

1979

Scott M. Matheson et al v. Weston E. Hamilton : Brief of Respondent

Utah Supreme Court

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SCOTT M. HAMILTON, et al.
of the State of Utah,
DAN S. BROWN, et al.
mao of the State of Utah,
ing Ownership Rights

Plaintiffs

WESTON E. HAMILTON, et al.
man of the State of Utah,
ing Ownership Rights

Defendant-Respondent

BRIEF OF RESPONDENT IN OPPOSITION TO

WRIT OF HABEAS CORPUS

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IN THE SUPREME COURT
OF THE STATE OF UTAH

SCOTT M. MATHESON, Governor)
of the State of Utah, and :
DAN S. BUSHNELL, Vice Chair-)
man of the Utah State Build- :
ing Ownership Authority,)

Plaintiffs-Petitioners)

-v-)

WESTON E. HAMILTON, Chair-)
man of the Utah State Build- :
ing Ownership Authority,)

Defendant-Respondent.)
:

Case No. 16545

BRIEF OF RESPONDENT IN OPPOSITION TO
WRIT OF MANDAMUS

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Case No. 16545

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FACTS

Defendant accepts the facts as set forth in plaintiffs' Brief, with a few additional facts added.

SB 238, creating the State Building Ownership Authority (hereinafter Authority), expressly requires the Authority to lease the facilities to be built with the bond issue to only State bodies defined as the State of Utah and any department, board, commission or agency thereof, except universities or colleges. The Authority cannot lease to any other entity whatsoever. SB 238, Section 7. The interest and principal of the bonds must be payable solely out of the rentals or lease payments received by the Authority from the State bodies. SB 238, Section 8. The Authority is mandatorily required to secure said bond issue by "a pledge and assignment of the revenues out of which that obligation shall be made payable." SB 238, Section 9 (1)(a). Nothing in any of the acts requires the Authority to give the bondholders a mortgage or a priority lien position, but the Authority may do so if it deems it advantageous. Section 15 of SB 238 provides that all property acquired or held by the Authority is declared to be "public property used for essential, public and governmental purposes and shall be exempt from taxation."

ARGUMENT

POINT I

THE PROPOSED BOND ISSUE AND FINANCING SCHEME CONTEMPLATED BY ALL THREE SENATE BILLS ARE IN VIOLATION OF THE UTAH

CONSTITUTION.

Article XIII, Section 2 of the Utah Constitution, generally prohibits the Legislature from incurring any debt unless it has provided for levying a tax annually sufficient to pay the annual interest and principal of such debt. Article XIII, Section 9 of the Utah Constitution, likewise provides that no appropriation can be made or any expenditure authorized by the Legislature, whereby the expenditure during any fiscal year would exceed the total tax then provided for by law. Article XIV, Section 1, provides that the Legislature may not incur any debt exceeding in the aggregate at any one time an amount equal to $1\frac{1}{2}$ percent of the value of the taxable property of the State. There is no dispute that the Legislature, when adopting Senate Bills 237, 238, and 321, did not levy a tax sufficient to pay for the debt contemplated by said acts, and that said debt would exceed the available revenue in the current year.

It is defendant's contention that the financing scheme set forth in Senate Bill 238, which authorizes a State Building Ownership Authority to: (1) issue bonds; (2) construct a facility which is held for essential public and governmental purposes; (3) lease to State agencies and State agencies only; (4) repay the bond proceeds from the lease rentals; and (5) generally acquire the building for the government of the State of Utah, is unconstitutional. It is an attempt by the Legislature of the State of Utah to do indirectly what it could not do directly,

as such would be a violation of the above-cited constitutional provisions. Defendant submits that a close examination of the proposed financing scheme will disclose when the substance is viewed rather than the form, that, in fact, a debt of the State of Utah has been created. Defendant also submits that the proposed lease agreements with State agencies are not lease agreements but rather cleverly disguised contracts for the purchase of buildings where the Legislature of the State of Utah is the ultimate guarantor and purchaser of said building. Defendant also submits that the Building Authority is really an instrumentality of the State and, as such, pledges the credit of the State of Utah, notwithstanding the express disclaimers by the Legislature in the statute that it is not creating a debt of the State of Utah.

Defendant submits herewith the analysis of six cases from other jurisdictions which deals with the same fact situation and statutory financing schemes as found in the present case. In every one of the six cases cited, the statutes carried express and mandatory disclaimers to the effect that: (1) a State debt was not created; (2) the bondholders could not look to the general taxing power of the State to repay the leases; and (3) nothing could be construed by a court to find that a debt of the State had been created. In all of the cases cited, that legislative disclaimer was required to be placed on the face of the bonds. In all of the cases cited, for various reasons, the courts found

said financing schemes to be in violation of their respective State constitutions which generally prohibited incurring debt in excess of percentage taxable property limitations or incurring debt without having first submitted the matter to a vote of the people.

In the case of State ex rel. Nevada Building Authority v. Hancock, 468 P.2d 333 (Nevada 1970), the Supreme Court of Nevada held that a statutory financing scheme which would be used to pay rent on buildings constructed by an independent Authority solely from legislative appropriations was unconstitutional. The express legislative disclaimer that it was not creating a general obligation of the State of Nevada is referred to in the Court's opinion at page 335. The Court held that the creation of a separate body corporate does not alter the essence of the financing scheme, and the Building Authority was part of government since it is managed by public officials and its income depended on governmental appropriations for rent. The Court noted:

"Section 8 provides, however, that rentals payable from a State agency may be derived from legislative appropriations made in each biennium or the legislature may pledge itself to make future appropriations for rent, either in full or to the extent not defrayed by revenues. These provisions are the essence of the financing scheme. The permissive word 'may', used with regard to legislative appropriations for rent cannot serve to disguise the basic character of the scheme. Without question, the legislature will appropriate the needed funds. If it did not do so, the contemplated public construction for State agency use could not proceed." At page 336.

The Nevada Supreme Court concluded that the Legislature would make the appropriations, notwithstanding the express legislative disclaimer set

set forth in the statute. .The Court stated:

"... Within the context of the public building program involved, however, it is our view that successive biennial appropriations for rent until the bonds issued by the Authority are fully retired must be considered in the same light as a legislative pledge to make future appropriations for the purpose. It is inconceivable that the legislature would default in either instance since the good faith of Nevada would not allow it... ." At page 338.

The Nevada Supreme Court also examined the "special fund" exception. This exception generally provides that revenue bonds may be issued not subject to State constitutional debt limitations if they are to be repaid from proceeds from the use of the facility constructed. This defendant submits that the special fund doctrine is not applicable when the revenues from the use of the facility do not come from nongovernmental sources, usually from private or commercial use of the facilities. This distinguishes the present case from the cases of Spence v. Utah State Agriculture College, 225 P.2d 18 (Utah 1950), and Tribe v. Salt Lake City, 540 P.2d 499 (1975), cited by plaintiffs' in their Brief as each of those cases contemplated the receipt of revenue from the general public which would offset the cost of operating and constructing the facility and repay the bond proceeds. The Nevada Supreme Court stated:

"... To the extent that such revenues are derived from a nongovernmental source, or from rentals paid by a State agency which in turn derives rent paying income from user fees, a State public debt within the meaning of the Constitution is not created... . In such a case the nongovernmental user is the debtor rather than the State." At page 337. (Citations omitted.)

In the case of State of Washington v. Yelle, 289 P.2d 355 (Washington 1955), the Washington Supreme Court held unconstitutional a statute setting up a State Building Financing Authority, as such would in effect create an installment purchase by the State of certain buildings with State money raised by taxation in excess of the constitutional debt limitation. The Court held the scheme unconstitutional. The express legislative disclaimer found in the statute authorizing the bond issue and reciting that it did not create a general obligation of the State is referred to in the opinion at page 356. The Washington Supreme Court concluded that the proposed lease arrangement was, in substance, really a purchase agreement by the State through a State instrumentality of certain buildings to get around the debt limitations in the Constitution. The Court concluded that the Building Authority did not deal at arms' length with the various State agencies; that it was statutorily required to lease to only State agencies, and the relationship was not that of an ordinary landlord and tenant. The Court examined the "special fund" doctrine and concluded that it was inevitable that to pay off the rentals, "a resort to the general taxation was necessary." The Court stated:

"We recognize the housing problem with which the State is confronted. Nevertheless, we cannot permit the exigency of the situation to override the constitutional safeguard against improvidence and the integrity of the State's economy. We cannot resort to dexterity of judicial thinking in order to assist the

State in its problem. We cannot close our eyes to what is actually being attempted. When we strip the plan down to fundamentals, we find that it is not a leasing arrangement between landlord and tenant, but the installment purchase by the State of certain buildings and facilities with State moneys raised by taxation far in excess of the constitutional limitation." At pages 361, 362.

Defendant submits that the proposed bond issue in the present case is also, in substance, a purchase agreement by the State of Utah of certain buildings which are declared to be for "public and governmental purposes" and exempt from taxation. At the conclusion of the repayment of the bonds, the buildings will revert to the State of Utah for public use. Therefore, the Legislature has done indirectly what it could not do directly--that is, create a debt in excess of available funds in the current year to purchase a building. They have also bound future Legislatures to appropriate the funds because the holders of the bonds must look to the Legislature for payment of the lease and rentals and cannot look to anyone else. The Utah statute does not even require granting the bondholders a mortgage or lien interest in the building, although under the facts in the present case, the Authority has do so by resolution.

The above-cited Yelle case drew heavily on McCutcheon v. State Building Authority, 13 N.J. 46, 97 A.2d 663 (1953), wherein the Supreme Court of the State of New Jersey held a statute creating a Building Ownership Authority violated constitutional provisions prescribing debt limitation when required to lease solely to State agencies and to repay bond

proceeds from lease rentals. The express legislative disclaimer that it was not creating a debt or obligation of the State, or pledging its faith and credit, is referred to in the opinion at 97 A.2d 663, 666. The Court stated:

"... While in form a way of providing the State with leasehold interests in building facilities for public use, in reality the design of the act is to enable the State by contracts of purchase to acquire for State use buildings possessed and constructed by the Authority by means of bond issues sustained by the State's promise to supply in the guise of rentals sufficient money to liquidate the bonds, available only through the medium of annual appropriations. And this in disregard of the constitutional debt limitation and the restraints laid by the organic law upon the appropriation process... . The legislation proceeds upon the hypothesis that the fulfillment of the project will not burden the State with a debt or liability within the constitutional sense. But in this the accent is on the external appearance rather than the substance. The label is unimportant; it is not the form but the essence that controls. It is an obvious truism that constitutional limitations may not be set at naught by indirection." At page 668.

The Court also noted in very strong language at page 666 that the proposed lease agreement was, in substance and effect, a purchase agreement of the property, and the Authority could not function were it not for the appropriation from the Legislature. This parallels the Utah statute exactly. The Court noted:

"... The Authority may 'lease' only to State departments, agencies, and instrumentalities and at a 'rental' determined by this standard. These are not leases as in the case of the Prentice Company, but contracts of purchase by the sovereign for public use; the 'rentals' constitute appropriations made by the State, not alone to provide operating expenses, but in quantum sufficient for the ultimate payment

and retirement of the bonds. A true lease rental is compensation for the use of the property, not the consideration price for its purchase." At page 669.

The significance of the New Jersey Supreme Court decision is not so much in its conclusion that the leasing device is really an installment purchase by the State or a lease agreement by the State with itself (at page 671), but in the following express language:

"The constitutional debt-limitation provision is not limited in quality and scope to debts enforceable by action. It has in view the temptation or inducement and incentive to make appropriations for 'debts' beyond the prescribed amount, unless approved by the people in the manner ordained. Moral and ethical compulsions are not to be allowed to override the constitutional safeguard against improvidence and the integrity of the State's economy." At page 671.

The Court also concluded by noting that one Legislature cannot bind a succeeding Legislature with the duty of making appropriations, as well as severely criticizing the Building Authority for attempting to discover a legal way to illegally evade the constitutional requirements. At page 673.

Defendant submits that under the above-cited case, wherein the New Jersey Supreme Court found that it was not necessary to have a "legally enforceable debt" in order to violate the spirit of their constitutional provisions on debt limitations, that the Utah Legislature has, in fact, lent the full faith of the State of Utah upon which the bondholders will surely rely to guaranty that sufficient funds will be appropriated in each session of the Legislature until the proposed 25 million dollars in

bonds are fully retired. In this regard, a debt has been created in violation of the spirit of the constitutional prohibitions on debt limitations.

In the case of State Office Bldg. Commission v. Trujillo, 46 N.M. 29, 120 P.2d 434 (1942), the Supreme Court of New Mexico held unconstitutional a Building Ownership Commission which would incur a debt to be repaid entirely from agencies utilizing the facilities. The express legislative disclaimer that a general obligation debt of the State of New Mexico was not created is referred to in the opinion at page 438. The New Mexico Supreme Court discussed in depth the development of the "special fund" doctrine within the State of New Mexico and concluded that it had no application because the "special fund" doctrine expressly requires that the monies be derived from sources other than general taxation, such as private and commercial users of the facility. The Court also, in reviewing the application of the "special fund" doctrine, noted the following regarding constitutional "debt":

"'Speaking of the term 'debt' as used in article 9, Section 12, of the State Constitution, in *Seward v. Bowers* (37 N.M. 385, 24 P.2d 253), we said: 'The idea of a 'debt' in the constitutional sense is that an obligation has arisen out of contract, express or implied, which entitles the creditor unconditionally to receive from the debtor a sum of money, which the debtor is under a legal, equitable, or moral duty to pay without regard to any future contingency.'" At page 442.

The New Mexico Supreme Court concluded that it was inevitable that to pay off the rentals, a resort to general taxation is necessary, and, therefore, the special fund doctrine could not obtain. The Court stated:

"... And, in the case of enterprises authorized by the Legislature to be embarked upon through State agencies, a particular scheme of financing will be held to be valid only where it is clearly demonstrable from the specific terms of the financing proposal itself that no tax burden or pecuniary liability of the State to appropriate or pay for the indebtedness about to be incurred will ever arise, or be looked to as security, in whole or in part, for repayment of the borrowed moneys.'" At page 445.

The New Mexico Supreme Court also dealt specifically with the express legislative disclaimer that it was not creating a debt of the State of New Mexico by stating:

"... Such expression /disclaimer of indebtedness of the State of New Mexico/ can be of no force because the basic purpose, substance and plan of the Act, and the detailed provisions looking to the accomplishment of such purpose, show differently. Such matters are for judicial and not legislative determination." At page 449. (Bracketed portion added.)

In the case of State of West Virginia ex rel. Hall v. Taylor, 178 S.E. 2d 48 (1970), the West Virginia Supreme Court held unconstitutional a statute authorizing a Building Commission to issue bonds to be repaid by renting buildings to State agencies, despite a legislative declaration that a State debt was not created. The express legislative disclaimer that it was not creating a general debt of the State of West

Virginia or pledging the credit or taxing power of the State for payment of the rentals, is referred to in the opinion at page 52. The Court, in holding that the proposed financing scheme was unconstitutional, stated that the "separate fund doctrine" could not be applied to a fund which is created and maintained, in whole or in part, by general tax revenues. They also concluded that the Court must consider the substance of a plan rather the form, and said that the financing scheme was an unconstitutional attempt to bind subsequent Legislatures to make appropriations of monies.

In the case of In re Matter of the Constitutionality of Chapter 280, Oregon Laws 1975, Martin v. Oregon Building Authority, et al., 276 Or. 135, 554 P.2d 126 (1976), the Supreme Court of Oregon held unconstitutional a Building Authority Act which would borrow funds through a bond issue to erect a building to be leased solely to State agencies, the proceeds to be repaid by lease rentals from said State agencies. Reference to the express legislative disclaimer that a general debt or obligation of the State was not being created is found at page 127 of the opinion. The Oregon Supreme Court provided a historical development of the constitutional provisions regarding debt limitation.

Generally, debt limitations were in response to heavy borrowing engaged in by many States prior to 1840. Bond proceeds were utilized to finance internal improvements, such as canals, railroads, turnpikes, enlargement of banking facilities, and to open up markets and stimulate

commerce. Following the depression of 1837, many States defaulted on their obligations during the 1840's. These embarrassments led to taxpayer adoptions of constitutional provisions designed to curb the Legislature's ability to subject tax funds to long-term obligations and debt servicing. States entering the Union in later years adopted provisions containing debt limitations. About thirty years later, States began requiring, by constitutional provisions, that local governmental entities could not incur debts above certain limitations. The predominant purpose of constitutional debt limitations was the achievement of a high degree of control over debt creation in order to forestall irresponsibly imposed tax burdens. Likewise, they were to be a protection to the people of the whole against burdensome and excessive taxation to pay for debt obligations incurred in earlier years. They were also intended to prevent exposing the sources of public revenue to potential hazard and otherwise impairing the flexibility of planning and the ability of future Legislatures to avoid a tax increase. Said debt restrictions were designed to force representatives of the people to operate the government within its means and remove the temptation to undertake projects on an "enjoy now, pay later" basis. This defendant submits that, if the present financing scheme is approved by this Court as contemplated by the Utah Legislature, then the floodgates are thrown open and the Legislature would no longer have to comply with constitutional requirements that a sufficient tax be levied to pay any debt that is incurred in the current year. This manifestly violates the spirit of Article

XIII, Sections 2 and 9, placing limitations upon the Legislature incurring debt. It would of necessity render portions of Sections 2 and 9 of Article XIII null and void.

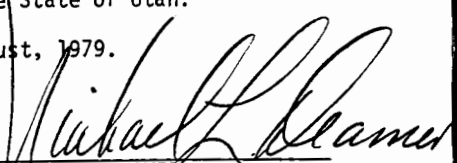
The proposed financing scheme by the Utah Legislature in the current case is one of several devices designed to skirt debt limitations. It basically divorces the borrowing function from the paying function in what is essentially one integrated transaction. That is, the borrowing power is located in the State Building Ownership Authority, and the paying function is vested in the Utah Legislature through appropriations for leases and rentals as the Oregon Supreme Court noted:

"... Use of the authority permits the discretionary incurrence of long-term obligations, which the state is in substance obligated to repay from general tax revenues, without limit and without control by the voters." At page 132.

This defendant submits that the current financing scheme to be repaid solely from rentals generated by State agencies occupying the facilities is, in fact, the creation of a obligation of the State of Utah to which the State's full faith is pledged in violation of the Utah Constitution. The proposed lease agreements are, in fact, purchase agreements whereby the State would acquire a building for essential public and governmental purposes. The Building Ownership Authority is an instrument of the State of Utah, and, as such, has entered into a contract with the State. This Court should look to the substance of the proposed financing scheme rather than the form and conclude that the Utah constitutional provisions

on debt limitations set forth in Article XIII, Section 2 and
Section 9, and Article XIV, Section 1, have in substance been violated
to the detriment of the people of the State of Utah.

DATED this 9 day of August, 1979.


MICHAEL L. DEAMER
Deputy Attorney General