2000

Ezra J. Fjeldsted v. Ogden City, A Municipal Corporation; Ora Bundy, W.J. Rackham, and Fred E. Williams as City Commissioners of said City; Hever J. Heiner, City Treasurer of said City; and J.C. Littlefield, City Recorder of said City : Brief of Petitioner

Utah Supreme Court

UTAH SUPREME COURT

BRIEF

In the Supreme Court
of the State of Utah

January Term—1933

EZRA J. FJELDSTED,

Plaintiff;

vs.

OGDEN CITY, A Municipal Corporation; ORA BUNDY, W. J. RACKHAM, and FRED E. WILLIAMS as City Commissioners of said City; HEBER J. HEINER, City Treasurer of said City; and J. C. LITTLEFIELD, City Recorder of said City,

Defendants.

PETITIONER'S BRIEF

STATEMENT

Counsel for defendants has, with commendable frankness, stated the facts as strongly against defendants as is permissable from the pleadings. It is, therefore, not necessary, as we view it, to make any further statement of the case.

The principal issue raised by the pleadings is correctly set forth in Counsel's brief at page 7 as follows:

> "If the proposed bond issue is subject to the Constitutional provisions imposing limitations upon the power of Cities of the second class as to issuance of bonds or incurrence of indebtedness, or to the provisions of the budget laws, the ordinance is

> void, the city commissioners have exceeded their powers and the writ requested should be made permanent."

We shall attempt to treat this subject in the same order as Counsel for defendant leaving for final discussion the so-called "technical objections."

ARGUMENT

I

"Has a Utah municipality power, under statute or otherwise, to authorize the issuance of bonds as contemplated? It is to be observed that Ogden City intends to issue bonds in the sum of $645,000.00, and sell the same for the purpose of obtaining funds to improve its water works system. Chap. 25, Laws Utah, 1917, Secs. 792-794, as amended, is the only statutory provision expressly authorizing the city to issue bonds for that purpose. Defendant concedes, as he must, that the attempted issuance of bonds does not come within these provisions, hence the same may be excluded from further consideration.

Counsel says, however, that Sec. 570X2, 570X6, and 570X75 gives cities either express power to issue these bonds, or if not there is implied power granted therein. This calls for a careful analysis of these provisions. Sec. 570X2 gives cities power to appropriate money for corporate purposes only, and to provide for payment of its debts. The powers therein granted authorize a City to appropriate from its general fund money for corporate purposes only, and to provide for payment of its debts from the same source. The power to purchase property, to improve the same and do all other things in relation thereto as a nat-

ural person also implies the use of money collected by it from general taxes. In other words, this section authorizes the expenditure of its general fund for specific purposes, but nothing is said about borrowing money or issuing bonds. Such power cannot be implied from a power to purchase property. Van Eaton vs. Sidney, 231 NW 4757.

Sec. 570X6 authorizes a city to borrow money *on the credit of the corporation* for corporate purposes in the manner and extent allowed by the constitution and laws and to issue warrants and bonds therefore, and further provides for the payment of interest and sinking funds.

This statute is passed pursuant to Secs. 3 and 4, Art. 14, of the constitution of Utah, expressly conferring authority to incur an indebtedness within the limitations therein prescribed. It is to be observed that this section authorizes the city to borrow money *on the credit of the corporation.* This means that a City is given power to borrow money when it pledges its general credit to pay the same. In this case counsel contends that the city is not borrowing money *on its general credit,* therefore he is not bringing himself within the provisions of this section. Defendant cannot be heard to say that section 570X6 authorizes the borrowing of money in excess of the taxes for the current year and the issuance of bonds therefore when the credit of the corporation is not given as an assurance of payment. This section authorizes the borrowing of money and the issuance of bonds provided it is *on the credit of the corporation* and the same is not in excess of the taxes for the current year, or if in excess, that the same has been authorized by vote of the taxpayers.

Sec. 570X75 authorizes the purchase or construction of water works. There is, however, no provision for borrowing money or issuing bonds. Therefore, this section only grants the power to purchase and no doubt carries the implied power to use the general funds of the city to pay for the same, or to issue bonds in accordance with Secs. 792-794, but the mere power to purchase does not give the power to incur an indebtedness in excess of the general revenue, nor to issue bonds.

McQuillan 2nd edition, volume 6, Sec. 2436 says:

> "In considering the legality of a proposed bond issue, courts construe the constitution and statutes more strictly than they are construed in determining the validiy of bonds already issued and disposed of."

Sec. 2437 says:

> "If inherent power to issue does not exist a municipality may issue bonds only when duly empowered."

Sec. 2437 says:

> "At present it is the law in most of the states and in the Supreme Court of the United States that municipal corporations have no power to issue bonds unless expressly authorized so to do."

And that page 138 the authority says:

> "Moreover it is usually held that authority to issue bonds can be conferred only by language which leaves no reasonable doubt of an intention to grant it and if the intention of a statute purporting to authorize the issuance of bonds is doubtful, the doubt will be resolved against the authority to issue bonds.

And Sec. 2443 says:

> "Limitations as to indebtedness usually apply to bond issues and when they do to validate the bonds they must be observed."

While there are many cases cited we might call attention to the following: Van Eaton vs. Town of Sidney, 231 N. M. 475, 71 A. L. R. 802. Mote vs. Carlisle, 233 N. W. 695. Christensen vs. Town of Kimballton, 236 N. W. 406.

Express power to purchase property does not include the power to issue bonds. Hazel Hurst vs. Mayes, 51 S. 890. See also 44 C. J. 1177, Sec. 4141. Kaw Valley District vs. Kansas City, 239 Pac. 760. The power to borrow money does not grant the power to issue bonds. Brenham vs. German, American bank, 144 U. S. 173.

Bonds cannot be issued under implied powers. Van Eaton vs. Sidney, 231 N. W. 475.

Counsel says that this court has held in the Barnes case that a city may incur such a debt, payable in such a manner without regard to limitations affecting other debts.

We submit that the Barnes case does not go to that exent. It does hold that the contract therein made did not create an indebtedness. Therefore, the constitutional prohibitations against incurring indebtedness in excess of current taxes did not apply. It logically follows that if Lehi City did not incur an indebtedness, then it did not borrow money. Therefore the question of power to borrow and issue bonds as evidence of the indebtedness did not arise in the Barnes case. Here Ogden City is borrowing money and issuing bonds. True the bonds are payable out of a special fund, but the city, nevertheless, is borrowing money and issuing bonds. Unfortunately the Barnes case does not

specifically discuss the question suggested here. It holds, in line with some other cases, that the act therein attempted was not in violation of the constiutional prohibitations against incurring an indebtedness in excess of current taxes without submitting the same to a vote and held that the same was not prohibited under the constitution. However, assuming that the act is not prohibited under the constitution, still the further quesion arises: Is there any power expressly or impliedly conferred to do the act in question? The Barnes case seems to assume that if not prohibited by the constitution the city has the authority to do the act, but does not refer to any provision of our statute giving the city the power to make the contract irrespective of the constitutional provision.

Counsel says page.....:

> "The constitution limits the power to incur indebtedness, but is silent as to the matter otherwise. The statutes are silent as to the extent to which such self liquidative borrowings may go. And nowhere is there to be found a provision limiting the manner in which such bonds may be issued unless it is to be found in Chap. 25, Title 16, Laws 1917."

We submit that Counsel's argument is unsound. The cases and text above cited all say it is not a question of whether the statutes limit the power, but it is rather a question as to whether the statute grants the power because admittedly a municipality has no power except as given to it by the legislature. The question here presented suggests the wisdom of that policy. Here a city is the owner of a waterworks system in which it has invested approximately $2,000,000.00. A commission of three men now propose to borrow $645,000.00 and to tie up the income from all the

property for years in advance, use the entire income to pay off the $645,000.00, increase the rates, force the city to pay the outstanding bonded indebtedness of one and a half million dollars from general tax-action without realizing a dollar from the income of the system to pay the same. We respectfully submit that the legislature never intended to vest such powers in the hands of two of its three commissioners and unless such power can be found in the statutes the same cannot be authorized.

II

"Is the contemplated improvement one of a character which warrants application of the rule that self liquidating bonds are not within the scope of constitutional and statutory limitations."

We agree with counsel that the Barnes case would seem to be decisive of this question against the contention of petitioner. However, we desire to discuss the question in the light of some recent decisions. The case of Garrett vs. Swanton, 13[illegible] P. 2nd 725 and cases therein cited recognize the familiar rule contended for by defendant and adopted by this court in the Barnes case:

> "That where the indebtedness or liability is made payable solely out of a specified fund created entirely from the income of the water system, and is not a general obligation of the city, the constitutional provision has not been violated."

And then holds that this same doctrine prevails in California. California is not, as asserted by counsel, committed to the minority rule respecting the so-called "Special Fund Doctrine," but the court then proceeds to limit

the "Special Fund Doctrine" and calls attention to the fact that there are at least two well settled limitations or exceptions to this doctrine.

> (a) "A municipality incurs an indebtedness or liability when by the terms of the transaction it is obligated directly or indirectly to feed the special fund from the general *or other revenues* in addition to those arising solely from the specific improvement contemplated."
>
> (b) "That a municipality incurs an indebtedness or liability when by the terms of the transaction the municipality may suffer a loss if the special fund is not sufficient to pay the obligation incurred."

The court approved these limitations and held that the contract involved came within either or both. The facts of that case seem to be in point. The City of Santa Cruz owned its own water works system acquired with money raised from the sale of its own water works bonds. Part of these bonds are still outstanding and constitute a general obligation of the City. All monies collected from the operation of the water works system are placed in a special fund. An ordinance provides that the fund is to be used exclusively for the operation, maintenance, construction, improvement, extension, enlargement and up keep of the water system, and for the payment of any bonded indebtedness now existing or which may be hereafter created for the operation, maintenance, etc., of the system.

Up to this point the cases appear to be identical, the only difference we perceive is the one suggested by counsel that the ordinance therein provided for the application of the fund to the payment of bonded indebtedness incur-

red for acquiring the system, while the Ogden ordinance appears to leave it to the discretion of the commission whether or not the funds are so applied. But we regard the attempted distinction as immaterial to the point involved because if the fund is not used directly to pay the bonded indebtedness it is turned into the general fund and money taken from the general fund to pay the interest and create the sinking fund to meet the bonded indebtedness. The same result is accomplished, one by direct and the other by indirect action. (At this point it might be well to state parenthetically that Sec. 794 as amended by Chap. 63 laws, 1925, seems to contemplate that while the bonds are general obligations imposing a duty on the commission to levy a tax to pay the same, yet rates may be charged sufficient to pay the operating charges and the bonded indebtedness. In other words this amendment authorizes the commission to use the proceeds from the system to pay the bonded indebtedness even though the bonds constitute a general obligation.)

The California court observes that it is not only the income earned by the property purchased that constitutes the special fund from which the payments are to be made, but the income from the entire system which creates such special fund. Hence the court concludes that while directly the contract provides that payments from this fund shall not constitue a general obligation indirectly such contract does create a general liability, because if the fund be depleted by payments to Fairbanks Morse & Company for the pumping plant the fund created for the payment of interest and principal on the bonds will be depleted and since such bonds are a general obligation, the taxpayers must at all

times be ready to feed the special fund if the income is not sufficient to pay the contract and the bonds. Therefore the taxpayers became indirectly liable to pay this obligation.

The court concludes that if the "Special Fund Doctrine" is extended to such a case the subterfuge would go far to effectually wipe out the purpose and intent of the constitutional provision. The court then proceeds to cite cases supporting the rule and dismisses any attempt to distinguish from the cases cited because of the provisions of the ordinance and concludes the argument with the following notation from the Wilder vs. Murphy case.

> "The contract in question requires the use of the earnings of the entire property. In Bell vs. City of Fayette, supra, the court said, "It will be noted that the distinction is whether any other property of the city is liable for the payments or whether the purchase price of such improvements is to be paid for wholly out of the earnings of the improvement" and then says: The logic of these cases, and of the case cited by the Federal Circuit Court seems unescapable. The contract here involved is not payable solely from the income of the improvement contemplated, but is payable from the revenues of the entire water system. Part of those revenues can, and in fact must be applied to the payment of the interest and principal on the bonds which is a general obligation of the city."

If the attempted distinction arising from the ordinance is of any importance the subsequent cases referred to, as well as the cases cited in the Garrett case cannot be distinguished because of any provision in the ordinance.

An interesting situation prevails in North Dakota. In the case of Lang vs. Cavalier, 228 N. W. 819, decided Jan.

15, 1930, the court adopted the so-called majority rule and held that a contract to purchase a plant and pay for the same out of its revenues was not prohibited by the constitution. Then in the case of Hess vs. Watertown, 232 N. W. 53, decided Sept. 22, 1930, the court, just as in California, limited the doctrine and held that proposed bonds for addition to existing municipal electric plant payable from revenues of the entire plant issued without election was invalid. The case carefully distinguishes it from the Lang case and reviews the authorities very carefully. The facts in the Hess case seem to be identical as are also the facts in the Federal case cited in the Garrett case (55 Fed. 2nd 560). It is further interesting to note that in the Barnes case reference is made to the case of Kosch vs. Miller, 135 N. E. 813. This case seems to recognize the limitation heretofore referred to because it discusses some cases and then distinguishes them on the principal that here they were only pledging the revenues received exclusively from the improvement while in the other cases cited, the obligation was made a lien on the property of the municipality. And the case of the City of Joliet, 62 N. E. 861, referred to, clearly recognizes this distinction; while the city there mortgaged its existing water works, a condition not found in the Ogden case; it also pledged the whole of its income and on this latter question the court says:

> "In addition to mortgaging the existing system, the ordinance proposes to take the income now derived from it, amounting to about $10,000.00 a year, and devote it to the payment of the certificates. This is existing property and income of the city derived annually from the present system of waterworks, independent of the extension, and in no manner resulting fro mor depending upon it. The City

> is to lose property in the form of established income for the purpose of paying the certificates.

This same distinction is clearly recognized in the recent case of Bell vs. Fayette, 28 S. W. 2nd 356. The court says:

> "Test whether city's contract for purchase of machinery is within constitutional limitations of indebtedness, is whether price is to be paid wholly out of earnings on the improvement or otherwise."

Counsel for defendant admits that the facts of these cases fit our case with respect to inability of the city to segregate the income of the contemplated inprovement from the balance of the system, and also that for the past six years the revenue from the system, as now constituted, has produced net revenue of from $55,000.00 to $90,000.00 per year which sum can be, and under the provisions of Chapter 63, laws 1925, should be applied to the payment of interest and principal on the bonds.

We frankly admit that it would appear from reading the Barnes case that the equipment purchased was to extend and improve a present plant, rather than to construct a new plant. In other words, that the Barnes case should have come within the limitation now urged by us. However, the writer has read all of the cases cited in the Barnes case and has carefully studied the Barnes opinion, and after doing so has come to the conclusion that this so called limitation of the "Special Fund Doctrine" was not called to the attention of its court and not considered by it at that time. In practically all of the cases cited the facts did not bring the case within the limitation contended for, or, like the Barnes case, does not discuss these limitations. Therefore, we feel justified in saying that no doubt

this phase of the question was never suggested to this court. About the only case cited which does seem to discuss this question is the case of Bolling Green vs. Kirby, 295 SW 1004. It is interesting to note that most of the cases which have limited the doctrine have been decided since the Barnes case. This is particularly true of the California, North Dakota and Federal cases. If this court feels, as the California and North Dakota courts, that the "logic of these cases seems unescapable" then it should not hesitate to place this limitation upon the "Special Fund Doctrine" broadly approved in the Barnes case. We believe that the courts, as expressed in these recent decisions, are finding it necessary to limit this doctrine. We desire to be of assistance to this court in presenting this matter and so we desire to state frankly that Colorado has recently been asked to adopt the California and North Dakota doctrine, but has refused to do so. See Searle vs. Town of Hartun, 271 Pac. 630. This case attempts to distinguish between a pledge of the property and a pledge of the income. We submit that the distinction is one of degree only but on principle there can be no distinction because both are property belonging to the city and it ought to make no difference whether one or both is pledged, in either case it constitutes an indirect obligation. We appreciate the fact that courts are reluctant to overrule prior decisions, however, we do not think this is necessary to sustain our position. The Barnes case may be good law in so far as it applies to the general proposition accepting the Special Fund Doctrine and after all that is what was intended by that decision, but the effect of this decision should be limited to those cases where the entire proceeds from the

improvement can be segregated and applied to liquidation of the indebtedness and not extended to cases like the present. We might cite a few additional cases principally for the value of their argument against this authority: Cachary vs. Wagoner, 292 Pac. 345; Miller vs. City of Buhl, 284 Pac. 834. We believe that the foregoing authorities pretty well covers the field so far as our investigation has disclosed.

III

"So called technical objections."

At this point permit us to state frankly that these so called technical objections have been suggested by approving bond attorneys, including counsel for R. F. C. and for that reason it is desired that this court expressly approve or disapprove these various objections in order to settle the matter, not only for the benefit of Ogden City, but other municipalities in this state which may become vitally interested in this decision. We will take up these objections in the order suggested by us in our petition, Par. 13.

(a) Assuming the city has authority to borrow $645,000.00 as proposed, and issue bonds for the same. If the issuance of these proposed bonds do not come within the provision of Section 794 as amended, because the same does not constitute a general obligation of the city, then the provisions found therein restricting the power to sell for not less than their face value does not apply. It seems to be the law that a sale by a municipality of its bonds for less than their par value is permissable when expressly authorized or not prohibited by statute or charter. Mcquillan 2nd edition, Vol. 2, Sec. 2463 44 CJ 1217 Sec. 4188.

We do not find any other prohibitation in the statute regarding sale of bonds for less than par except Sec. 794. We are therefore unable to find any authority prohibiting the sale of these bonds for less than par unless the provision of section 794 applies.

(b) The answer to this objection is similar to (a). If the contemplated bond issue is not an indebtedness within the provision of 792-794, then the provisions of Sec. 794, as amended, Chap. 63 laws 1925, requiring the levying of taxes to meet any deficiency does not apply. On the other hand if these provisions do apply, then the objection is well taken.

(c) This objection is really a further argument for the rule prescribing a limitation upon the "Special Fund Doctrine." By the terms of the ordinance Ogden City agrees to pay into this fund a reasonable value of all water used by it. This money will come from the general fund and thereby indirectly creates a liability against the city and constitutes *other revenues* from which the fund is payable, because before the contemplated improvement the income was paid into the general fund. Now the city obligates itself to take money from its general fund to pay for water used by it. Clearly other property of the city is thereby rendered liable for the payment of the bond and *other revenues*, in addition to those arising from the improvement, contemplated, is used to pay for the improvements.

(d) This calls for a construction of Art. 13, Sec. 1 of the constitution which provides as follows: "The fiscal year shall begin on the first day of January unless changed by the legislature." Sec. 670 provides; "The fiscal year of

cities shall commence on the first day of January." Counsel claims that this provision does not apply to cities. In this contention we think he is mistaken. Art. 13 deals with revenue and taxation. Such subject is germane to cities and this court has held that under the constitution and Sec. 670 the fiscal year of all cities begins January 1, and ends December 31. Dickenson vs. Salt Lake City, 57 Utah 530-195 Pac. 110. By Section 10 of the ordinance in question Ogden City covenants for the purpose of servicing the bonds that its fiscal year shall continue to be the same as the calendar year until all of said bonds are paid up and retired. The authority to change the fiscal year rests entirely with the legislature. Ogden City cannot bind it and clearly this provision of the ordinance is absolutely void.

(e-f-g-h) All of these objections deal with the proposition heretofore discussed. If the "Special Fund Doctrine" does not apply to the facts in this case, then clearly each of these objections are well taken. If, however, this doctrine does apply, then under the rule announced in the Barnes case, none of these objections are tenable because there is no indebtedness within the meaning of the Constitutional limitation.

(i) We submit that the city cannot pledge the net revenues of such water system unless express authority can be found authorizing or empowering the city to pledge or mortgage its property. We have searched the statutes, but can find no authority granting a city commission power to pledge property belonging to the municipalities. That such cannot be done, see Hight vs. City of Harrisonville,

41 SW 2nd 155. City of Campbell vs. Arkansas Power, 55 Fed. 2nd. 560. Van Eaton vs. Sidney, 231 NW 475. Note 71 ALR 828.

(j) This raises a question somewhat similar to that discussed under sub-division (i). Can the City by ordinance create a lien on the net revenues to be subsequently earned from the water system? It is our contention that there is no authority in the statutes auhorizing or empowering a Ciy to create a lien upon this fund. This is akin to pledging its property. If there is no such authority in the statute, then the City is without authority to do so, and such attempted provision in the ordinance is void.

(k) This raises the question whether or not the ordinance, together with section 162 of the Revised Ordinances (referred to in the petition) are valid. It is our position that there is no authority authorizing the city to create a special fund into which a part of its revenue shall be paid. Chapter 63, Laws of Utah 1925, provides that the revenues may be used for the payment of the bonds, but nowhere is there any provision in the statute authorizing or empowering the City Commission to create a special fund, and to place the earnings of the system into that fund.

(l) This objection is closely analagous to subdivision (c). We contend that it is further evidence of an indirect obligation to be paid out of other revenues than the income derived from thte water works system. Here again there is no express authority authorizing the City to provide for the accumulation in the special fund, as proposed, and again we say that the ordinance attempts to permit acts not authorized by legislative sanction.

(m) The statute makes no provisions as to the form of the bonds, and the question naturally arises, can a city under authority to issue bonds, issue registered bonds, coupon bonds, convertible bonds, registered coupon bonds, or is the city authorized to issue only registered bonds? For a discussion of the various kinds of bonds, see McQuillan, Vol. 6. Sec. 2423-2425. It is to be observed that the author refers to the kind of bond proposed here as an "mongrel," and says that it is not usually issued by a municipality. It seems to us that in the absence of legislative authority, a city ought not to be permitted to issue other than registered bonds, as these are the safest kind of bonds to be issued.

(n) The constitution requires cities to charge a reasonable rate for water service, Sec. 6 Art. 11. The ordinance in question purports to bind the city, in favor of the bondholders, to fix a rate sufficiently high so that the same will pay the operating and maintenance charges, the interest on the bonded indebtedness, and retire the bonds. In addition to this the city also covenants to set aside sufficient funds to create a guarantee fund for one year. If such a fund required the charging of a rate entirely out of proportion to the service rendered, it would be prohibited by the constitution. We do not believe that it was the intent of the framers of the constitution in using the term "reasonable rate" to mean that a city may incur an indebtedness without limitation to purchase or construct a water system and then make a charge sufficiently high to pay for the same in a limited number of years and call that a reasonable rate. We think the framers meant by the term "reasonable rate," a rate commensurate with that

charged by other localities, or a rate which is commensurate with the service rendered.

(o) We do not believe that the city has authority to provide in an ordinance that the same shall constitute a contract binding upon the city and subsequent administrations. The effect of this ordinance is to take from the subsequent Commission te power to control, change, or modify the provisions of the ordinance. Here again the authority must be found in the statutes. We do not find any statutory provision warranting such authority.

In conclusion, permit us to state that many of these propositions are so closely allied that it is impossible to segregate the same, and a general discussion applies to many of these obligations.

As a further ground for our contention, we desire to briefly refer to Section 6, Article 11 of the constitution which prohbits a municipal corporation from directly or indirectly leasing, selling, alienating, or disposing of any water works, water rights, etc., and providing that the same shall be preserved, maintained and operated for the benefit of the inhabitants at a reasonable charge. The ordinance in question in effect ties the hands of the administration for a long period of time. While the water works system itself is not pledged, yet the revenue derived therefrom is pledged, and the city covenants to charge a rate sufficiently high to pay all operating expenses, and interest on this bonded indebtedness, and also to retire the bonds. No one knows what that rate will be. It will obviously depend upon the amount of water consumed. It is, however,

probable that the rate will be extremely high. Is not the transaction, when viewed as a whole, in violation of section 6 of the constitution? And does not the constitution above referred to really mean that no water works system can be tied up, or the funds pledged or encumbered in the manner proposed, but rather that the same shall always be free, unencumbered and unhampered by any contracts, pledges or ordinances seeking to, indirectly, at least, handicap the inhabitants in the enjoyment of the water works system belonging to the city?

Respectfully submitted,

THATCHER and YOUNG.