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December 14, 1988

OPINION
OF
HAL STRATTON
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Opinion No. 88-79

By: Scott D. Spencer
Assistant Attorney General

To: Harroll H. Adams
State Auditor
PERA Building - Room 302
Santa Fe, New Mexico 87501

QUESTION:

1. Should the Board of Regents of the New Mexico Military Institute control the Board of Trustees of the New Mexico Military Institute Foundation, Inc. to avoid an illegal gift of state assets?

2. Is the New Mexico Military Institute Foundation, Inc. subject to audit by the State Auditor?

CONCLUSION:

1. No.

2. No.

ANALYSIS:

You have informed us that the New Mexico Military Institute Foundation, Inc. (Foundation) a non-profit corporation, was incorporated in 1945 pursuant to the laws of the State of New Mexico. The Foundation's purpose, pursuant to its articles of incorporation, is to create, maintain and administer an endowment fund to be used for the benefit of the New Mexico Military Institute for research, scientific and literary purposes and for increasing the building, equipment and other facilities. The endowment fund also provides for scholarships and promotes generally the growth, welfare and maintenance of the Institute.

You have advised us that you are concerned that an improper gift of land was made by the Institute to the Foundation, and that therefore, whether the Institute board should somehow take control of the Foundation Board. In 1956, the New Mexico Military Institute (Institute) agreed to sell real property, non-essential for school or educational purposes, to the Foundation for the sum of \$250,000. The contract entered into provided for the payment of \$250,000 over a period of 25 years from October 1, 1956 out of one-half of the proceeds which may be derived from the sale of certain tracts of land described in Exhibit A attached thereto, as well as any other income of the corporation.¹ The interest rate was 1%. The transaction occurred when the Foundation's Board was composed solely of the Institute's Board of Regents.

Even assuming that an illegal gift of land was made, the proper remedy would not be to shift control of the Foundation to the Institute. Rather, when public monies or assets are illegally conveyed, or they constitute an illegal donation or gratuity, the recipient must reimburse the state agency. State v. Axtell, 74 N.M. 339, 393 P.2d 451 (1964). Therefore, if it is determined that the transfer of property by the Institute to the Foundation constituted a donation or illegal gift, then the Foundation would be obligated to return it.

The Foundation is a separate corporate entity having a distinct existence apart from the Institute. You have advised that at the present time the Foundation's board consists of the five Institute Regents, ten "outsiders" and one ex-officio member. You have stated that your office has taken the position in the past that because state land has been transferred to the Foundation it is a "controlled corporation," or, in the alternative, that the transfer of land was an unconstitutional donation. We shall determine whether the conveyance to the foundation constituted an illegal gift or whether it was properly transferred.

1. First, it must be determined whether the fact that each entity had the same board of directors at the time of the alleged conveyance requires that we treat them as one. If the Foundation is found to be a mere instrumentality of the Institute, then no conveyance took place and the property continues to belong to the Institute.

1 The Foundation received ten tracts of land in the real estate transaction with the Institute. The Foundation was allowed to sell Tracts 1 through 4, inclusive, but was prohibited from selling, mortgaging or otherwise encumbering any portion of Tracts 5,6,7,8, 9 and 10.

A private corporation may be organized in such a way that it is merely an instrumentality or an agent of the state. Cf. Cole v. City of Las Cruces, 99 N.M. 302, 305, 657 P.2d 629, 632 (1983). The New Mexico Military Institute, as a state educational institution may act as an agent of the state. See New Mexico Constitution, Article XII, Section 11. Therefore, it is possible that the New Mexico Military Institute controlled the Foundation as an instrumentality and that they should be treated as one entity.

Although the New Mexico Military Institute is not a corporation, per se, the relationship between a state agency and a private corporation, by analogy, could be construed as that of parent corporation to subsidiary. In such cases the "alter ego" doctrine may be applied, so that the entities are treated as being one. See, Cole v. City of Las Cruces, supra. "To find that a subsidiary is the alter ego of the parent corporation, it must be established that the parent control is so complete as to render the subsidiary an instrumentality of the parent." Cruttenden v. Mantura, 97 N.M. 432, 434, 640 P.2d 932, 934 (1982). Several factors can be used to determine if the alter ego theory is appropriate:

- (1) The parent corporation owns all or majority of the capital stock of the subsidiary.
- (2) The parent and subsidiary corporations have common directors or officers.
- (3) The parent corporation finances the subsidiary.
- (4) The parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation.
- (5) The subsidiary has grossly inadequate capital.
- (6) The parent corporation pays the salaries or expenses or losses of the subsidiary.
- (7) The subsidiary has substantially no business except with the parent corporation or no assets except those conveyed to it by the parent corporation.
- (8) In the papers of the parent corporation, and in the statements of its officers, "the subsidiary" is referred to as such or as a department or division.

- (9) The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take direction from the parent corporation.
- (10) The formal legal requirements of the subsidiary as a separate and independent corporation are not observed.

Cruttenden v. Mantura, supra. However, all of these factors are not required to find that the subsidiary was an instrumentality of the parent. Id.

In the instant case, several of the factors are present. The Institute and Foundation, at the time of the transaction, had identical board members. Until the transaction the Foundation had no assets, and the only assets it acquired were from the Institute.

There are also several factors which are not present. According to a report entitled "Analysis of the Financial Resources of the Institutions of Higher Learning of the State of New Mexico" prepared by the Legislative Finance Committee, the Foundation the time of its incorporation "was not controlled" by the Board of Regents of the Institute.² Additionally, there are no grounds to support the conclusion that the Institute paid the salaries or expenses or losses of the Foundation, nor was the Foundation referred to as a department or division or branch of the Institute. Finally, it appears that all formal legal requirements for incorporation of the Foundation have been met and continuously observed throughout its existence. It is therefore our opinion that the Foundation is not the alter ego of the Institute.

There are no mechanisms to reconstruct what occurred 32 years ago; however, it appears that both parties received a benefit from this transaction. The Foundation received property, and in return, the Institute received money. Therefore, the fact that the board of each institution was the same does not automatically lead to the conclusion that the transaction was improper.

There is no significant proof that the dealings between the Institute and the Foundation were not conducted on an arm's length basis or that either corporation has failed to comply with

2 That report alleges that the transfer of land was not a bona fide arms-length sale because both corporations were controlled by the same board.

the formalities incident to doing business in the corporate form. There has been no showing of overreaching, nor has there been any showing that the Institute sought to affect the way the Foundation conducts its affairs.

The foregoing analysis leads us to conclude that the Foundation and Institute were separate entities and there was an arms-length conveyance of land in 1956. Thus, it must next be determined whether the conveyance constituted an illegal gift. Article IX, Section 14 of the New Mexico Constitution provides in part:

Neither the state, nor any county, school district, or municipality, except as otherwise provided in this constitution, shall directly or indirectly lend or pledge its credit, or make any donation to or in aid of any person, association or public or private corporation,...

The Institute is authorized to sell its property:

All of the said institutions, including the New Mexico military institute, shall be entitled to receive all the benefits and donations made and given to similar institutions of learning and charity in other states and territories of the United States, or from private individuals or corporations, and for the benefit of said institutions they shall have the power to buy and sell or lease or mortgage realty, and do all things that, in the opinion of the several boards, will be for the best interests of said institutions, and are in the line of its object.

Section 21-1-20:

With the exception of the 40-acre tract upon which the main portion of the buildings of the New Mexico military institute are now situated and excepting lands granted by acts of congress, the board of regents of the New Mexico military institute shall have authority and the power to sell, convey, lease or otherwise dispose of, for the benefit of the New Mexico military institute, any and all lands and property belonging to the New Mexico military institute or conveyed to the board of regents of the New Mexico military institute for the benefit of the New Mexico military institute, or conveyed to the state of New Mexico for the use and benefit of the New Mexico military institute.

Section 21-12-5

In City of Clovis v. Southwestern Public Service Co., 49 N.M. 270, 161 P.2d 878 (1945) the New Mexico Supreme Court addressed the constitutionality of municipality entering into a contract for the sale of property to a private company. This case arose out of the sale by the City of Clovis of its utilities properties to New Mexico Utilities Company. It was argued on appeal that the contract violated Article IX, Section 14 of the New Mexico Constitution in that the City lent its credit and made a donation to, and in aid of, Southwestern Public Service Company.

The Court ultimately held that the contract between the City and the New Mexico Utilities Company did not constitute the lending or pledging of credit by the City within the constitutional prohibition because:

The debts and liabilities of the City, and the burden on its taxpayers, were not increased. By such transaction it did not thereby become surety for, or guarantee the payment of, anything for which the utilities might have been liable to third persons. The credit, the ability to pay, there involved was no more than, and involved only, the credit of the utility company whereby it drew upon its credit in agreement to pay the City, and whereby it pledged its credit to the City, to assure such payment.

City of Clovis, supra, at p. 275. The Court also held that because there was no intention by the parties to pay interest there could have been no donation of such obligation. Id., at p. 282. Based upon this holding, the fact that the contract for sale of the Institute's property required payment of interest at one percent per year or was to be paid off in installments does not, in and of itself, violate Article IX, Section 14.

This office has held that the amount obtained for the sale of any state property must bear a reasonable relationship to its actual value. Cf. 1966-67 Opinion of the Attorney General No. 67-149. Information you have provided to us suggests that the \$250,000.00 contract price bears a sufficient relationship to the actual value of the property. It is our opinion, therefore, that the conveyance of property to the Foundation was not a violation of Article IX, Section 14.

In conclusion, we hold that there was a proper conveyance of property from the Institute to the Foundation. We further hold that the conveyance of property for the sale price of

\$250,000.00 did not violate Article IX, Section 14 of the New Mexico Constitution.

2. The second question raised is whether the New Mexico Military Institute Foundation, Inc. is subject to audit by the State Auditor. For the following reasons we conclude that it is not.

Section 12-6-3 NMSA 1978 provides:

A. The financial affairs of every agency shall be thoroughly examined and audited each year by the state auditor, personnel of his office designated by him or by independent auditors approved by him. The audits shall be conducted in accordance with generally accepted auditing standards.

B. In addition to the annual audit, the state auditor may cause the financial affairs and transactions of an agency to be audited in whole or in part.

Section 12-6-2 NMSA 1978 provides:

"[A]gency means any department, institution, board, bureau, court, commission, district or committee of the government of the state, including district courts, magistrate courts, district attorneys and charitable institutions for which appropriations are made by the legislature....

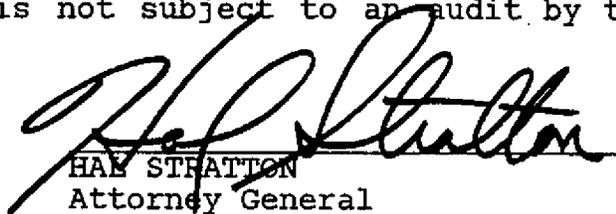
Attorney General Opinion No. 87-65 analyzed these sections and opined that the Audit Act, Sections 12-6-1 to 12-6-14 NMSA 1978, should be construed liberally to apply to a wide range of public entities, and "that the legislature intended the Act to apply to all local public bodies that handle public funds and that this term [agency] be given a very broad interpretation." Id.

However, even with an expansive interpretation of the term "agency", it is our opinion that the Foundation does not fall within this definition. The Foundation does not receive public funding, but rather, it relies on revenues from rental property, investments and private contributions for its operation. Moreover, unless the Foundation is under state control, which we have determined that it is not, it cannot receive appropriations from the legislature. Article IV, Section 31 of the New Mexico Constitution provides:

No appropriation shall be made for charitable, educational or other benevolent purposes to any

person, corporation, association, institution or community, not under the absolute control of the state...

We hold, therefore, that the Foundation does not fall within the purview of the Audit Act and is not subject to an audit by the State Auditor.


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