revenue bonds must be issued by a state or political subdivision.

debt service on any such bonds.⁵ For example, section 39A-231, Hawaii Revised Statutes, provides that:

“No holder or holders of any special purpose revenue bonds issued under this part shall ever have the right to compel any exercise of taxing power of the State to pay such bonds or the interest thereon and no moneys other than the revenues pledged to such bonds shall be applied to the payment thereof. Each special purpose revenue bond issued under this part shall recite in substance that such bond, including interest thereon, is not a general obligation of the State and is payable solely from the revenues pledged to the payment thereof, and that such bond is not secured directly or indirectly by the full faith and credit or the general credit of the State or by any revenues or taxes of the State other than revenues specifically pledged thereto.”

Furthermore, the bonds and any interest thereon is payable solely from the revenues pledged to their payment and are secured solely by such revenues and pledges.⁶ After the department issues the special purpose revenue bonds, they are sold to investors. The department, or a trustee appointed by the department, collects the bond proceeds and then loans those proceeds to the special purpose entity. The special purpose entity makes loan payments of principal and interest, which are conveyed to the investor.

As noted previously, special purpose revenue bonds may only be issued to assist those special purpose entities specifically delineated in Article VII, section 12 of the Hawaii Constitution and provided for in chapter 39A, Hawaii Revised Statutes. Therefore, these provisions clearly would have to be amended to include private schools among those special purpose entities that may be assisted by the issuance of special purpose revenue bonds. However, other provisions of the Hawaii Constitution are also relevant to this issue. For example, Article I, section 4, contains Hawaii’s version of the Establishment Clause⁷ and Article VIII, section 5, prohibits any grant made in violation of Article I, section 4.⁸ The Bureau’s conclusions with respect to whether the issuance of special purpose revenue bonds to assist nonpublic educational institutions would violate the First Amendment’s Establishment Clause are equally relevant to whether such action would violate Article I, section 4 or Article VIII, section 5.⁹

5. See Haw. Const. art. VII, §12; Haw. Rev. Stat. §§ 39A-41, 39A-81, 39A-121, 39A-161, 39A-201, and 39A-231.

6. See Haw. Rev. Stat. §§ 39A-40, 39A-80, 39A-120, 39A-160, 39A-200, and 39A-230.

7. Article I, section 4 of the State Constitution provides that “no law shall be enacted respecting an establishment of religion or prohibiting the free exercise thereof.”

8. Article VIII, section 5, of the State Constitution states in pertinent part that: “No grant shall be made in violation of Section 3 of Article I of this Constitution.”

9. See discussion in chapter 6. Both the department of the attorney general and HAIS have raised the possibility that permitting special purpose revenue bonds for nonsectarian private educational institutions while excluding sectarian private educational institutions might violate the latter’s First Amendment rights to free religious speech and to freely exercise their religion. See Letter from Randall S. Nishiyama, Deputy Attorney General, to Calvin K.Y. Say, Speaker of the House, November 30, 1999, at 6 [hereinafter cited as A.G. letter to Say]; Letter from Robert Witt, Executive Director, HAIS, to Wendell K. Kimura, Acting Director, Legislative Reference Bureau, June 8, 2000, at 7 [hereinafter cited as HAIS, Witt letter]. Cf. *Rosenburger v. Rector & Visitors of Univ. of Va.*, 515 U.S. 819 (1995) (invalidating state university policy

In addition, Article X, section 1 of the Hawaii Constitution is relevant to this discussion. Article X, section 1, provides:

Section 1. The State shall provide for the establishment, support and control of a statewide system of public schools free from sectarian control, a state university, public libraries and such other educational institutions as may be deemed desirable, including physical facilities therefor. There shall be no discrimination in public educational institutions because of race, religion, sex or ancestry; *nor shall public funds be appropriated for the support or benefit of any sectarian or private educational institution*, except that proceeds of special purpose revenue bonds authorized or issued under section 12 of Article VII may be appropriated to finance or assist not-for-profit corporations that provide early childhood education and care facilities serving the general public. (emphasis added).

Issuance of special purpose revenue bonds to assist nonpublic educational institutions would contravene this provision if special purpose revenue bonds constitute “public funds” within the meaning of Article X, section 1. Hawaii case law is silent on this particular point and, indeed, provides little guidance as to what constitutes “public funds” generally.

Applicable Legislative History

The legislative history behind the creation of special purpose revenue bonds themselves gives some indication of a lack of intent by the constitutional convention delegates that such bonds be used to assist nonpublic schools. During debates by the Committee of the Whole on the constitutional amendment to authorize special purpose revenue bonds, Delegate Alcon raised the question whether “the words ‘public purpose’ include private schools and churches?”¹⁰ Delegate Lewis responded that “it is my understanding that it does not, inasmuch as Article I of the Constitution provides for separation of church and state.” Legal counsel present at the proceedings was invited to “amplify” on this statement, but apparently felt it unnecessary to do so, as no further discussion of this issue is reflected in the proceedings.¹¹ While a conclusion that Delegate Lewis’ “understanding” was accepted by the majority of delegates may go too far, it at least seems safe to say that no delegate present voiced disagreement with that understanding. Accordingly, although it provides some evidence of intent with respect to the use of special

denying student activity funds for printing Christian student newspaper); *Lamb’s Chapel v. Center Moriches Union Free School Dist.*, 508 U.S. 384 (1993) (invalidating religious use restriction on public access to school property); *Widmar v. Vincent*, 454 U.S. 263 (1981) (invalidating policy prohibiting student religious organization from using state university’s facilities). This may be so. However, the Bureau believes that the Establishment Clause and Article X, section 1, are controlling, with respect to the particular issue of SPRBs to benefit sectarian schools, and the latter’s prohibition on aid extends equally to sectarian and nonsectarian private educational institutions. In view of time constraints, the Bureau consequently sees no need to examine this issue further.

10. Proceedings of the Constitutional Convention of Hawaii of 1978 Vol II, 525. Article VII, section 12, requires the legislature (or county, if applicable), as a condition of issuing special purpose revenue bonds, to find that the bonds are “in the public interest.”
11. Proceedings of the Constitutional Convention of Hawaii of 1978 Vol II, 525.

purpose revenue bonds, this single exchange during the constitutional convention proceedings is insufficient to establish clear intent.

The legislative history of House Bill No. 2692, Regular Session of 1994, which proposed an amendment to Article VII, section 12, to authorize the State to use the proceeds of special purpose revenue bonds to finance or assist early childhood education care and facilities is also instructive. In House Standing Committee Report No. 202-94, the House Committee on Education noted that the attorney general's office, through an advisory letter, had informed the Committee that:

Article X, Section 1, prohibits the appropriation of public funds for the support or benefit of any private education institution, and that *since special purpose revenue bonds are considered public funds*, an amendment to Article X, Section 1, would also be necessary in order to allow the State to use the proceeds of special purpose revenue bonds to finance or assist early childhood education care and facilities provided to the general public by not-for-profit corporations.¹²

Consequently, an exception was carved out of Article X, section 1, to permit special purpose revenue bonds to be used to finance or assist early childhood education care and facilities provided to the general public by not-for-profit corporations.¹³

Thus, in considering this issue previously, the legislature has accepted the position of the attorney general, as chief legal officer of the State, that special purpose revenue bonds are "public funds" and that their issuance to assist nonpublic educational facilities requires an amendment to Article X, section 1. This action does constitute some precedence and may be viewed by a court as persuasive evidence of intent, or at least acceptance, that special purpose revenue bonds constitute "public funds." The attorney general has reiterated its position in an advisory letter to the Bureau. (See Appendix C)

On the other hand, the Hawaii Association of Independent Schools (hereafter referred to as HAIS) contends that the attorney general's conclusion is in error and that "there is a wealth of state and federal case law that suggest that the issuance of revenue bonds to a private entity does not constitute the use of public funds."¹⁴ HAIS takes the position that the issuance of special purpose revenue bonds constitutes neither an appropriation by the State nor the use of public funds.¹⁵ If this were so, the issuance of such bonds to assist private educational institutions would not violate Article X, section 1, and no amendment to the provision would be required.¹⁶

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12. House Standing Committee Report No. 202-94 on House Bill No. 2692, Journal of the House of the Seventeenth Legislature at 933 (emphasis added).
 13. See Act 280, Session Laws of Hawaii 1994, and election November 8, 1994.
 14. Letter from Ethan Jones, HAIS, to Keith Fukumoto, Researcher, Legislative Reference Bureau, July 25, 2000 at 4 (emphasis supplied) [hereinafter cited as HAIS, Jones letter].
 15. HAIS, Witt letter at 2.
 16. See *Id.* at 1.

Accordingly, a deeper analysis of the attorney general's conclusion that special purpose revenue bonds are "public funds" and that their issuance to assist nonpublic educational facilities requires an amendment to Article X, section 1, is warranted.

Article X, section 1 was originally enacted as Article IX, section 1 by the Constitutional Convention of 1950.¹⁷ Although some difference in language exists between Article IX, section 1, and Article X, section 1, the prohibition on appropriation of public funds for nonpublic educational institutions remained virtually unchanged.¹⁸ When the framers adopted this prohibition during the Constitutional Convention of 1950, they could not actually have contemplated, as an appropriation of "public funds," the use of special purpose revenue bonds to assist private schools because such bonds did not yet exist.¹⁹ However, in construing the application of the Constitution to new subject matter, the courts have indicated they will consider "the great purposes which were intended to be achieved by the Constitution as a continuing instrument of government."²⁰

Caselaw: *Spears v. Honda*

The controlling Hawaii case with respect to interpreting the framers' purpose or intent behind Article IX, section 1, of the Hawaii Constitution is *Spears v. Honda*,²¹ in which the Hawaii Supreme Court ruled unconstitutional two statutory provisions and an administrative rule that authorized subsidies to private and sectarian school students for their bus transportation to and from school.²² The defendant-appellees had argued that the provisions did not violate Article IX, section 1 because the bus subsidy constituted "support or benefit" not to the institutions themselves, but to the children attending the nonpublic educational institutions (known as the child benefit theory).²³

17. Article IX, section 1 reads as follows:

Section 1. The State shall provide for the establishment, support and control of a statewide system of public schools free from sectarian control, a state university, public libraries and such other educational institutions as may be deemed desirable, including physical facilities therefor. There shall be no segregation in public educational institutions because of race, religion or ancestry; nor shall public funds be appropriated for the support or benefit of any sectarian or private educational institution.

18. During the Constitutional Convention of 1978, Article IX, section 1, was amended by changing "segregation" to "discrimination," to include the term "sex" to the list of suspect classifications, and to renumber Article IX to Article X. See Standing Committee Report No. 39, Proceedings of the Constitutional Convention of Hawaii of 1978, Vol. I at 586-87 (1980). In 1994, the legislature amended Article X, section 1, to exclude from its prohibition special purpose revenue bonds to assist not-for-profit corporations providing early childhood education and care facilities serving the general public. See Act 280, Session Laws of Hawaii 1994, and election November 8, 1994.

19. Const. Con. 1978 and election Nov. 7, 1978.

20. *Employees' Retirement System v. Ho*, 44 Haw. 154, 170-71, 352 P.2d 861, 870 (1960), quoting *United States v. Classic*, 313 U.S. 299, 316 (1941).

21. 51 Haw. 1, 449 P.2d 130 (1968).

22. *See id.* at 2-4 & 15.

23. *See id.* at 5.

The Hawaii court found that the intent of the framers of the State Constitution was “clear” from the proceedings of the Constitutional Convention of 1950, in which the framers had “delineated the scope of the State’s role in the education of children in public and nonpublic schools and [had] specifically rejected the child benefit theory as applied to bus transportation and similar general welfare programs for nonpublic school students.”²⁴ The court pointed out that the Committee on Education’s report presenting Article IX to the Committee of the Whole was “permeated with a strong recognition of the importance and unique function of public education in a democratic state, as compared with nonpublic education.”²⁵ The court further noted that the Committee on Education had indicated it was “acting in accordance with the will of the electorate of Hawaii in placing major emphasis on public education through a separate article on that subject in the Constitution rather than tacking or telescoping it onto the article on general welfare.”²⁶ The court contended that this emphasis on public education could be:

[L]argely attributed to the fact that, at that time, nonpublic schools in this jurisdiction were considered better able to provide education than public schools, although the latter had shouldered the burden of educating the bulk of the populace and of assimilating vast numbers of offspring of immigrants into the mainstream of American life, despite somewhat shabby treatment by the Legislature.²⁷

The appellees had argued that, because the Committee on Education had specifically indicated in its report that dental and public health services were intended to be excluded from the prohibition on public aid in Article IX, section 1, the legislature therefore had the power to adopt any other program similarly benefiting the welfare of children. The court emphatically rejected this argument, stating: “We find that the framers did not open the door [to the child benefit theory] one bit. *The language of the Constitution itself is unequivocal. It explicitly states: ‘Nor shall public funds be appropriated for the support or benefit of any sectarian or private educational institution.’*”²⁸ The court maintained that the framers’ exception of this “existing practice” was not related to any view that funding dental and health services for private school children was a benefit to such children but was instead related to the State’s exercise of its “‘nominal supervisory control’ over nonpublic schools ‘in the interest of the public health’” to ensure safety at these schools.²⁹

Furthermore, the court points to the debate of the Committee of the Whole concerning Article IX, section 1, as evidence that an appropriation for free bus transportation for nonpublic

24. *Id.* at 6-7.

25. *Id.* at 7, citing Standing Committee Report No. 52, The Proceedings of the Constitutional Convention of Hawaii, Vol. I, 201-06 (1950) (emphasis added).

26. 51 Haw. at 7.

27. *Id.* The court pointed out that the gap in the quality of education between public and nonpublic schools was still apparent at the time of its decision in *Spears*. *Id.* at 7. n.5.

28. *Id.* at 8-9 (emphasis added).

29. *Id.* at 9 (provision of dental and health services was “aimed at assuring that the nonpublic schools, as centers of learning, were as safe to attend as the public schools” *Id.*).

school children was “exactly” the type of public aid that the framers desired to prohibit.³⁰ In the debate, Delegate Kauhane had urged that textbooks and bus transportation, if provided free to children attending public schools, also should be provided by the State to private school children. He reasoned that “all accommodations should be made for parents who are taxpayers and citizens of the state whose children attend private schools. They should be compensated or some just return for their tax money that they pay to the public school educational system.”³¹ Speaking in immediate response, Delegate Akau stated:

I’d like to speak in favor of “*nor shall the public funds be appropriated for the support or benefit of any sectarian, denominational school*.” Not primarily because I believe in separation of church and state but for the very simple reason that those people who send their children to either parochial schools or private schools send their children there because they wish to send their children there.³²

The court observed that the Committee of the Whole’s rejection of Delegate Kauhane’s “head-on attack” on the prohibition against appropriations to nonpublic schools was “*not particularly surprising among a body that was vitally concerned with the need for better public education in Hawaii . . .*”³³

Despite what the court categorized as the “clear-cut intent of the framers,” the appellees had also urged the Hawaii court to rely upon an interpretation of language in the Louisiana Constitution, which was similar to Article IX, section 1, upholding the child benefit theory.³⁴ The Hawaii court dismissed this argument, declaring that it found the Louisiana decision to be “of no relevance in interpreting our own Constitution.”³⁵ The court concluded that the framers of Hawaii’s Constitution had already debated this issue and had declined to grant the legislature the “power to authorize funds for programs of public welfare benefiting nonpublic school children,” including the provision of textbooks or bus transportation.³⁶

On the other hand, the Hawaii court found “highly relevant the experience of our sister state, Alaska,” which had considered “whether a ban against ‘support or benefit’ of nonpublic schools” prohibited free bus transportation to all children living along pre-established bus

30. *Id.*

31. *Id.* at 9-10, quoting from the proceedings of the Constitutional Convention of Hawaii, Vol. II, 583-84 (1950).

32. 51 Haw. at 10 (emphasis supplied), quoting from The Proceedings of the Constitutional Convention of Hawaii, Vol. II, 584 (1950)

33. 51 Haw. at 10 (emphasis added).

34. *Id.* discussing *Borden v. Board of Educ.*, 168 La. 1005, 123 So. 655 (1928) (upheld appropriation of public funds to purchase textbooks for all children, regardless of the school attended).

35. The Hawaii court emphasized that the Louisiana decision revealed nothing about whether that state’s experience with regard to public and private education, at the time of the adoption of its constitution, was similar to Hawaii’s. 51 Haw. at 10-11.

36. *Id.* at 11.

routes.³⁷ In *Matthews v. Quinton*,³⁸ the Alaska Supreme Court had ruled that the free bus transportation for nonpublic school children violated the Alaska Constitution because it provided a “direct benefit” to nonpublic schools.³⁹ Such transportation also constituted “support or benefit” to nonpublic schools in violation of the Alaska Organic Act.⁴⁰ In comparing the Hawaii Constitution with that of Alaska’s, the Hawaii Court noted that the wording of the former “is even more stringent in that it makes no distinction between ‘direct’ and ‘indirect’ benefits and continues the [Hawaii] Organic Act proscription against ‘the support or benefit’ of nonpublic educational institutions.”⁴¹

The Alaska court had concluded that the bus transportation program, because it induced attendance at nonpublic schools and promoted their interests, “help[ed] build up, strengthen and make successful the schools as organizations.”⁴² The Hawaii court maintained that this was “precisely the kind of reasoning” that had “motivated” the framers of the Hawaii Constitution in “approving the prohibition against ‘support or benefit’ of nonpublic educational institutions, as is made clear by the report of the Committee on Education and the Kauhane-Akau debate.”⁴³ Addressing the issue before it, the Hawaii Court asserted that:

The mechanics of the bus subsidy program at issue indicates that the fears of the framers were well-founded. The subsidy does “build up, strengthen and make successful” the nonpublic schools.... Also, ... the subsidy induces attendance at nonpublic schools, where the school children are exposed to a curriculum that in many cases, if not generally, promotes the special interests and biases of the nonpublic group that controls the school. Finally, to the extent that the State pays out funds to carriers owned by the nonpublic schools or agents thereof, the State is giving tangible “support or benefit” to such schools.⁴⁴

The Hawaii court also rejected the appellees argument that *Everson v. Board of Education*⁴⁵ was controlling, finding the case to be inapposite. The court noted that *Matthews* had pointed out that, in *Everson*, the United States Supreme Court had done “nothing more than accept the state court’s interpretation of the New Jersey constitution” that the New Jersey

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37. *Id.* At issue was language in the Alaska Constitution (no public funds for the direct benefit of any religious or other private educational institution) and the Alaska Organic Act (no public money appropriated for support or benefit of any sectarian, denominational, or private school, or any school not under exclusive government control). See 48 U.S.C.A §77 and 48 U.S.C.A. §562. The Hawaii court noted the close similarity between the Alaska provisions and those of Hawaii.
38. 362 P. 2d 932 (Alaska 1961), appeal dismissed, 368 U.S. 517 (1962).
39. *See* 51 Haw. at 12.
40. *Id.* at 12.
41. *Id.* at 11.
42. *See id.* at 12. The Alaska Court, relying in its reasoning on *Judd v. Board of Education*, 278 N.Y. 200, 15 N.E.2d 576 (1938), also noted that “[w]ithout pupils there could be no school.” 362 P. 2d at 935.
43. 51 Haw. at 12.
44. *Id.* at 12-13. Additionally, the court noted that the State had “abdicated responsibility for administering the subsidy program as applied to nonpublic school students.” *Id.* at 12-13.
45. 330 U.S. 1 (1947).

legislature had “the power ... to declare that ‘a public purpose [would] be served by using tax-raised funds to pay the bus fares of all school children, including those who attend parochial schools.’”⁴⁶

The Hawaii court concluded that:

As pointed out by the discussion ... of the historical bases of our Constitution, *this State has tied its own hands regarding appropriations for the “support or benefit” of nonpublic schools.* Regardless of the presumption in favor of the validity of the Legislature’s actions, *where the Legislature has not been granted the power by the people, under the state constitution, to pass certain legislation, it cannot validly pass such legislation.* Rather the Legislature must return to the people to ask them to decide whether their State Constitution should be amended to grant the Legislature the power it seeks, in this case, the power to provide “support or benefit” to nonpublic schools....

Having decided that the Hawaii Constitution ties the hands of the Legislature and prohibits it from making any appropriation aiding a sectarian or private school, including subsidies for bus transportation, we are compelled to conclude that Acts 97 and 233 and Rule 1 violate Article IX, Section 1, to the extent that they authorize appropriations to sectarian and private schools.⁴⁷

The Hawaii Court also recognized that Article IX, section 1, overlapped somewhat with Article VI, section 6, which stated in pertinent part that: “No grant shall be made in violation of Section 3 of Article I of this Constitution.”⁴⁸ Section 3 of Article I contained Hawaii’s version of the Establishment Clause and stated that “no law shall be enacted respecting an establishment of religion or prohibiting the free exercise thereof.”⁴⁹ However, the court declined to address this issue, stating that “having decide that this state has *totally denied itself the power to make appropriations aiding private and sectarian schools under Article IX, Section 1*, we do not find it necessary, at this time, to determine whether the transportation of all school children under a general welfare program, as allowed by *Everson*, would violate Article VI, Section 6, or Article I, Section 3.”⁵⁰ Furthermore, the court broadly hinted in dictum that, if called upon to make such a determination, it might follow the example of Washington’s high court, which found, in “light of the clear provisions of [the Washington] constitution” and despite the United States Supreme Court’s holding in *Everson*, that it was “constrained to hold” that its state constitution, although

46. 51 Haw. at 13-14, quoting from *Everson*, 330 U.S. at 6. The Hawaii Court indicated that, “in other words,” this only meant that the New Jersey Constitution did not contain a specific prohibition against appropriations to nonpublic schools. 51 Haw. at 14. A few months after the *Everson* decision, the New Jersey Constitution was amended to provide explicitly for bus transportation for all students. *See id.* at 14, n.8.

47. 51 Haw. at 15 (emphasis added).

48. Renumbered Article VIII, §5, Const. Con. 1968 and election Nov. 5, 1968; renumbered and amended Const. Con. 1978 and election Nov. 7, 1978.

49. Renumbered Article I, §4, Const. Con. 1978 and election Nov. 7, 1978.

50. 51 Haw. at 17-18 (emphasis added).

based on the same precepts as the First Amendment, clearly prohibited the use of public funds to aid parochial educational institutions.⁵¹

The Hawaii court in *Spears* found the intent of the framers of Article IX, section 1, to be “clear-cut” and the language of the constitutional prohibition on public aid to nonpublic educational institutions to be “unequivocal.”⁵² Its decision also clearly indicated the court felt constrained to follow the unequivocal intent of Hawaii’s constitution, thus according little weight to the decisions in other jurisdictions. Given the court’s forceful pronouncement that the State has “*totally denied itself the power to make appropriations aiding private and sectarian schools under Article IX, Section I*” and its conclusion that “*where the Legislature has not been granted the power by the people, under the state constitution, to pass certain legislation, it cannot validly pass such legislation,*”⁵³ it would appear that any aid to nonpublic educational institutions would be suspect. There remains to be determined, however, whether the issuance of special purpose revenue bonds constitute “public funds.”

Contrasting Positions Of The Attorney General And HAIS

The department of the attorney general (hereafter referred to as the “attorney general”) maintains that special purpose revenue bonds are “public funds.” As noted, the opinion of the attorney general, as chief legal officer of the State, is entitled to some weight. The attorney general cites two reasons in support of the contention that special purpose revenue bonds are “public funds” as the term is used in Article X, section 1 of the State Constitution:

- (1) Special purpose revenue bonds are a form of public aid contrary to the purpose of Article X, section 1; and
- (2) Special purpose revenue bonds constitute public funds to permit the bond proceeds to be loaned by the department of budget and finance to the special purpose entity.⁵⁴

The tax-exempt status of the interest on special purpose revenue bonds, by virtue of the bonds being issued under the auspices of the State, would enable private schools to borrow money at a lower than normal interest rate. The attorney general contends that this tax advantage constitutes a form of public aid that, like the bus subsidy in *Spears*, would help to “build up, strengthen and make successful the private schools.”⁵⁵ The attorney general points out that “[i]n

51. *Id.* at 18, n.10, citing *Visser v. Nooksack Valley School District*, 33 Wash. 2d 699, 207 P.2d 198, 204-05 (1949).

52. See notes 28 and 34 *supra* and accompanying text.

53. See notes 47 and 50 *supra* and accompanying text.

54. Letter from Randall S. Nishiyama, Deputy Attorney General, to Wendell K. Kimura, Acting Director, Legislative Reference Bureau, December 4, 2000, at 4 [hereinafter cited as A.G. letter to Kimura] (included as Appendix C).

55. See *id.* at 7. The attorney general notes that, in enacting Article VII, section 12 of the Hawaii Constitution, which authorizes issuance of special purpose revenue bonds, the framers recognized the public aid that

Spears, the need to ensure that public schools would not be neglected is expressed as the reason for Article X, section 1's bar against 'public funds' for Private Schools."⁵⁶ Thus, the attorney general urges that construing "public funds" to include special purpose revenue bonds used to assist private schools would be consistent with the intent of the framers of Article IX, section 1, of the State Constitution.⁵⁷

The attorney general also maintains that special purpose revenue bonds must be viewed as "public funds" so that they may be loaned to the special purpose entity."⁵⁸ The attorney general reasons that if the department of budget and finance "did not control the special purpose revenue bonds as 'public funds,' it would not be able to loan the bond proceeds to the special purpose entity."⁵⁹ Additionally, the attorney general contends that the special purpose revenue bonds are public funds and therefore "must be appropriated before they can be disbursed to qualified special purpose entities."⁶⁰ The attorney general emphasizes the State's involvement with special purpose revenue bonds: the legislature must first authorize the issuance of the bonds; the director of finance issues the bonds, collects the proceeds, and loans the proceeds to the special purpose entity; and the special purpose entity is obligated to the State to pay the principal and interest on the bonds.⁶¹ The attorney general notes that Black's Law Dictionary defines "appropriation" as a "legislative body's act of setting aside a sum of money for a public purpose."⁶² Accordingly, the attorney general maintains that, "since the special purpose revenue bond proceeds are receipts of the State, we believe that an appropriation is implied in the legislative authorizations of special purpose revenue bonds to permit the ... bond proceeds, which are public moneys, to be loaned to the special purpose entity."⁶³

The construing of the authority to issue special purpose revenue bonds as including an implied appropriation was cited by Governor Cayetano in his 1995 veto message relating to a bill to issue special purpose revenue bonds to assist Kapiolani Health Care Systems.⁶⁴ Because of the determination that it involved "an implied appropriation," the bill's passage was deemed to have violated the order of passage of appropriation bills required by Article VII, section 9 of the

special purpose revenue bonds would provide, stating: "The tax-exempt status of special purpose revenue bonds represent a national policy of assisting certain limited categories of enterprises." *See id.* at 6, n.6, quoting Standing Committee Report No. 66, Proceedings of the Constitutional Convention of Hawaii of 1978, Vol. I, at 653, 657 (1980).

56. *See* A.G. letter to Kimura at 6.

57. *Id.* at 7.

58. *Id.* at 7 & nn.7-8.

59. *Id.* at 7.

60. A.G. letter to Say at 7.

61. *Id.* at 7, n.5.

62. *Id.* at 10, n.9, quoting from Black's Law Dictionary 98 (7th ed. 1999); *accord*, A.G. letter to Kimura at 8, n.9.

63. A.G. letter to Kimura at 8; A.G. letter to Say at 7-8.

64. Benjamin J. Cayetano, Governor of Hawaii, Statement of Objection to House Bill No. 898, Regular Session of 1995.

State Constitution.⁶⁵ In explaining this interpretation of the issuing of special purpose revenue bonds as an implied appropriation, the department of the attorney general cited to the definition in the, then current, sixth edition of Black’s Law Dictionary, which defined “appropriation [i]n governmental accounting” as “an expenditure authorized for a specified amount, purpose, and time.”⁶⁶ The attorney general noted that this definition was consistent with that used in *Opinion of Justices*, in which the Massachusetts high court found that “an appropriation is the setting apart from the public revenue a certain sum of money for a specified object, in such manner that the executive officers of the government are authorized to use that money, and no more, for that object, and for no other.”⁶⁷ This interpretation of “appropriation” is also reflected in Attorney General Opinion 61-39 (1961)⁶⁸ and Attorney General Opinion 72-6 (1972).⁶⁹ The attorney general concluded that:

By authorizing the special purpose revenue bonds, the Legislature has expressed its intent to appropriate such bond proceeds by setting aside a “certain sum of money for a specified object, in such manner that the executive officers of the government are authorized to use that money, and no more, for that object, and for no other.”

65. *Id.* Article VII, section 9 of the State Constitution provides in pertinent part: “no appropriation bills, except bills recommended by the governor for immediate passage, or to cover the expenses of the legislature. Shall be passed on final reading until the bill authorizing operating expenditures for the ensuing fiscal biennium, to be known as the general appropriations bill, shall have been transmitted to the governor.”

66. Letter from Randall S. Nishiyama, Deputy Attorney General, to Representative Marcus R. Oshiro, Fortieth District, June 24, 1999, at 2 [hereinafter cited as A.G. letter to Oshiro], quoting Black’s Law Dictionary 101 (6th ed. 1990). Interestingly, the fifth edition of Black’s Law Dictionary (although not repeated in later editions) contains the following definitions of the more specific terms “Appropriation (Public Law)” and “Appropriation bill”:

“Appropriation (Public law).” The act by which the legislative department of government designates a particular fund, or sets apart a specified portion of the public revenue or of the money in the public treasury, to be applied to some general object of governmental expenditure, or to some individual purchase or expense.

“Appropriation bill.” A measure before a legislative body authorizing the expenditure of public moneys and stipulating the amount, manner, and purpose of the various items of expenditure.

These definitions emphasize the intent that the sum of money, revenue, or fund to be expended is to come from the “public treasury,” “public revenue,” or “public moneys,” implying that it is the designation of “public moneys” in a specified amount to be applied in a specific manner for a specific purpose that constitutes an appropriation.

67. A.G. letter to Oshiro, at 2, quoting *Opinion of Justices*, 79 N.E.2d 881, 882 (Mass. 1948) (citations omitted in original). *But see*, In *Opinion of the Justices*, 354 Mass. 779, 236 N.E. 2d 523 (1968) (financing scheme not grant or appropriation of public money; public money is raised by taxation).

68. *See* A.G. letter to Oshiro, at 2. *See* A.G. Opinion 61-39 (1961) at 4 (appropriates a specific sum of money from a designated fund for a specified purpose).

69. *See* A.G. letter to Oshiro, at 2. *See* A.G. Opinion 72-6 (1972) at 4 (authorizes, the expenditure of money and stipulates the amount, manner and purpose of the various items of expenditure).

Thus we believe that special purpose revenue bond authorizations include an implied appropriation to permit the special purpose revenue bond proceeds, which are public moneys, to be loaned to the special purpose entity.⁷⁰

H AIS points to the same two attorney general opinions cited by the attorney general as “instructive” in determining what constitutes an “appropriation.” In Attorney General Opinion 61-39 (1961), the attorney general, in considering what constituted an appropriation bill, opined that it was a bill that appropriated a specific sum of money from a designated fund for a specified purpose or that constituted an obligation of the State.⁷¹ H AIS maintains therefore that for the issuance of special purpose revenue bonds to be in violation of Article X, section 1, “either the legislature must appropriate a specific sum of money from a designated fund or it must impose an obligation upon the state to the benefit of a sectarian or private institution.⁷² H AIS further contends that, because it “is axiomatic that any issue of special purpose revenue bonds would be strictly limited to the revenues of the particular institution for repayment, with the State expressly indemnified from any obligation whatsoever,” such bonds would not impose an obligation upon the State.⁷³ Indeed state law, as well as the bonds themselves, make clear that such bonds are payable solely from revenues pledged to their payment and that they are not general obligations of the State and not secured directly or indirectly by the full faith and credit or the general credit of the State or by any revenues or taxes of the State.⁷⁴

H AIS also cites Attorney General Opinion 72-6 (1972) for the proposition that bills constitute appropriation bills “only if they authorize the expenditure of money and stipulate the amount, manner and purpose of the various items of expenditure.”⁷⁵ H AIS maintains that because “bills to authorize the issuance of special purpose revenue bonds *do not authorize the expenditure of money by the state*, it is our belief that they do not constitute appropriations by the state.”⁷⁶

It is true that acts authorizing the issuance of special purpose revenue bonds do not contain typical language indicating the “appropriation” of a certain sum from a designated fund. Rather such bills only authorize the department of budget and finance to issue special purpose revenue bonds in a specified amount.⁷⁷ However, the department of the attorney general

70. A.G. letter to Oshiro, at 5, quoting from Opinion of Justices, 79 N.E.2d at 882 (Mass. 1948). A.G. Opinion 72-6 (1972) at 5.

71. A.G. Opinion 61-39 (1961) at 4. However, in the same opinion, the attorney general concluded that a bill accepting land-grant college aid from the United States Congress constituted an appropriation when read together with the federal law appropriating the sum of \$6,000,000 to the State under the federal land-grant college aid program. A.G. Opinion 61-39 (1961) at 5 (related statutes to be read and construed together).

72. H AIS, Witt letter, at 2.

73. *Id.*

74. See Haw. Const. art. VII, §12; Haw. Rev. Stat. §§ 39A-41, 39A-81, 39A-121, 39A-161, 39A-201, and 39A-231.

75. See H AIS, Witt letter, at 2-3; A.G. Opinion 72-6 (1972) at 4.

76. H AIS, Witt letter, at 2 (emphasis added).

77. See e.g., Act 250, 2000 Haw. Sess. Laws.

contends that the use of technical words in a bill is not essential to create an appropriation; rather, the “legislative intent determines whether a statute contains an appropriation.”⁷⁸

The attorney general cites *Hallas v. Town of Windsor*⁷⁹ in support of the contention that an action may constitute an appropriation even though neither the actual word “appropriation” nor any of its derivatives is used. In *Hallas*, the Connecticut Supreme Court found that the intent, not the special form of the language, was controlling in determining whether there was an appropriation.⁸⁰ The specific issue before the court was whether a vote of the townspeople to approve a bond resolution to authorize the issuance of bonds constituted an “appropriation.” Although the town council had previously appropriated the funds, the town charter required the townspeople to approve the bonds by resolution at a town meeting. The townspeople subsequently voted to approve a resolution approving the appropriation of the bonds at a special meeting called for the specific purpose of taking such vote. However, the plaintiffs maintained that the townspeople at the meeting “merely authorized a ‘transfer’ of monies” from the general fund balance to a specified general fund account.⁸¹ The court disagreed, stating that:

[T]he language of the resolution at issue in this case, together with the events leading up to its passage, convince us that the townspeople were on notice that the “manifest intent and purpose” of the ... special town meeting was to approve or disapprove an appropriation for the [road] construction ... and that the vote in favor of the resolution “clearly [made] an appropriation.”⁸²

In view of this language, it seems clear that *Hallas* does not support a broad proposition that the issuance of bonds *inherently* constitutes an implied appropriation. Rather, the Bureau is persuaded that HAIS’s summation of the case is more accurate: “The transaction in Hallas constituted an appropriation *not because a bond issue inherently constitutes an appropriation*, but because the townspeople understood that they were approving the expenditure of the proceeds of the bonds, and because the townspeople understood that they were committing themselves to the repayment of the bonds.”⁸³

78. A.G. letter to Kimura, at 8, n.9, quoting from *Cal. Ass’n. for Safety Educ. v. Brown*, 36 Cal. Rptr.2d 404, 415 (Cal. App. 6 Dist. 1994); *accord*, A.G. letter to Say, at 7, n.5.

79. 562 A.2d 499 (Conn. 1989).

80. *Id.* at 505, relying upon *Woodward v. Reynolds*, 58 Conn. 486, 19 A. 511 (1890).

81. 562 A.2d at 504.

82. *Id.* at 505, quoting from *Woodward v. Reynolds*, 58 Conn. 486, 491, 19 A. 511 (1890).

83. HAIS, Jones letter, at 2 (emphasis added). Likewise, HAIS notes that the court in *Woodward v. Reynolds* did not rule that the act of approving the issuance of bonds constituted an appropriation; rather the court ruled that a resolution approved by the townspeople constituted an appropriation because it authorized the expenditure of the proceeds to the bond issue for improvement of the city’s parks system. *Id.* Additionally, HAIS distinguishes these cases as involving instances in which the townspeople were extending the credit of their town in approving the issuance of the bonds and also were extending an obligation to repay the bonds through future tax revenues. HAIS notes that, in contrast, “[i]t is essential to conduit bonds such as special purpose revenue bonds, ... that the credit of the government agency is not extended to secure the bonds, and the government does not pledge tax revenues for repayment of the bonds.” *Id.* at 3.

The department of the attorney general also relies upon *State ex rel. Amemiya v. Anderson*,⁸⁴ in which the Hawaii Supreme Court considered whether the “issuance of anti-pollution revenue bonds violated provisions of Article VII, section 4, of the State Constitution, (then numbered Article VI, section 2) ‘in that it appropriates public money or public property or uses the public credit for other than an public purpose.’”⁸⁵ Although the issue before the court concerned what constitutes a “public purpose,” the court did not question the view that the anti-pollution revenue bonds involved the use of public money or credit.⁸⁶ The attorney general categorizes this as a “finding” and contends that the court’s finding in this regard supports the attorney general’s interpretation that special purpose revenue bonds (which the attorney general maintains are similar to anti-pollution revenue bonds), likewise involve public money or public credit.⁸⁷

Finally, the attorney general has relied upon section 103 of the Internal Revenue Code to argue that this section requires the bond proceeds to be considered “public money” to qualify for tax exempt status: “[I]f the proceeds of special purpose revenue bonds are not considered ‘public money,’ then the bonds could not be issued on a tax exempt basis under the Internal Revenue Code of 1986, as amended.”⁸⁸ Section 103 of the Internal Revenue Code of 1986 does require the bond to be a state or local bond to qualify for tax exempt status, which is defined as an obligation of a State or political subdivision thereof.⁸⁹ However, the conclusion that the bond must be considered “public money” to qualify for tax-exempt status is inconsistent with the holding in a number of jurisdictions that such tax-exempt bonds do not constitute public funds.⁹⁰ Moreover, Hawaii State constitutional and statutory law clearly state the intent that special purpose revenue bonds are not general obligations of the State.⁹¹

In contrast to the position of the attorney general, HAIS maintains that the issuance of special purpose revenue bonds have “always been a ‘special case’; and as such, these bonds are classified as ‘special obligations’ of the state or respective government agencies, reflecting the fact that the bonds are not debts of the government agency. This does not mean, however, that the proceeds of the bond must be classified as public money.”⁹²

To support its contention that special purpose revenue bonds do not constitute public funds, HAIS relies upon Attorney General Opinion No. 94-04 (1994) (hereafter A.G. Opinion), dealing with the Hawaii public procurement code, which noted that there was no Hawaii case law helpful in construing the term “public funds” and that the legislative history was similarly

84. 56 Haw. 566, 545 P.2d 1175 (1976).

85. A.G. letter to Kimura, at 9, quoting from 56 Haw. at 569-70.

86. A.G. letter to Kimura, at 9, quoting from 56 Haw. at 574-76.

87. See A.G. letter to Kimura, at 9.

88. A.G. letter to Oshiro, at 4.

89. Internal Revenue Code of 1986, §103(c)(1), as amended.

90. See notes 99-115 *infra* and accompanying text.

91. See notes 5-6 *supra* and accompanying text.

92. See HAIS, Jones letter at 3.

unenlightening.⁹³ Consequently, the A.G. Opinion looked to other courts that have “determined whether moneys owed individuals by government in other contexts are ‘public moneys’” and concluded that funds held by a state agency are not necessarily public funds.⁹⁴ The opinion maintains that:

To be ‘public funds,’ the state must have ‘equitable’ and ‘legal’ rights to them. Navajo Tribe v. Arizona Dept. of Administration, 528 P.2d 623 (1974). A distinction must be drawn between money over which a state has control, e.g., money collected as rent from a source and use to pay an obligation owed by a state to another, which are public funds, and money which the state merely collects, holds, or disburses. McIntosh v. Aubry, 18 Cal. Rptr. 2d 680,688 (1993).⁹⁵

The opinion also cites, from the *Navajo* decision, the Arizona court’s summary of law from other jurisdictions:

Payment of funds into the state treasury does not necessarily vest the state with title to those funds. Ross v. Gross, 300 KY. 337, 188 S.W.2d 475 (1945). Only monies raised by the operation of some general law become public funds. Cvr & Evans Contracting Co. v. Graham, 2 Ariz. App. 196, 407 P.2d 385 (1965). Custodial funds are not state monies. MacManus v. Love, 499 P.2d 609 (Colo. 1972). The term “public funds” refers to funds belonging to the state and does not apply to funds for the benefit of contributors for which the state is a mere custodian or conduit.⁹⁶

In view of these decisions, HAIS maintains that it is “clear” that the State does not have an “‘equitable’ or ‘legal’ claim” to funds derived from the issuance of special purpose revenue bonds. Rather, such bonds “are issued with the intent of financing a capital improvement project for private entities and are not an obligation of the State. The state merely serves as a conduit between investors and the institution that is to benefit from the issuance of the bonds.”⁹⁷ HAIS also emphasizes that no state moneys are used in connection with the administrative or implementation of the special purpose revenue bonds because state law requires the special purpose entity to reimburse the State for any and all costs and expenses associated with entering into any agreement concerning special purpose revenue bonds.⁹⁸

Furthermore, HAIS cites a number of authorities that suggest the issuance of revenue bonds to a private entity does not constitute the use of public funds. For example, in *California*

93. *Id.* at 5, citing A.G. Opinion No. 94-04 (1994) at 8. See also HAIS, Witt letter at 3.

94. See A.G. Opinion No. 94-04 (1994) at 8.

95. HAIS Jones letter at 6, quoting from A.G. Opinion 94-04 (1994) at 8.

96. Attorney General Opinion No. 94-04 (1994) at 8 n.7, quoting from *Navajo Tribe v. Arizona Dept. of Administration*, 528 P.2d 623, 624-25 (1974).

97. HAIS, Witt letter at 3. HAIS further notes that it is “fundamental to any conduit tax-exempt school funding program that the revenue bonds would not constitute an appropriation of public funds.” *Id.* at 1.

98. See *id.* at 3. See generally, Haw. Rev. Stat. §§ 39A-34, 39A-74, 39A-114, 39A-154, 39A-194, and 39A-224.

Educational Facilities Authority v. Priest,⁹⁹ the California Supreme Court examined whether the issuance of revenue bonds by a public instrumentality were public funds. The pertinent provision of the California Constitution prohibited the appropriation of public money for “the support of any sectarian or denominational school or any school not under the exclusive control of officers of the public schools.”¹⁰⁰ The Court ruled that:

The Act [authorizing the issuance of bonds] does not require the outlay or appropriation of public money. Here as in [*Hunt v. McNair*], “The ‘state aid’ involved in this case is of a very special sort. We have here no expenditure of public funds, either by grant or loan, no reimbursement by a State for expenditures made by a parochial school or college, and no extending or committing of a State’s credit.” The bonds issued by the Authority will be repaid from revenues generated by the projects themselves.¹⁰¹

The court also noted that the Act authorizing the bonds stated, and the face of the bonds reflected, that the bonds do not constitute a debt or liability of the state or a pledge of the faith and credit of the state.¹⁰²

In *Minnesota Higher Education Facilities Authority v. Hawk*,¹⁰³ the court considered whether the issuance of tax-exempt revenue bonds by an agency of the state, to refinance indebtedness incurred by private religious affiliated colleges in the construction of facilities devoted exclusively to secular educational purposes, constituted an expenditure of public funds.¹⁰⁴ The Court noted that the Minnesota statute set out detailed requirements for the establishment of bond and loan funds to be used to repay the loans and specifically stated that the bonds were not debts or liabilities of the state and that the state instrumentality issuing the bonds would incur on liability or expense as a result.¹⁰⁵ The court observed that “[d]espite these apparently clear and unequivocal legislative statements, defendants contend that the challenged statutory program necessarily involves the expenditure of ‘public funds.’”¹⁰⁶ In ruling that the issuance of tax-exempt revenue bonds did not involve the expenditure of “public funds,” the court specifically rejected the defendant’s “hypothesis that since the bonds are instruments of a public agency, then the proceeds must be public funds.”¹⁰⁷ Noting that the bond financing scheme was similar in all relevant respects to the one in South Carolina that was at issue in *Hunt v. McNair*, the court relied heavily on *Hunt*’s statements to the effect that the state aid involved

99. 12 Cal. 3d 593, 526 P.2d 513, 116 Cal. Rptr. 361 (1974).

100. 526 P.2d at 520.

101. *Id.*, citing *Hunt*, 413 U.S. 734, 745, n.7 (1973).

102. 526 P.2d at 522.

103. 305 Minn. 97, 232 N.W.2d 106 (1975) (declaratory judgment).

104. 232 N.W.2d at 110. The court also considered and rejected a challenge that the statutory financing scheme violated the Establishment Clause of the First Amendment to the United States Constitution, relying upon *Hunt v. McNair*, 413 U.S. 734, 93 Sup. Ct. 2868 (1973).

105. See *id.*, citing Minn. Stat. §§ 136A.35 & 136A.30.

106. 232 N.W.2d at 110.

107. See *id.* at 111-12 (not an expenditure of “public money.”) The defendant also had argued that the bond financing deprived the state treasury of tax income. *Id.* at 111.

was “of a very special sort,” involving no expenditure of public funds, either by grant or loan, no reimbursement by a State for expenditure, and no extending or committing of a State’s credit.¹⁰⁸

Similarly, in *Washington Health Care Facility v. Spellman*,¹⁰⁹ the Washington Supreme Court ruled that use of revenue bonds to fund capital improvements at health facilities that were affiliated with religious organizations did not involve the appropriation or use of public money or property.¹¹⁰ In considering whether public money or property was involved, the Court found the following persuasive:

- (1) No money comes from the public treasury;
- (2) The bond proceeds never enter the public treasury;
- (3) Repayments of the bonds do not pass through the public treasury;
- (4) The bonds are not state debts; and
- (5) Although bond sales are enabled by a public body, the money is not acquired either for or from the general public.¹¹¹

Acknowledging that the bond proceeds come from the sale of bonds under the name of a public entity, the Court nevertheless concluded that “this does not make the proceeds ‘public money.’”¹¹² In so holding, the court reasoned that:

The Authority does not dispense the money to or for the public. It all goes to the hospitals. Nor does the Authority obtain the money from the public. It does not obtain it (1) by taxation; (2) from another unit of government; (3) by borrowing on the promise of repayment from taxation; (4) by incurring obligations on behalf of the State; or (5) by selling the bonds to the State. The bonds are not state investments. Rather, the Authority obtains the money from a sale of bonds to private underwriters, which in turn resell to investors.¹¹³

108. *Id.* at 111, citing *Hunt*, 413 U.S. 734, 745, n.7 (1973); *accord*, California Educational Facilities Authority v. Priest, 12 Cal. 3d 593, 526 P.2d 513, 116 Cal. Rptr. 361 (1974); in Opinion of the Justices, 354 Mass. 779, 236 N.E. 2d 523 (1968) (financing scheme not grant or appropriation of public money; public money is raised by taxation); Clayton v. Kervick, 56 N.J. 523, 267 A.2d 503 (1970).

109. 96 Wash. 2d 68, 633 P.2d 866 (Wash. 1981).

110. 633 P.2d at 867. The defendants based their constitutional violation claim upon Article 1, §11 of the Washington Constitution, which provided in pertinent part: “No public money or property shall be appropriated for or applied to any religious worship, exercise or instruction, or the support of any religious establishment.” The defendants conceded that the financing proposal did not violate the Establishment Clause of the First Amendment to the United States Constitution or Article 9, § 4 of the Washington Constitution. *Id.*

111. 633 P.2d at 867-69.

112. *Id.* at 869.

113. *Id.* *accord*, Kentucky AG Opinion 93-80 (public nature of bond issue nothing more than tax and interest advantage for bondholders; no taxpayer funds involved and city not liable on bonds); Oklahoma AG

The Washington Court also rejected the argument, similar to one made by the Hawaii attorney general, that the tax advantage of the revenue bonds constitutes “state aid.” The Court asserted that:

The only “public” financial assistance given borrower hospitals here is indirect, not measurable in dollars, and is not state aid: Those who receive the interest from tax exempt bonds are relieved of the obligation to pay a tax on this income. This relief can hardly be called an appropriation or application of public money unless the income which is taxed is claimed to be public money in the first place. This we refuse to do.

...

... The State gives nothing but its blessing; it passes its conceptual hands over the bonds to permit a favored federal tax treatment.¹¹⁴

The Court further emphasized that the bonds were “neither general nor special obligations of the State” nor general obligations of the issuing public entity and no bondholder had “the right to require the State or the Authority, at any time or under any circumstances, to levy any tax or expend any of its funds for the payment of the principal of or interest on the bonds.”¹¹⁵

HAIS also relies upon *Hunt v. McNair*¹¹⁶ in which the United States Supreme Court, examining conduit revenue bond financing for sectarian colleges and universities, stated, albeit in dictum, that:

The “state aid” involved in this case is of a very special sort. We have here no expenditure of public funds, either by grant or loan, no reimbursement by a State for expenditures made by a parochial school or college, and no extending or committing of a State’s credit. Rather the only state aid consists, not of financial assistance directly or indirectly that would implicate public funds or credit, but the creation of an instrumentality (the Authority) through which educational institutions may borrow funds on the basis of their own credit and the security of their own property The South Carolina Supreme Court, in the opinion below, described the role of the State as that of a “mere conduit.”¹¹⁷

A number of jurisdictions have permitted the use of special purpose revenue bonds or some type of conduit bond to assist private educational facilities. HAIS points out that Georgia, Illinois, Maryland, Michigan, New York, Texas, and Virginia have permitted the use of tax-exempt revenue bonds by religiously affiliated primary and secondary schools.¹¹⁸ In Chapter 5, the Bureau notes that Standard & Poor and Moody’s Investors Service have reported that 36

Opinion 83-227 (where money is raised by issuance of revenue bonds, repayment does not pass through the public treasury, and bonds are not general obligations of the public instrumentality, the state or a political subdivision, such money is not “public money”).

114. 633 P.2d at 868.

115. *Id.* See notes 5-6 *supra* and accompanying text.

116. 413 U.S. 734, 93 S. Ct. 2868, (1973).

117. HAIS, Witt letter at 3-4 (emphasis supplied), quoting *Hunt*, 413 U.S. at 745, n.7.

118. HAIS, Witt letter at 6.

issuing authorities from 21 states have issued rated tax-exempt municipal bonds on behalf of seventy-five private nonprofit grade schools. The actual use of bonds issued on behalf of private nonprofit grade schools most likely is much higher because it does not include the use of unrated bonds.¹¹⁹

Although acknowledging that in Hawaii the State is the financing agency rather than a public entity or instrumentality created by the State for that purpose, as is the case in many of these jurisdictions, HAIS nevertheless maintains that the “essence of the transaction” would be the same: the State serves merely as a conduit, administering the proceeds of the bonds; the funds do not come from the public treasury; the proceeds of the bonds are obtained by extending the credit of the private entity, not that of the State; the bonds are not general obligations of the State; and no state moneys are used to pay for the bonds or the interest thereon or for any expenses in connection with the bonds.¹²⁰ Furthermore, HAIS notes that the State may avoid even nominal control of funds generated by bond sales by designating a national or state bank or trust company as trustee for the bondholders.¹²¹

Not mentioned by HAIS, but somewhat analogous to the issue at hand is *In re Anzai*¹²² in which the Hawaii Supreme Court considered whether financing agreements entered into by state agency, pursuant to chapter 37D, Hawaii Revised Statutes, are counted toward the constitutional debt ceiling established for general obligation bonds by Article VII, section 13 of the State Constitution. The court held that such financing agreements are not bonds or other debt within the meaning of Article VII, sections 12 and 13 and therefore do not count against the State’s debt ceiling. In its decision, the court relied heavily upon the following characteristics that are similar to special purpose revenue bonds:

- (1) Repayment of financing agreements, unlike repayment of general obligation bonds, is not unconditional because “the legislature is not required to appropriate money to pay obligations due under such agreements”;
- (2) Section 37D-5, Hawaii Revised Statutes, denies the holder of any financing agreement “the right to compel any exercise of taxing power of the agency to pay such financing agreements or the interest thereon and no moneys other than amounts appropriated or otherwise held in trust for such purpose shall be required to be applied to the payments thereof.”
- (3) Financing agreements are not an obligation for which the “full faith and credit” of the agency is pledged and “no claim or lien” can be made on any revenue or other

119. See discussion in Chapter 5, at 1-2 and Table 1.

120. See HAIS, Witt letter at 4.

121. See *id.* at 4.-5. See e.g., Haw. Rev. Stat. §39A-229.

122. 85 Haw. 1, 936 P.2d 637 (1997).

moneys of the agency other than that appropriate or held in trust for such purpose.¹²³

The court concluded that:

The lack of an obligation to repay Hawaii Revised Statutes chapter 37D financing agreements is in stark contrast to article VII, section 12’s definition of a “general obligation bond,” including reimbursable general obligation bonds, as a pledge of repayment against the full faith and credit of the State or a political subdivision.¹²⁴

Conclusion

While *In re Anzai* is hardly controlling on the issue of whether the issuance of special purpose revenue bonds constitutes use of “public funds,” the present day Hawaii Supreme Court has at least considered that characteristics such as those shared by special purpose revenue bonds are sufficiently significant as to exclude them as state debt. Nevertheless, there remains no clear-cut answer to the question, do “public funds” encompass special purpose revenue bonds? The attorney general contends that because the proceeds of special purpose revenue bonds are “public moneys to be loaned to the special purpose entity,” the authorization to issue the bonds constitutes “implied appropriation” within the context of Article X, section 1.¹²⁵ As chief legal officer of the State, the attorney general’s opinion is entitled to some weight. On the other hand, HAIS argues that the issuance of special purpose revenue bonds is not an appropriation because the State has no obligation or liability with respect to the bonds and because the bills authorizing the issuance of special purpose revenue bonds does not authorize the “expenditure of money.”¹²⁶ Furthermore, HAIS cites a number of authorities for the proposition that the issuance of special purpose revenue bonds does not constitute the use of public funds.¹²⁷

As a general matter, the Bureau finds these authorities persuasive on the issue that the better rule to follow would be that the issuance of special purpose revenue bonds does not involve the use of public funds. However, in *Spears*, the Hawaii court found an “unequivocal” constitutional prohibition on public aid, based upon the framers’ “clear cut” intent to ensure support of the public schools and protection from any public assistance that would “build up, strengthen and make successful the private schools” at the expense of public schools.¹²⁸

123. 85 Haw. at 6. Compare with Haw. Rev. Stat. §§ 39A-41, 39A-81, 39A-121, 39A-161, 39A-201, and 39A-231 (not general obligation of the State; bondholder has no right to compel exercise of taxing power of State to pay bonds or interest; no moneys other than pledged revenues shall be applied to payment thereof; not secured by full faith and credit or general credit of State).

124. 85 Haw. at 6.

125. See note 58 *supra* and accompanying text.

126. See notes 75-83 *supra* and accompanying text.

127. These authorities include a Hawaii attorney general opinion that cites with approval cases that have concluded that funds held by a state agency are not necessarily public funds. See notes 93-117 *supra* and accompanying text.

128. See notes 34-44 *supra* and accompanying text.

Moreover, the present day court, if faced with the issue, may well feel constrained by *Spear's* powerful conclusion that the State has “tied its own hands” by “totally [denying] itself the power to make appropriations aiding private and sectarian schools under Article IX, Section I” and that the legislature, lacking such power, “must return to the people to ask them to decide whether their State Constitution should be amended to grant the Legislature ... the power to provide ‘support or benefit’ to nonpublic school.”¹²⁹ If so, the present day court may be compelled to dismiss, like *Spears*, the decisions of other jurisdictions as having “no relevance in interpreting [the Hawaii] Constitution,” and, instead decide the issue consistent with the “clear” intent of Article X, section 1.¹³⁰ Moreover, the legislature’s own decision to seek a constitutional amendment to Article X, section 1, to permit the issuance of special purpose revenue bonds to be used to finance or assist early childhood education care and facilities provided to the general public by not-for-profit corporations will be viewed in all likelihood as persuasive evidence of legislative recognition that “special purpose revenue bonds are considered public funds.”¹³¹

129. See notes 50-53 *supra* and accompanying text.

130. See notes 34-36 *supra* and accompanying text.

131. See notes 12-13 *supra* and accompanying text.

Chapter 8

SUMMARY AND CONCLUSIONS

Part I

Toward the end of 1999, Standard & Poor's and Moody's Investors Service reported that thirty-six issuing authorities, from twenty-one states, had issued rated tax-exempt municipal bonds on behalf of seventy-five private nonprofit grade schools. These figures most likely underestimated the extent to which tax-exempt municipal bonds had been issued on behalf of private nonprofit grade schools because they did not include the sale of unrated bonds. The ratings given by Moody's Investors Service to these tax-exempt municipal bond issues range from "Aaa" to "Baa3". A rating of Aaa, with or without credit enhancement, is the highest rating given by Moody's Investors Service. A rating of Baa3 is the lowest rating given by Moody's Investors Service to investment grade bonds.

Student demand is one of many broad categories considered by Standard & Poor's, Moody's Investors Service, and Fitch Incorporated when they rate a private nonprofit grade school that wants to utilize tax-exempt municipal bonds to fund construction projects. Student demand affects a school's enrollment level, which in turn affects the amount of tuition-based money flowing into the school's treasury, which in turn affects the school's ability to repay the principal of and interest on a bond issue.

Financial strength and flexibility is another of many broad categories considered by Standard & Poor's, Moody's Investors Service, and Fitch Incorporated when they rate a private nonprofit grade school that wants to utilize tax-exempt municipal bonds to fund construction projects. Financial strength and flexibility, which the writer represents simply as the size of a school's endowment and the amount of unrestricted moneys available for the school's immediate use, can affect a school's ability to repay the principal of and interest on a bond issue during financially difficult times.

According to Standard & Poor's, the number of private nonprofit grade schools entering the public bond market and seeking ratings is likely to increase. Among the reasons given by Standard & Poor's for the likely increase are:

- (1) Private nonprofit grade schools that successfully utilized tax-exempt municipal bonds to fund construction projects are introducing other schools to the idea of utilizing tax-exempt bonds; and
- (2) More states are either creating new issuing authorities to allow private nonprofit grade schools to utilize tax-exempt municipal bonds or broadening the powers of existing authorities to include private nonprofit grade schools.

Authorizing the issuance of SPRBs to assist private nonprofit grade schools, and universities and colleges with their capital improvement projects may not provide the desired assistance to all the institutions that need or want it. Some schools will benefit from the issuance of SPRBs, others will not. Special purpose revenue bonds are loans that must be repaid promptly and with interest; and not all loan applicants may be considered adequately creditworthy. Despite these limitations, private nonprofit grade schools, and universities and colleges could benefit from the authorization of joint issuance techniques such as composite issues and bond pools, in addition to stand alone techniques.

Part II

Establishment Clause Issues

The Establishment Clause of the First Amendment of the United States Constitution states that “Congress shall make no law respecting an establishment of religion.” The Establishment Clause is applicable to the states through the Fourteenth Amendment. The Establishment Clause is implicated whenever government (federal or state) attempts to assist educational institutions that include private, sectarian schools. Establishment Clause jurisprudence has been described as a “dizzying array of disparate holdings.”¹ The United States Supreme Court’s reaction to specific factual situations, as well as shifting coalitions around political philosophies, has resulted in “multiple, interwoven paths”² through a maze of Establishment Clause jurisprudence. As the Court in *Tilton* cautioned:

Constitutional adjudication does not lend itself to the absolutes of the physical sciences or mathematics.... [A]s we have noted in [*Lemon*,] candor compels the acknowledgment that we can only dimly perceive the boundaries of permissible government activity in this sensitive area of constitutional adjudication.³

Consequently, this has made discerning a logical and rational line of legal reasoning from the case law a challenging affair. The reader is cautioned that the discussion in Chapter 6 is far from comprehensive and certainly makes no pretense of having covered all the nuances of Establishment Clause jurisprudence. Due to time constraints, as well as the volume of Establishment Clause case law, Chapter 6 is intended to present only the highlights of Establishment Clause jurisprudence as it reasonably pertains to government school aid programs. The issue to be determined from this review of the cases is whether the government may provide assistance to private, sectarian and nonsectarian schools, primarily through the use of special purpose revenue bonds to finance construction and renovation of educational facilities, without contravening the Establishment Clause.

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1. J. Lewis & J. Farina, “Tax-Exempt Bond Financing for Faith-Based Institutions: The new Constitutional Climate,” at 1. Source: <http://www.imdr.com/publish/Tax-Exempt.htm>
 2. See *id.* at 3.
 3. *Tilton v. Richardson*, 403 U.S. 672, 677-78 (1971), quoting *Lemon v. Kurtzman* and *Earley v. DiCenso*, 403 U.S. 602, 612 (1971).

Recent United States Supreme Court cases *Agostini* and *Mitchell* have affirmed that, in evaluating whether a government school aid program violates the Establishment Clause, courts should inquire whether the program:

- (1) Has a secular purpose;⁴ or
- (2) Has a principal or primary effect of advancing or inhibiting religion.⁵

With respect to the second inquiry, these cases provide the following guidelines. A government aid program has the effect of advancing religion if it:

- (1) Results in governmental indoctrination;
- (2) Defines its recipients by reference to religion; or
- (3) Creates an excessive entanglement.⁶

Furthermore, review of these same criteria would determine whether a program constitutes an endorsement of religion.⁷

Even with these guidelines, however, Justice O'Connor has acknowledged that "school-aid cases often defy simple categorization" and therefore resolution requires "sifting through the details" to determine "whether the challenged program offends the Establishment Clause. Such judgment requires courts to draw lines, sometimes quite fine, based on the particular facts of each case."⁸

With those caveats in mind, the Bureau makes the following observations. Relevant case law indicates that a "program that neutrally provides state assistance to a broad spectrum of citizens is not readily subject to challenge under the Establishment Clause."⁹ Courts have long ago rejected the "simplistic argument that every form of financial aid to church-sponsored

4. With respect to the first inquiry, the Court generally has had no problem finding that a particular aid program satisfies the "secular purpose" criterion. See e.g., *Mitchell v. Helm*, 120 S. Ct. 2530, 2540 (plurality opinion), 2560 (concurring opinion) (secular purpose of program not questioned); *Zobrest v. Catalina Foothills School Dist.*, 509 U.S. 1, 5 (1993) (IDEA program has a clear secular purpose); *Witters v. Washington Dep't of Services for the Blind*, 474 U.S. 481, 485-86 (1986) (all parties concede the "unmistakably secular purpose" of program); *School Dist. of Grand Rapids v. Ball*, 473 U.S. 373, 383 (1985) (Court noted that "[a]s has often been true in school aid cases, there is no dispute as to the first [Lemon] test" that the purpose of the aid is "manifestly secular"); *Roemer v. Bd. of Pub. Wks. of Md.*, 426 U.S. 736, 754 (1976) (secular purpose of program not challenged); *Hunt v. McNair*, 413 U.S. 734, 741 (1973) (purpose of statute is manifestly a secular one); *Tilton v. Richardson*, 403 U.S. 672, 679 (1971) (legitimate secular objective entirely appropriate for governmental action).

5. See notes 133-163 and 175 *supra* and accompanying text.

6. See *Mitchell*, 120 S. Ct. at 2540 (plurality opinion), 2560 (concurring opinion); *Agostini*, 521 U.S. at 234.

7. See *Mitchell*, 120 S. Ct. at 2555 (plurality opinion), 2560 (concurring opinion).

8. *Id.* at 2560 (concurring opinion), quoting *Rosenberger*, 515 U.S. at 847.

9. *Meuller v. Allen*, 463 U.S. 398-99 (1983).

activity violates” the Establishment Clause.¹⁰ Furthermore, even aid in the form of direct construction grants (*Tilton*) or direct noncategorical grants (*Roemer*) is permissible under the Establishment Clause to assist “religiously affiliated schools,” provided they are not “pervasively sectarian.” Thus it appears that the issuance of special purpose revenue bonds for the benefit of religiously affiliated schools clearly would be permissible under the Establishment Clause, provided the schools were not pervasively sectarian. On the other hand, however, it also appears that “direct” money payments, made under a government school aid program, to pervasively sectarian institutions that could then use the financial aid for religious purposes would have the impermissible effect of advancing religion under the Establishment Clause. Nevertheless, after *Agostini* and *Mitchell*, courts may no longer *presume* that all government aid that directly assists the educational function of religious schools is invalid.¹¹ As Justice O’Connor observed in *Mitchell*, “our cases have taken a more forgiving view of neutral government programs that make aid available generally without regard to the religious or nonreligious character of the recipient school.”¹²

Thus, under *Mueller*, *Witters*, *Zobrest* and *Agostini*, it appears that even pervasively sectarian institutions may receive some government aid; provided that: eligibility for the government aid flowing to the institution is determined on the basis of neutral, secular criteria without regard to religion; the aid is indirect or incidental or the aid reaches the institution as a result of independent private choice rather than state decisionmaking; the aid supplements, rather than supplants, the institution’s core educational functions; and adequate safeguards are present to prevent actual diversion of aid to sectarian uses. Moreover, because a court no longer may *presume* that any aid flowing to the educational mission of a pervasively sectarian school inevitably has the impermissible primary effect of advancing religion, the court must inquire into the sectarian nature of an institution and require proof of actual diversion of aid to religious uses. This may not be an easy task, as courts have recognized: “The criteria for assessing whether an institution is pervasively sectarian are complex, elusive, and heavily fact intensive.”¹³ Therefore, any designation of “pervasively sectarian” should be made only after a cautious, thorough and searching inquiry.¹⁴

In addition, *Hunt* has implied that tax-exempt special purpose revenue bond financing is a “special type” of government aid that may be so unique that its provision does not result in the primary effect of advancing or inhibiting religion, even if the recipient institution is pervasively

10. *Tilton v. Richardson*, 403 U.S. 672, 679, quoting *Bradfield v. Roberts*, 175 U.S. 291 (1899).

11. *Mitchell*, 120 S. Ct. at 2530, 2545 (plurality opinion), 2567 (concurring opinion), quoting *Agostini*, 521 U.S. at 225.

12. *Mitchell*, 120 S. Ct. at 2562 (concurring opinion), citing *Agostini*, 521 U.S. at 225-26.

13. See 159 F.3d at 169 (even institutions “obviously and firmly devoted to the ideals and teachings of a given religion are not necessarily ‘so permeated by religion that the secular side cannot be separated from the sectarian.’”) *Id.* at 163.

14. 159 F.3d at 164 (the Supreme Court has set the bar to finding an institution of higher learning pervasively sectarian quite high). See inquiry into pervasively sectarian nature of institution in *Steele v. Industrial Development Board*, 117 F. Supp.2d 693, 724-25 (M.D. Tenn. 2000); *Virginia College Building Authority v. Lynn*, No. 992099 (Nov. 3, 2000); 2000 W.L. 1650111 (Va.).

sectarian.¹⁵ The Supreme Court, as well as other lower courts considering the issue, have emphasized that the tax-exempt revenue bond financing program involves:

*[N]o expenditure of public funds, either by grant or loan, no reimbursement by a State for expenditures made by a parochial school or college, and no extending or committing of a State's credit. Rather, the only state aid consists, not of financial assistance directly or indirectly which would implicate public funds or credit, but the creation of an instrumentality (the Authority) through which educational institutions may borrow funds on the basis of their own credit and the security of their own property upon more favorable interest terms than otherwise would be available.*¹⁶

Relying upon this language, a number of lower courts have found tax-exempt special purpose revenue bond financing permissible under the Establishment Clause.¹⁷ Furthermore, in the aftermath of *Agostini* and *Mitchell*, two lower courts (*Johnson v. Economic Development Corporation*¹⁸ and *Virginia College Building Authority v. Lynn*¹⁹) have upheld issuance of tax-exempt special purpose revenue bonds for the benefit of religious schools, relying in part on the principle of independent private choice. These courts found that, because tax-exempt special purpose revenue bond financing involves the use of private investor funds, rather than taxpayer dollars, and because the government bears no expense or obligation under such a financing scheme, the aid reaches the schools as a result of independent private choice.²⁰

Accordingly, if tax-exempt special purpose revenue bond financing is viewed as a form of “special aid” or the aid is deemed to reach the religious school as a result of the private,

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15. See 2000 W.L. 1650111 (Va.) at 15, citing *Hunt*, 413 U.S. at 745 n.7.
 16. 413 U.S. at 745 n.7 (emphasis added); see also 2000 W.L. 1650111 (Va.) at 14 (no taxpayer dollars are transferred directly or indirectly to a participating institution; and no taxpayer dollars are pledged or utilized as surety for bond obligations. The bond proceeds are the funds of private investors, all money comes from private investors, no money comes from the government, and the government incurs no expenses and no obligation whatsoever in connection with the bonds). It also should be pointed out that, typically under special purpose revenue bond financing schemes (in contrast to the unrestricted grants in *Roemer*), the bonds are issued for specified construction or improvement purposes, with restrictions against use for sectarian purposes.
 17. See note 321 in Chapter 6 and accompanying text.
 18. 64 F. Supp.2d 657 (E.D. Mich. 1999). The court did not specifically address the allegation that the Roman Catholic grade school was “pervasively sectarian.” This suggests that the issue was irrelevant to the court’s ruling upholding issuance of special purpose revenue bonds for the benefit of the school.
 19. No. 992099 (Nov. 3, 2000); 2000 W.L. 1650111 (Va.) (Court specifically found that Regent University was a pervasively sectarian institution).
 20. See notes 277-280 and 321-331 in Chapter 6 and accompanying text. Cf. *Rosenberger v. Rector and Visitors of the Univ. of Va.*, 515 U.S. 819, 851-52 (1995) (O’Connor, J., concurring opinion) in which she suggest that proceeds of student fees can be distinguished from those of general assessments in support of religion and from government funds generally because, “[u]nlike monies dispensed from state or federal treasuries, the Student Activities Fund is collected from students The government neither pays into nor draws from this common pool, The Student Activities Fund, then, represents not government resources, whether derived from tax revenue, sale of assets, or otherwise, but a fund that simply belongs to the students.” But see *Steele v. Industrial Development Board*, 117 F. Supp.2d 693, 724-25 (M.D. Tenn. 2000) (argument that independent, private choice involved in providing proceeds of bond issue to the university was “without merit” because the Industrial Development Board, not the private investors, decided who would receive the benefit of the sale of the bonds).

independent choices of the individual rather than state decisionmaking, then such aid may be permissible to religious schools even if they are determined to be pervasively sectarian. This, of course, is assuming the aid is allocated pursuant to a neutral government aid program with sufficient use restrictions and adequate safeguards to ensure the bond proceeds are not diverted to religious use.

It remains to be seen whether this type of tax-exempt bond financing scheme will be viewed by the Supreme Court as a “true private choice program.” At the least, the rationale underlying *Hunt*, *Johnson*, and *Virginia College Building Authority* seems persuasive that this is a “special type of aid” that defies simple categorization as either direct or indirect government aid. Regardless of how it ultimately may be categorized, however, it would appear that a carefully crafted tax-exempt bond financing program to assist religious schools could withstand an Establishment Clause challenge. Given the Court’s recent rulings, there are a number of factors, while not exhaustive, that would appear to be significant in analyzing any future Establishment Clause challenge to government school aid programs generally. Thus, for example, a tax-exempt bond financing program could be devised with the following characteristics: has a clear secular purpose; determines aid eligibility in a nondiscriminatory manner on the basis of neutral secular criteria; makes aid available to religious and nonreligious schools alike on the basis of neutral secular criteria; imposes sufficient use restrictions and other safeguards to ensure that neither the funds nor the facilities constructed or improved with the funds will be used only for sectarian purposes and yet avoids excessive entanglement; requires that aid be supplemental to funds otherwise available to the religious school; and contains sufficient disclaimers of any endorsement of the religious practices or beliefs of the school.

However, surviving an Establishment Clause challenge is only one constitutional hurdle a tax-exempt bond financing program to assist religious schools would likely face. Such a program also would have to survive state constitutional challenges.

State Constitutional Issues

Issuance of special purpose revenue bonds must be authorized by the Legislature pursuant to Article VII, section 12 of the Hawaii Constitution and chapter 39A, Hawaii Revised Statutes. These provisions permit the issuance of special purpose revenue bonds on behalf of special purpose entities to finance facilities of or for, or to loan the bond proceeds for, certain specified types of projects.²¹ These provisions clearly would have to be amended to include private schools among those special purpose entities that may be assisted by the issuance of special purpose revenue bonds. A proposed amendment to Article V, section 12 is set forth in the Appendix.

Other provisions of the Hawaii Constitution are also relevant to this issue. For example, Article I, section 4, contains Hawaii’s version of the Establishment Clause²² and Article VIII,

21. See Haw. Const. art. VII, §12(9).

22. Article I, section 4 of the State Constitution provides that “no law shall be enacted respecting an establishment of religion or prohibiting the free exercise thereof.”

section 5, prohibits any grant made in violation of Article I, section 4.²³ The Bureau's conclusions with respect to whether the issuance of special purpose revenue bonds to assist nonpublic educational institutions would violate the First Amendment's Establishment Clause are equally relevant to whether such action would violate Article I, section 4 or Article VIII, section 5.²⁴

In addition, Article X, section 1 of the Hawaii Constitution is relevant to this discussion. Article X, section 1, provides:

Section 1. The State shall provide for the establishment, support and control of a statewide system of public schools free from sectarian control, a state university, public libraries and such other educational institutions as may be deemed desirable, including physical facilities therefor. There shall be no discrimination in public educational institutions because of race, religion, sex or ancestry; *nor shall public funds be appropriated for the support or benefit of any sectarian or private educational institution*, except that proceeds of special purpose revenue bonds authorized or issued under section 12 of Article VII may be appropriated to finance or assist not-for-profit corporations that provide early childhood education and care facilities serving the general public. (emphasis added).

Issuance of special purpose revenue bonds to assist nonpublic educational institutions would contravene this provision if special purpose revenue bonds constitute "public funds" within the meaning of Article X, section 1. Hawaii case law is silent on this particular point and, indeed, provides little guidance as to what constitutes "public funds" generally.

The legislative history of House Bill No. 2692, Regular Session of 1994, which proposed an amendment to Article VII, section 12, to authorize the State to use the proceeds of special purpose revenue bonds to finance or assist early childhood education care and facilities indicates that the attorney general's office, through an advisory letter, had informed the House Education Committee that the attorney general's position was:

Article X, Section 1, prohibits the appropriation of public funds for the support or benefit of any private education institution, and that *since special purpose revenue bonds are considered public funds*, an amendment to Article X, Section 1, would also be necessary
....²⁵

As chief legal officer of the State, the attorney general's opinion carries some weight. Accordingly, an exception was carved out of Article X, section 1, to permit special purpose revenue bonds to be used to finance or assist early childhood education care and facilities provided to the general public by not-for-profit corporations.²⁶

23. Article VIII, section 5, of the State Constitution states in pertinent part that: "No grant shall be made in violation of Section 3 of Article I of this Constitution."

24. See discussion in Chapter 6; see also note 9 in Chapter 7.

25. House Standing Committee Report No. 202-94 on House Bill No. 2692, Journal of the House of the Seventeenth Legislature at 933 (emphasis added).

26. See Act 280, Session Laws of Hawaii 1994, and election November 8, 1994.

The legislature’s previous acceptance of the attorney general’s assertion that special purpose revenue bonds are “public funds” and that their issuance to assist nonpublic educational facilities requires an amendment to Article X, section 1, constitutes some precedence and may be viewed by a court as persuasive evidence of intent, or at least acceptance, that special purpose revenue bonds constitute “public funds.” However, the Hawaii Association of Independent Schools (hereafter referred to as HAIS) contends that the attorney general’s conclusion is in error and that “there is a wealth of state and federal case law that suggest that the issuance of revenue bonds to a private entity does not constitute the use of public funds.”²⁷ HAIS takes the position that the issuance of special purpose revenue bonds constitutes neither an appropriation by the State nor the use of public funds. If this were so, the issuance of such bonds to assist private educational institutions would not violate Article X, section 1, and no amendment to the provision would be required.

The controlling Hawaii case with respect to interpreting the framers’ purpose or intent behind Article IX, section 1, of the Hawaii Constitution is *Spears v. Honda*,²⁸ in which the Hawaii Supreme Court ruled unconstitutional provisions that authorized subsidies to private and sectarian school students for their bus transportation to and from school.²⁹ Article X, section 1 was originally enacted as Article IX, section 1 by the Constitutional Convention of 1950.³⁰ The Hawaii court found that the intent of the framers of the State Constitution was “clear” from the proceedings of the Constitutional Convention of 1950, noting that the Committee on Education’s report presenting Article IX to the Committee of the Whole was “permeated with a strong recognition of the importance and unique function of public education in a democratic state, as compared with nonpublic education.”³¹ Furthermore, the court found evidence in the debate of the Committee of the Whole concerning Article IX, section 1, that an appropriation for free bus transportation for nonpublic school children was “exactly” the type of public aid that the framers desired to prohibit.³²

The Hawaii court dismissed a Louisiana case interpreting similar language in the Louisiana Constitution, which upheld an appropriation of public funds to purchase textbooks for all children, declaring the Louisiana decision to be “of no relevance in interpreting our own Constitution.”³³ The court concluded that the framers of Hawaii’s Constitution had already debated this issue and had declined to grant the legislature the “power to authorize funds for

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27. Letter from Ethan Jones, HAIS, to Keith Fukumoto, Researcher, Legislative Reference Bureau, July 25, 2000 at 4 (emphasis supplied) [hereinafter cited as HAIS, Jones letter].
 28. 51 Haw. 1, 449 P.2d 130 (1968).
 29. See *id.* at 2-4 & 15.
 30. See notes 17-18 in Chapter 7 and accompanying text.
 31. 51 Haw. at 7, citing Standing Committee Report No. 52, The Proceedings of the Constitutional Convention of Hawaii, Vol. I, 201-06 (1950) (emphasis added).
 32. See note 43-44 in Chapter 7 and accompanying text.
 33. The Hawaii court emphasized that the Louisiana decision revealed nothing about whether that state’s experience with regard to public and private education, at the time of the adoption of its constitution, was similar to Hawaii’s. 51 Haw. at 10-11.

programs of public welfare benefiting nonpublic school children,” including the provision of textbooks or bus transportation.³⁴

On the other hand, the Hawaii court found “highly relevant” *Matthews v. Quinton*,³⁵ in which the Alaska Supreme Court had ruled that the free bus transportation for nonpublic school children violated the Alaska Constitution because it provided a “direct benefit” to nonpublic schools.³⁶ The Alaska court had concluded that the bus transportation program, because it induced attendance at nonpublic schools and promoted their interests, “help[ed] build up, strengthen and make successful the schools as organizations.”³⁷ The Hawaii court maintained that this was “precisely the kind of reasoning” that had “motivated” the framers of the Hawaii Constitution in “approving the prohibition against ‘support or benefit’ of nonpublic educational institutions.”³⁸

The Hawaii court concluded that:

As pointed out by the discussion ... of the historical bases of our Constitution, *this State has tied its own hands regarding appropriations for the “support or benefit” of nonpublic schools.* Regardless of the presumption in favor of the validity of the Legislature’s actions, *where the Legislature has not been granted the power by the people, under the state constitution, to pass certain legislation, it cannot validly pass such legislation.* Rather the Legislature must return to the people to ask them to decide whether their State Constitution should be amended to grant the Legislature the power it seeks, in this case, the power to provide “support or benefit” to nonpublic schools....

The Hawaii court in *Spears* found the intent of the framers of Article IX, section 1, to be “clear-cut” and the language of the constitutional prohibition on public aid to nonpublic educational institutions to be “unequivocal.”³⁹ Its decision also clearly indicated the court felt constrained to follow the unequivocal intent of Hawaii’s constitution, thus according little weight to the decisions in other jurisdictions. Given the court’s forceful pronouncement that the State has “*totally denied itself the power to make appropriations aiding private and sectarian schools*

34. *Id.* at 11.

35. 362 P.2d 932 (Alaska 1961), appeal dismissed, 368 U.S. 517 (1962).

36. See 51 Haw. at 12. In comparing the Hawaii Constitution with that of Alaska’s, the Hawaii Court noted that the wording of the former “is even more stringent in that it makes no distinction between ‘direct’ and ‘indirect’ benefits and continues the [Hawaii] Organic Act proscription against ‘the support or benefit’ of nonpublic educational institutions.” *Id.* at 11.

37. See 51 Haw. at 12. The Alaska Court, relying in its reasoning on *Judd v. Board of Education*, 278 N.Y. 200, 15 N.E.2d 576 (1938), also noted that “[w]ithout pupils there could be no school.” 362 P.2d at 935.

38. 51 Haw. at 12-13. The court asserted:

The mechanics of the bus subsidy program at issue indicates that the fears of the framers were well-founded. The subsidy does “build up, strengthen and make successful” the nonpublic schools.... Also, ... the subsidy induces attendance at nonpublic schools, where the school children are exposed to a curriculum that in many cases, if not generally, promotes the special interests and biases of the nonpublic group that controls the school. Finally, to the extent that the State pays out funds to carriers owned by the nonpublic schools or agents thereof, the State is giving tangible “support or benefit” to such schools.

39. See notes 28 and 34 in Chapter 7 and accompanying text.

under Article IX, Section I” and its conclusion that “where the Legislature has not been granted the power by the people, under the state constitution, to pass certain legislation, it cannot validly pass such legislation,” it would appear that any aid to nonpublic educational institutions would be suspect. There remains to be determined, however, whether the issuance of special purpose revenue bonds constitute “public funds.”

The attorney general has reiterated the position that special purpose revenue bonds are “public funds” in an advisory letter to the Bureau. (See Appendix C). The attorney general cites two reasons in support of its contention that special purpose revenue bonds are “public funds” as the term is used in Article X, section 1 of the State Constitution:

- (1) Special purpose revenue bonds are a form of public aid contrary to the purpose of Article X, section 1; and
- (2) Special purpose revenue bonds constitute public funds to permit the bond proceeds to be loaned by the department of budget and finance to the special purpose entity.⁴⁰

The attorney general also emphasizes the State’s involvement with special purpose revenue bonds: the legislature must first authorize the issuance of the bonds; the director of finance issues the bonds, collects the proceeds, and loans the proceeds to the special purpose entity; and the special purpose entity is obligated to the State to pay the principal and interest on the bonds. Accordingly, the attorney general maintains that, “since the special purpose revenue bond proceeds are receipts of the State, we believe that an appropriation is implied in the legislative authorizations of special purpose revenue bonds to permit the ... bond proceeds, which are public moneys, to be loaned to the special purpose entity.”⁴¹ As chief legal officer of the State, the attorney general’s opinion is entitled to some weight.

HAIS maintains that for the issuance of special purpose revenue bonds to be in violation of Article X, section 1, “either the legislature must appropriate a specific sum of money from a designated fund or it must impose an obligation upon the state to the benefit of a sectarian or private institution.”⁴² HAIS contends that special purpose revenue bonds would not impose an obligation upon the State because the issue of such bonds would be strictly limited to the revenues of the particular institution for repayment, with the State expressly indemnified from any obligation whatsoever,” such bonds. Indeed state law, as well as the bonds themselves, make clear that such bonds are payable solely from revenues pledged to their payment and that they are not general obligations of the State and not secured directly or indirectly by the full faith and credit or the general credit of the State or by any revenues or taxes of the State.⁴³

40. Letter from Randall S. Nishiyama, Deputy Attorney General, to Wendell K. Kimura, Acting Director, Legislative Reference Bureau, December 4, 2000, at 4 [hereinafter cited as A.G. letter to Kimura] (included as Appendix C).

41. A.G. letter to Kimura at 8; A.G. letter to Say at 7-8.

42. HAIS, Witt letter, at 2.

43. See Haw. Const. art. VII, §12; Haw. Rev. Stat. §§ 39A-41, 39A-81, 39A-121, 39A-161, 39A-201, and 39A-231.

HAIS maintains that because bills to authorize the issuance of special purpose revenue bonds *do not authorize the expenditure of money by the state*, they do not constitute appropriations by the state.⁴⁴ Furthermore, in contrast to the position of the attorney general, HAIS maintains that special purpose revenue bonds have “always been a ‘special case’ and as such, these bonds are classified as ‘special obligations’ of the state or respective government agencies, reflecting the fact that the bonds are not debts of the government agency. This does not mean, however, that the proceeds of the bond must be classified as public money.”⁴⁵ In support of its contention, HAIS points to Attorney General Opinion No. 94-04 (1994) (hereafter A.G. Opinion), (dealing with the Hawaii public procurement code), in which the attorney general, finding no Hawaii case law helpful in construing the term “public funds,” looked to other courts that have “determined whether moneys owed individuals by government in other contexts are ‘public moneys’” and concluded that funds held by a state agency are not necessarily public funds. The opinion maintains that:

To be ‘public funds,’ the state must have ‘equitable’ and ‘legal’ rights to them. Navajo Tribe v. Arizona Dept. of Administration, 528 P.2d 623 (1974). A distinction must be drawn between money over which a state has control, e.g., money collected as rent from a source and use to pay an obligation owed by a state to another, which are public funds, and money which the state merely collects, holds, or disburses. McIntosh v. Aubry, 18 Cal. Rptr. 2d 680,688 (1993).⁴⁶

In view of these decisions, HAIS maintains that it is “clear” that the State does not have an “‘equitable’ or ‘legal’ claim” to funds derived from the issuance of special purpose revenue bonds. Rather, such bonds “are issued with the intent of financing a capital improvement project for private entities and are not an obligation of the State. The state merely serves as a conduit between investors and the institution that is to benefit from the issuance of the bonds.”⁴⁷ HAIS also emphasizes that no state moneys are used in connection with the administrative or implementation of the special purpose revenue bonds because state law requires the special

44. HAIS, Witt letter, at 2 (emphasis added), citing Attorney General Opinion 72-6 (1972) for the proposition that bills constitute appropriation bills “only if they authorize the expenditure of money and stipulate the amount, manner and purpose of the various items of expenditure.”

45. See HAIS, Jones letter at 3.

46. HAIS Jones letter at 6, quoting from A.G. Opinion 94-04 (1994) at 8. The opinion also cites, from the Navajo decision, the Arizona court’s summary of law from other jurisdictions indicating funds held by a state agency are not necessarily “public funds”:

Payment of funds into the state treasury does not necessarily vest the state with title to those funds. Ross v. Gross, 300 KY. 337, 188 S.W.2d 475 (1945). Only monies raised by the operation of some general law become public funds. Cvr & Evans Contracting Co. v. Graham, 2 Ariz. App. 196, 407 P.2d 385 (1965). Custodial funds are not state monies. MacManus v. Love, 499 P.2d 609 (Colo. 1972). The term “public funds” refers to funds belonging to the state and does not apply to funds for the benefit of contributors for which the state is a mere custodian or conduit. Attorney General Opinion No. 94-04 (1994) at 8 n.7, quoting from Navajo Tribe v. Arizona Dept. of Administration, 528 P.2d 623, 624-25 (1974).

47. HAIS, Witt letter at 3. HAIS further notes that it is “fundamental to any conduit tax-exempt school funding program that the revenue bonds would not constitute an appropriation of public funds.” *Id.* at 1.

purpose entity to reimburse the State for any and all costs and expenses associated with entering into any agreement concerning special purpose revenue bonds.⁴⁸

Furthermore, HAIS cites a number of authorities that suggest the issuance of tax-exempt revenue bonds to a private entity does not constitute the use of public funds.⁴⁹ HAIS also relies upon *Hunt's*⁵⁰ recognition that this type of “state aid” is of a very special sort.⁵¹ The Bureau notes that nearly half of the states permit the use of special purpose revenue bonds or some type of conduit bond to assist private educational facilities.⁵²

As a general matter, the Bureau finds these authorities persuasive on the issue that the better rule to follow would be that the issuance of special purpose revenue bonds does not involve the use of public funds. However, in *Spears*, the Hawaii court found an “unequivocal” constitutional prohibition on public aid, based upon the framers’ “clear cut” intent to ensure support of the public schools and protection from any public assistance that would “build up, strengthen and make successful the private schools” at the expense of public schools. Moreover, the present day court, if faced with the issue, may well feel constrained by *Spear's* powerful conclusion that the State has “totally denied itself the power to make appropriations aiding private and sectarian schools under Article IX, Section I” and that the legislature, lacking such power, “must return to the people to ask them to decide whether their State Constitution should be amended to grant the Legislature ... the power to provide ‘support or benefit’ to nonpublic school.”⁵³ If so, the present day court may be compelled to dismiss the decisions of other jurisdictions as irrelevant and, instead, decide the issue consistent with *Spear's* finding of the “clear” intent underlying Article X, section 1. Moreover, the legislature’s own decision to seek a constitutional amendment to Article X, section 1, to permit the issuance of special purpose revenue bonds to be used to finance or assist early childhood education care and facilities provided to the general public by not-for-profit corporations will be viewed in all likelihood as persuasive evidence of legislative recognition that “special purpose revenue bonds are considered public funds.”⁵⁴

48. See HAIS, Witt letter at 3. See generally, Haw. Rev. Stat. §§ 39A-34, 39A-74, 39A-114, 39A-154, 39A-194, and 39A-224. See also notes 5-6 in Chapter 9 and accompanying text.

49. See e.g., *California Educational Facilities Authority v. Priest*, 12 Cal. 3d 593, 526 P.2d 513, 116 Cal. Rptr. 361 (1974) (no expenditure of public funds, citing *Hunt*, 413 U.S. 734, 745, n.7 (1973)); *Minnesota Higher Education Facilities Authority v. Hawk*, 305 Minn. 97, 232 N.W.2d 106 (1975) (declaratory judgment) (not an expenditure of “public money,” relying upon *Hunt v. McNair*, 413 U.S. 734, (1973)); *Washington Health Care Facility v. Spellman*, 96 Wash. 2d 68, 633 P.2d 866 (Wash. 1981); (not public money; rather, the Authority obtains the money from a sale of bonds to private underwriters, which in turn resell to investors). Accord, *Kentucky AG Opinion 93-80* (public nature of bond issue nothing more than tax and interest advantage for bondholders; no taxpayer funds involved and city not liable on bonds); *Oklahoma AG Opinion 83-227* (where money is raised by issuance of revenue bonds, repayment does not pass through the public treasury, and bonds are not general obligations of the public instrumentality, the state or a political subdivision, such money is not “public money”).

50. 413 U.S. 734, (1973).

51. HAIS, Witt letter at 3-4 (emphasis supplied), quoting *Hunt*, 413 U.S. at 745, n.7.

52. See notes 118-119 in Chapter 7 and accompanying text.

53. See notes 50-53 in Chapter 7 and accompanying text.

54. See notes 12-13 in Chapter 7 and accompanying text.

In view of the foregoing, we have set forth a proposed amendment to Article X, section 1 of the Hawaii Constitution in the Appendix D.

Conclusion

Special purpose revenue bond financing for the benefit of private schools (including sectarian schools) would seem to be allowable under the United States Constitution, but appears to be prohibited by the present day interpretation of the Hawaii Constitution's Article X, section 1, (prohibiting appropriation of public funds for the support of any sectarian or private educational institutions) and by Article VII, section 12, (restricting issuance of special purpose revenue bonds to certain specified special purpose entities). If the Legislature wishes to implement such a program, the problems raised by the state constitution can be rectified by enactment of constitutional amendments to Article X, section 1, and Article VII, section 12. For the Legislature's convenience we have provided drafts of proposed amendment to Article X, section 1 and Article V, section 12 in the Appendix. As an alternative to a constitutional amendment to Article X, section 1, the Legislature could seek a declaratory judgment from the state supreme court as to whether special purpose revenue bond financing for the benefit of private schools constitutes an "appropriation of public funds."

Even if the legal barriers are removed, however, the fact remains that, as a practical matter, many private schools may not be sufficiently strong economically to be considered credit worthy in the bond market. Consequently, the effect may be that only those private educational institutions having the strongest asset base and most stable enrollment will be able to benefit from a special purpose revenue bond financing program. There may be alternative means by which private schools could reduce the costs of issuing special purpose revenue bonds and, in the process, fortify their credit worthiness, such as through composite issues and bond pools. It should be noted, however, that these alternatives would face the same constitutional considerations faced by conventional special purpose revenue bonds. Furthermore, while such alternatives may be more advantageous from a business point of view, the legal analysis, although not insurmountable, may be more complex because of the involvement of multiple schools.

In an effort to assist the Legislature in the event it wishes to pursue special purpose revenue bonds financing for private schools, the Bureau has drafted proposed legislation to amend Article VII, section 12, and Article X, section 1, of the Constitution of the State of Hawaii to authorize the State to issue special purpose revenue bonds, and use the proceeds from those bonds, to assist not-for-profit private and sectarian elementary schools, secondary schools, universities and colleges serving the general public, provided that eligibility for such assistance has been determined in a nondiscriminatory manner on the basis of neutral, secular criteria. This proposed legislation appears as Appendix D. The Bureau suggests that this proposed language be reviewed by the State's bond counsel to assess whether it impacts other issues not considered by the Bureau.

**Bond Issuance Techniques Used to
Assist Private Nonprofit Elementary and Secondary Schools with
Construction Projects (Rated Paper Only)**

State	Issuing Authority	Stand Alone Issue	Composite Issue	Blind/Partially Pool	Dedicated Pool	Lease-Purchase/COP	Contact Person	Telephone Number
California	City of Los Angeles	#	#	#	#	#	#	#
	California Statewide Communities Development Authority	Yes	No	No	No	Yes	Lawrence Tonomura	(800) 635-3993
Connecticut	Connecticut Health & Educational Facilities Authority	Yes	No	No	No	Yes	Michael Morris	(860) 520-4002
	City of Woodstock	#	#	#	#	#	#	#
D.C.	District of Columbia	#	#	#	#	#	#	#
Illinois	Illinois Development Finance Authority	Yes	No	No	No	Yes	Townsend Albright	(312) 627-1434
Indiana	Indiana Development Finance Authority	Yes	No	No	No	No	Courtney Tobin	(317) 233-4332
	Indianapolis Economic Development Commission	Yes	No	No	No	No	Roderick Morgan	(317) 684-5175
Kansas	Kansas Development Finance Authority	Yes	No	No	No	No	Rebecca Floyd	(785) 296-6747
Maine	Town of South Berwick	#	#	#	#	#	#	#
	Maine Finance Authority	Yes	No	No	No	No	David Markovchick	(800) 228-3734
Maryland	Maryland Health & Higher Educational Facilities Authority	Yes	Yes	Yes	No	Yes	Annette Anselmi	(410) 837-6220
	Montgomery County	#	#	#	#	#	#	#
Massachusetts	Massachusetts Development Finance Agency	Yes	No	No	No	No	Jamie Loh	(800) 445-8030
Michigan	Oakland County Economic Development Corporation	Yes	?	No	No	No	Mary Langhauser	(248) 858-0783
Minnesota	City of Hopkins	#	#	#	#	#	#	#
	City of Golden Valley	#	#	#	#	#	#	#
	County of Stearns	#	#	#	#	#	#	#
	Saint Paul Housing & Redevelopment Authority	Yes	No	No	No	No	Sean Kershaw	(651) 266-6605
Missouri	Missouri Health & Educational Facilities Authority	Yes	No	No	No	No	Michael Stanard	(636) 519-0700

State	Issuing Authority	Stand Alone Issue	Composite Issue	Blind/Partially Pool	Dedicated Pool	Lease-Purchase/COP	Contact Person	Telephone Number
New Hampshire	New Hampshire Health & Education Facilities Authority	Yes	Yes	No	No	No	David Bliss	(603) 224-0696
	New Hampshire Business Finance Authority	Yes	No	No	No	No	Andy Bonte	(603) 271-2391
	New Hampshire Municipal Bond Bank	Insuff. data	Insuff. data	Insuff. data	Insuff. data	Insuff. data	George Zoukee	(603) 271-2595
New Jersey	New Jersey Economic Development Authority	Yes	No	No	No	No	John Rosenfeld	(609) 341-2062
New Mexico	City of Albuquerque	#	#	#	#	#	#	#
New York	New York City Industrial Development Agency	Yes	No	No	Yes	No	Valerie Rutstein	(212) 312-3600
Oklahoma	Oklahoma Development Finance Authority	Yes	No	No	No	No	John Harris	(405) 842-1145
	Tulsa County Industrial Authority	*	*	*	*	*	*	*
Pennsylvania	Montgomery County Industrial Development Authority	Yes	No	No	Pending	No	Gerald Birkelbach	(610) 278-5950
	Moon Township Industrial Development Authority	Yes	No	No	No	No	Ron Stout	(412) 454-0135
	Northeastern Pennsylvania Hospital & Education Authority	Yes	No	No	No	No	John Riccetti	(570) 788-5261
Texas	Houston Higher Education Finance Corporation	Yes	No	No	No	No	Brian Crabtree	(713) 868-8397
	Harlingen Higher Education Facilities Corporation ^{SPLS}	Yes	No	No	No	No	Quentin Anderson	(956) 423-3765
Vermont	Vermont Educational & Health Buildings Financing Agency	Yes	No	No	Yes	No	Malcolm Rode	(802) 223-2717
Virginia	Madison County Industrial Development Authority	Yes	No	No	No	No	Fritz Brittain	(540) 948-3816
	Alexandria Industrial Development Authority	N/A	N/A	N/A	N/A	N/A	Paula Riley	(703) 739-3820
#	Not surveyed							
?	Not sure							
!	Unable to survey							
Insuff. data	Insufficient data: specific private school involved in "tuitioning"							
SPLS	Data for St. Paul Lutheran School only							
N/A	Not applicable; all transactions handled by Banc of America							

A BILL FOR AN ACT

RELATING TO EDUCATION.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The purpose of this Act is to propose
2 amendments to article VII, section 12, and article X, section 1,
3 of the Constitution of the State of Hawaii to authorize the
4 State to issue special purpose revenue bonds, and use the
5 proceeds from those bonds, to assist not-for-profit private and
6 sectarian elementary schools, secondary schools, universities
7 and colleges serving the general public, provided that
8 eligibility for such assistance has been determined in a
9 nondiscriminatory manner on the basis of neutral, secular
10 criteria.

11 SECTION 2. Article VII, section 12, of the Constitution of
12 the State of Hawaii is amended to read as follows:

13 **"DEFINITIONS; ISSUANCE OF INDEBTEDNESS**

14 **Section 12.** For the purposes of this article:

15 1. The term "bonds" shall include bonds, notes and other
16 instruments of indebtedness.

H.B. NO.

1 2. The term "general obligation bonds" means all bonds for
2 the payment of the principal and interest of which the full
3 faith and credit of the State or a political subdivision are
4 pledged and, unless otherwise indicated, includes reimbursable
5 general obligation bonds.

6 3. The term "net revenues" or "net user tax receipts"
7 means the revenues or receipts derived from:

8 a. A public undertaking, improvement or system remaining
9 after the costs of operation, maintenance and repair
10 of the public undertaking, improvement or system, and
11 the required payments of the principal of and interest
12 on all revenue bonds issued therefor, have been made;

13 or

14 b. Any payments or return on security under a loan
15 program or a loan thereunder, after the costs of
16 operation and administration of the loan program, and
17 the required payments of the principal of and interest
18 on all revenue bonds issued therefor, have been made.

19 4. The term "person" means an individual, firm,
20 partnership, corporation, association, cooperative or other
21 legal entity, governmental body or agency, board, bureau or

H.B. NO.

1 other instrumentality thereof, or any combination of the
2 foregoing.

3 5. The term "rates, rentals and charges" means all
4 revenues and other moneys derived from the operation or lease of
5 a public undertaking, improvement or system, or derived from any
6 payments or return on security under a loan program or a loan
7 thereunder; provided that insurance premium payments,
8 assessments and surcharges, shall constitute rates, rentals and
9 charges of a state property insurance program.

10 6. The term "reimbursable general obligation bonds" means
11 general obligation bonds issued for a public undertaking,
12 improvement or system from which revenues, or user taxes, or a
13 combination of both, may be derived for the payment of the
14 principal and interest as reimbursement to the general fund and
15 for which reimbursement is required by law, and, in the case of
16 general obligation bonds issued by the State for a political
17 subdivision, general obligation bonds for which the payment of
18 the principal and interest as reimbursement to the general fund
19 is required by law to be made from the revenue of the political
20 subdivision.

21 7. The term "revenue bonds" means all bonds payable from
22 the revenues, or user taxes, or any combination of both, of a

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1 public undertaking, improvement, system or loan program and any
2 loan made thereunder and secured as may be provided by law,
3 including a loan program to provide loans to a state property
4 insurance program providing hurricane insurance coverage to the
5 general public.

6 8. The term "special purpose revenue bonds" means all
7 bonds payable from rental or other payments made to an issuer by
8 a person pursuant to contract and secured as may be provided by
9 law.

10 9. The term "user tax" means a tax on goods or services or
11 on the consumption thereof, the receipts of which are
12 substantially derived from the consumption, use or sale of goods
13 and services in the utilization of the functions or services
14 furnished by a public undertaking, improvement or system;
15 provided that mortgage recording taxes shall constitute user
16 taxes of a state property insurance program.

17 The legislature, by a majority vote of the members to which
18 each house is entitled, shall authorize the issuance of all
19 general obligation bonds, bonds issued under special improvement
20 statutes and revenue bonds issued by or on behalf of the State
21 and shall prescribe by general law the manner and procedure for
22 such issuance. The legislature by general law shall authorize

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1 political subdivisions to issue general obligation bonds, bonds
2 issued under special improvement statutes and revenue bonds and
3 shall prescribe the manner and procedure for such issuance. All
4 such bonds issued by or on behalf of a political subdivision
5 shall be authorized by the governing body of such political
6 subdivision.

7 Special purpose revenue bonds shall only be authorized or
8 issued to finance facilities of or for, or to loan the proceeds
9 of such bonds to assist:

- 10 1. Manufacturing, processing or industrial enterprises;
- 11 2. Utilities serving the general public;
- 12 3. Health care facilities provided to the general public
13 by not-for-profit corporations;
- 14 4. Early childhood education and care facilities provided
15 to the general public by not-for-profit corporations;
16 [or]
- 17 5. Low and moderate income government housing
18 programs[,]; or
- 19 6. Not-for-profit private and sectarian elementary
20 schools, secondary schools, universities and colleges
21 serving the general public,

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1 each of which is hereinafter referred to in this paragraph as a
2 special purpose entity.

3 The legislature, by a two-thirds vote of the members to
4 which each house is entitled, may enact enabling legislation for
5 the issuance of special purpose revenue bonds separately for
6 each special purpose entity, and, by a two-thirds vote of the
7 members to which each house is entitled and by separate
8 legislative bill, may authorize the State to issue special
9 purpose revenue bonds for each single project or multi-project
10 program of each special purpose entity; provided that the
11 issuance of such special purpose revenue bonds is found to be in
12 the public interest by the legislature. The legislature may
13 enact enabling legislation to authorize political subdivisions
14 to issue special purpose revenue bonds. If so authorized, a
15 political subdivision by a two-thirds vote of the members to
16 which its governing body is entitled and by separate ordinance
17 may authorize the issuance of special purpose revenue bonds for
18 each single project or multi-project program of each special
19 purpose entity; provided that the issuance of such special
20 purpose revenue bonds is found to be in the public interest by
21 the governing body of the political subdivision. No special
22 purpose revenue bonds shall be secured directly or indirectly by

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1 the general credit of the issuer or by any revenues or taxes of
2 the issuer other than receipts derived from payments by a person
3 under contract or from any security for such contract or special
4 purpose revenue bonds and no moneys other than such receipts
5 shall be applied to the payment thereof. The governor shall
6 provide the legislature in November of each year with a report
7 on the cumulative amount of all special purpose revenue bonds
8 authorized and issued, and such other information as may be
9 necessary."

10 SECTION 3. Article X, section 1 of the Constitution of the
11 State of Hawaii is amended to read as follows:

"PUBLIC EDUCATION

13 **Section 1.** The State shall provide for the establishment,
14 support and control of a statewide system of public schools free
15 from sectarian control, a state university, public libraries and
16 such other educational institutions as may be deemed desirable,
17 including physical facilities therefor. There shall be no
18 discrimination in public educational institutions because of
19 race, religion, sex or ancestry; nor shall public funds be
20 appropriated for the support or benefit of any sectarian or
21 private educational institution, except that proceeds of special
22 purpose revenue bonds authorized or issued under section 12 of

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1 Article VII may be appropriated to finance or assist [not-for-
2 profit corporations]:

- 3 (1) Not-for-profit corporations that provide early
4 childhood education and care facilities serving the
5 general public[.]; and
6 (2) Not-for-profit private and sectarian elementary
7 schools, secondary schools, universities and colleges
8 serving the general public, provided that eligibility
9 for such assistance has been determined in a
10 nondiscriminatory manner on the basis of neutral,
11 secular criteria."

12 SECTION 4. The question to be printed on the ballot shall
13 be as follows:

14 "Shall the State be authorized to issue special purpose
15 revenue bonds, and use the proceeds from those bonds, to
16 assist not-for-profit private and sectarian elementary
17 schools, secondary schools, universities and colleges
18 serving the general public, provided that eligibility for
19 such assistance has been determined in a nondiscriminatory
20 manner on the basis of neutral, secular criteria?"

1 SECTION 5. Constitutional material to be repealed is
2 bracketed and stricken. New constitutional material is
3 underscored.

4 SECTION 6. These amendments shall take effect upon
5 compliance with article XVII, section 3, of the Constitution of
6 the State of Hawaii.

Report Title:

Constitutional Amendment, SPRBs; Private Schools

Description:

Proposes amendments to the state constitution to authorize issuance of special purpose revenue bonds and use of proceeds to assist not-for-profit private and sectarian elementary schools, secondary schools, universities and colleges serving the general public and selected in a nondiscriminatory manner on the basis of neutral, secular criteria.

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