

OPINION
66-134

January 17, 1966 (OPINION)

Mr. George M. Thompson, Investment Director

The Bank of North Dakota

RE: Investment Board - Investment of Funds - Equipment Trust Certifi

This is in response to your letter in which you make reference to a pamphlet prepared by Salomon Brothers & Hutzler on "Equipment Trust Certificates." You then ask for an opinion whether or not the "Equipment Trust Certificates" described therein come within the provisions of Section 21-10-07 of the North Dakota Century Code, as enacted by Chapter 205 of the 1963 Session Laws.

The specific statutory provision sets forth the types of securities in which the Investment Board may invest certain moneys. The pertinent provision as pertaining to your question can be found in Subsections 8 and 9 of said section. Subsection 8 provides as follows:

8. Short term commercial and finance company paper traded on a national basis and issued by a corporation having a record of no default of obligations during the ten years preceding such investment and whose net income available for fixed charges for a period of five fiscal years immediately preceding such investment and during the last year of such period, shall have averaged per year not less than one and one-half times its average annual fixed charges applicable to such period; * * *."

Subsection 9 provides as follows:

9. Bonds, notes or debentures of any corporation duly incorporated under the laws of any state of the United States rated as 'A' or higher by a national recognized rating service approved by the board; * * *."

The question is whether or not the "Equipment Trust Certificates" constitute a bond, note or debenture as such terms are found in the statutory provision stated above. This might be further narrowed to the question whether or not the instrument referred to constitutes a debenture. The terms as used in the North Dakota statutes are not works of art.

The term "Debenture" has been judicially defined in 19 C.J.S., <1146, Page 723, as follows:

DEBENTURES. a corporate debenture represents and acknowledges an unsecured or secured debt of the corporation. It is difficult to distinguish from a corporate bond, and the designation of a corporate instrument as a debenture does not

necessarily determine its character.

"Debenture issues in this country are of comparatively recent use. While most commonly employed by industrial corporations, public utility holding companies and other investment and finance corporations have in recent years employed them to an increasing extent."

The United States Document Stamp Tax Act imposed a tax on bonds of indebtedness: "* * * on all bonds, debentures, or certificates of indebtedness issued by any person * * * known generally as corporate securities * * *." This provision was under consideration by the U.S. Supreme Court in the case of Ephrain Lederer vs. Fidelity Trust Co., 69 L. ed. 494. The Court held that certificates representing the interests of subscribers to a railroad equipment trust which are to be paid out of rentals for the equipment are corporate securities. The transaction therein was somewhat similar to the transactions described in the pamphlet you submitted to us entitled "Equipment Trust Certificates."

Similarly, the U.S. Supreme Court in U.S. vs. Leslie Salt Company, 100 L.ed. 441, had under consideration a similar trust program under a similar statute which was then designated as 26 U.S.C. 1801. The Court likewise concluded that such trust certificates were subject to the tax provision on the basis that they constituted a corporate security. The Court specifically stated that the debentures and certificates of indebtedness, along with other kinds of corporate securities, have been subject to the Stamp Tax Act. The Court observed that promissory notes, debentures, and certificates of indebtedness all serve the same purpose, i.e., that all evidence a debt.

The Court had under consideration a similar program in Sharon Stell Corp. vs. U.S., 139 Fed. Supp., 414. It there held that a note evidencing a loan of six million dollars by a life insurance company to the corporation for its business was subject to the documentary stamp tax as a debenture in view of the restrictions placed on activities of borrowers and indicates that loan was made as an investment and would be liquidated from long term realization of capital investment.

Another Court in Pennsylvania Co. for Insurance on Lives and Grant Annuities vs. Rothensies, Collector of Internal Revenue, 146 Fed. 2d. 148, held that the "Philadelphia Car Trust Plan" was subject to the documentary stamp tax, which imposed tax on bonds, debentures, or certificates of indebtedness. The Court had under consideration the federal statute which was referred to earlier above.

The federal statute which has been designated as 26 U.S.C.A., 4381, was repealed by P.L. 89-44, June 21, 1965, but this has no material effect on the conclusions reached herein.

The material portion of the federal statute as to the terms used therein is similar to the terms found in Subsection 9, quoted herein, and the meaning judicially ascribed thereto would apply here.

It is our opinion that "Equipment Trust Certificates" constitute

debentures as that term is used in Section 21-10-07 of the North Dakota Century Code.

We have also examined the program in which a conditional sales contract is entered into between the railroad and the maker in which the title of the property remains in the maker until paid for and a further agreement is entered into between an agent and investors who agree to provide the necessary money to make the periodic payments on the equipment and, as a result of such agreement, the title to the property is assigned to the agent under a separate assignment to be held in trust for the investors, the maker, and railroad pursuant to the conditions of the sales contract and the investors, whereupon certificates are issued by the railroad company acknowledging its indebtedness.

The conditional sales contract is assigned by a specific agreement and assignment, including the various trust relationships between the railroad and maker, or manufacturer. Under this program, the railroad is not required to make an initial down payment of twenty per cent or to provide an initial investment of twenty per cent as required under the "Philadelphia Car Trust Plan."

In direct response to your questions whether or not the railroad conditional sales contracts, together with the various agreements and assignments, are programs in which the Investment Board may periodically invest certain funds, it is our opinion that such program being, in effect, a modified form of debenture or a modification of the "Philadelphia Car Trust Plan", is one in which the Board may legally make investments.

HELGI JOHANNESON

Attorney General