49 Op. Att'y Gen. No. 3

BONDS - Lease purchase contract with "nonappropriation" clause under statute requiring election on general obligation bonds;
CITIES AND TOWNS - Lease purchase contract with "nonappropriation" clause under municipal debt limit statutes;
CITIES AND TOWNS - Lease purchase contract with "nonappropriation" clause under statute requiring election on municipal general obligation bonds;
ELECTIONS - Lease purchase contract with "nonappropriation" clause under statute requiring election on municipal general obligation bonds;
MUNICIPAL GOVERNMENT - Lease purchase contract with "nonappropriation" clause under municipal debt limit statutes;
MUNICIPAL GOVERNMENT - Lease purchase contract with "nonappropriation" clause under statute requiring election on municipal general obligation bonds;
MONTANA CODE ANNOTATED - Sections 7-1-4124, 7-7-4101, -4104, -4201, -4221, -4221(1);
MONTANA CONSTITUTION - Article XI, section 4(2);
OPINIONS OF THE ATTORNEY GENERAL - 38 Op. Att'y Gen. No. 56 (1979).

HELD:

1. A long-term lease with an option to purchase containing a provision allowing the City to terminate the agreement without penalty if the governing body of the City, in its sole discretion, fails to appropriate funds to make payments due under the lease in any fiscal year, does not create indebtedness of the City under Mont. Code Ann. § 7-7-4101 or -4201.

2. A city may enter a long-term lease with an option to purchase containing a provision allowing the City to terminate the agreement without penalty if the governing body of the City, in its sole discretion, fails to appropriate funds to make payments due under the lease in any fiscal year without first putting the question to a vote of the people under Mont. Code Ann. § 7-7-4221.

June 28, 2001

Mr. David V. Gliko
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Dear Mr. Gliko:

You have requested my opinion on two questions which I have phrased as follows:

1. Does a long-term lease with an option to purchase containing a provision allowing the City to terminate the agreement without penalty if the governing body of the City, in its sole discretion, fails to appropriate funds to make payments due under the lease in any fiscal year constitute indebtedness of the City under Mont. Code Ann. § 7-7-4101 or -4201?

2. Does such a lease agreement pledge the general credit of the City such that a vote of the City's electors would be required under Mont. Code Ann. § 7-7-4221?

Your letter informs me that the City of Great Falls is considering entering into a contract for the development and operation of a water park. The City envisions an arrangement under which the City would enter a long-term lease to a private party of certain real property adjacent to the current municipal swimming pool. Concurrently, the City would lease from that party for a somewhat shorter term certain personal property to be used in connection with the proposed water park. The personalty lease contract would include an option for the City to purchase the personal property at the close of the lease terms under certain conditions. It would also include a clause, which you have termed a "nonappropriation" clause, under which the personalty lease would terminate without penalty to the City in the event the City

chose not to appropriate funds for the lease payments in any fiscal year. Upon termination of the personalty lease in this way, possession of the personal property would revert to the lessor of that property, who would retain possession of the realty under the separate realty lease until the term of that lease expired. Your questions generally revolve around the assertion that the nonappropriation clause would operate to take the arrangement out of the scope of several state laws regulating municipal government debt and the pledging of the City's credit.

I.

For many years, various laws have regulated the accumulation of debt by city, county, and state government. See, e.g., Mont. Const. art. 8, § 8 (state debt); Mont. Code Ann. §§ 7-7-2101 (county debt); 7-7-4101 (municipal debt). A relatively large body of case law exists in which the Montana Supreme Court has spoken to the question of whether a particular government expenditure constitutes a "debt" to which these limitations apply. Since the same test seems to be applied to city, county, and state debts, see State ex rel. Rankin v. State Board of Exam'rs, 59 Mont. 557, 197 P. 988 (1921) (state expenditures), State ex rel. Diederichs v. Board of Trustees of Missoula County High Sch., 91 Mont. 300, 7 P.2d 543 (1932) (county expenditures), and Simmons (city expenditures), it appears that the authorities with respect to the definition of "indebtedness" are interchangeable without regard to the level of government involved.

The cases have been fairly consistent in holding that an expenditure payable from funds currently available is not a "debt" for purposes of these statutes, while one that would require appropriation by a future government legislative body would create a "debt." Compare Yovetich v. McClintock, 165 Mont. 80, 526 P.2d 999 (1974) (county contract for erection of multipurpose arena to be funded from proceeds of bond sale previously approved by electors, fire insurance proceeds, and federal revenue sharing funds did not create additional county debt since all funds to be expended were currently in the county treasury), with State ex rel. Simmons v. City of Missoula, 144 Mont. 210, 395 P.2d 249 (1964) (city contract for erection of building to be paid for in installments funded by taxes levied over a three-year period created "debt"); see also State ex rel. Diederichs v. Board of Trustees of Missoula County High Sch., 91 Mont. 300, 7 P.2d 543 (1932) (reconstruction of county high school from previously approved bond funds and insurance proceeds not a "debt"); State ex rel. Rankin v. State Bd. of Exam'rs, 59 Mont. 557, 197 P. 988 (1921) (issuance of treasury notes in anticipation of receipt of revenue to cover existing appropriations not "debt").

The basis of the various debt limitation statutes appears to be an aversion to the practice of obligating future legislative bodies to appropriate funds for current projects. As the Montana Supreme Court observed in State ex rel. Diederichs v. State Highway Comm'n, 89 Mont. 205, 211, 296 P. 1033, 1035 (1931):

Knowing the tendency of governments to run in debt, to incur liabilities, and thereby to affect the faith and credit of the state in matters of finance, thus imposing additional burdens on the taxpaying public, the framers of the Constitution placed positive limitations upon the power of the legislative assembly to incur a debt or impose a liability upon the state beyond the limit prescribed, without referring the proposition to the electorate for its approval.

The Supreme Court has consistently relied on this understanding of the purpose of debt limitation statutes.

Applying this test to the City's proposal, I conclude that the lease purchase agreement would not create a "debt" which would be subject to the limitations found in Mont. Code Ann. § 7-7-4201. The payments under the lease purchase contract would be made from currently available City revenue. Nothing in the contract as you have described it would obligate the City to make a payment in any future budget year. On the contrary, the City would remain free to decide in any budget year not to make the lease purchase payment. Under the contract the lessee would have no right to sue the City for specific performance of an obligation to pay under these circumstances.

Your request does not present the question of whether the result would be different if the City was under some practical financial compulsion to continue to make the payments, even if no legal obligation to do so

existed. Cf. Pollard v. City of Bozeman, 228 Mont. 176, 181, 741 P.2d 776, 779 (1987) (contract term obligating city to pay liquidated damages of $175,000 and to forfeit title to property could convert lease/purchase option contract to contract for outright sale). Under the proposal described in your letter, failure of the City to make payments could, at worst, place the parties in the status quo ante. The City would be out the value of the lease payments previously made, which would in effect serve as rental of the leased property, but would retain title to the real property leased to the lessor of the personalty. The lessor of the personalty would be entitled to the return of the leased personal property, and would have the right to retain possession of the realty during the term of the realty lease, but would acquire no other interest in the realty and have no other remedy against the City. Under these circumstances, no plausible argument could be made that the City would be under some practical compulsion to make future expenditures.

It could be argued that the legislature has spoken on this issue through the adoption of Mont. Code Ann. § 7-7-4104. That statute, adopted in 1999, allows cities and towns to incur "an obligation" in the form of bonded or note indebtedness, lease, lease purchase agreement, installment purchase contract, or any other "legal form," as long as the term of the obligation is less than twenty years, the principal amount of the obligation does not exceed 10 percent of the municipality's general fund budget for each of the two preceding years, and the total "debt service" on the present "obligation" and any other "obligations" does not exceed 2 percent of the city's general fund revenue for each of the two preceding years. The statute provides in subsection (2) that a valid "obligation" under its provisions "does not constitute indebtedness for the purpose of statutory debt limitations."

While the argument could be made that this provision limits the prerogatives of cities and towns to undertake other forms of financing under the principle of expressio unius est exclusio alterius, see State ex rel. Jones v. Giles, 168 Mont. 130, 133, 541 P.2d 355, 357 (1975) ("[A]n express mention of a certain power or authority implies the exclusion of non-described powers."), such an argument would not be well-taken in the context of the powers of local governments. The overriding constitutional principle is that the powers of local governments are to be liberally construed. Mont. Const. art. XI, § 4(2); see Granite County v. Komberec, 245 Mont. 252, 256-57, 800 P.2d 166, 169 (1990). A liberal construction of the statute would not permit an interpretation that it preempts municipalities from finding other financing methods not prohibited by law. This is especially so in light of subsection (7) of the statute, which recognizes that "[t]he powers conferred on a municipality under this section are in addition to and are supplemental to the powers conferred by other general, special, or local law."

The arrangement proposed by the City would not fall within the scope of Mont. Code Ann. § 7-4-4104. An "obligation" incurred under the statute would be "a general obligation of the municipality." Mont. Code Ann. § 7-7-4104(2). The statute provides further in subsection (6):

All obligations incurred under this section are legal and valid obligations of the municipality issuing the obligations, and the general credit of the municipality is irrevocably pledged for the prompt payment of both the principal of and interest on the obligations as they become due. However, the municipality may not be obligated to levy taxes for the payment of any obligation or interest on the obligation.

In contrast, the City's proposal does not envision that the general credit of the City will be pledged to make the full course of lease payments under the agreement. To the contrary, the agreement as described will clearly disclose that the City is not pledging to make any particular payment in any particular year, and the lessor will have no legal remedy to compel the City to pay if it chooses not to do so in any year. It therefore seems clear that the limits on the individual and aggregate amount of "obligations" undertaken pursuant to Mont. Code Ann. § 7-7-4104 would not apply to the City's proposal as described here.

The conclusion that the City's proposal does not create a "debt" is consistent with the rule adopted by a substantial majority of courts in other jurisdictions that have considered the question. See, e.g.,Wayne County Citizens for Better Tax Control v. Wayne County Bd. of Comm'rs, 328 N.C. 24, 31-32, 399 S.E.2d 311, 316 (1991) (collecting cases); State ex rel. Kane v. Goldschmidt, 308 Ore. 573, 783 P.2d 988 (1989) (statute allowing lease/purchase contract with nonappropriation clause not violative of limit on state debt); Baliles v. Mazur, 224 Va. 462, 297 S.E.2d 695 (1982) (same). The cases taking the minority position are distinguishable or are based on rules of law that have not been applied in Montana. Montano

v. Gabaldon, 108 N.M. 94, 766 P.2d 1328 (1989), seems to be based on the conclusion that local government powers are narrowly construed, an approach inconsistent with the Montana Constitution. Brown v. City of Stuttgart, 312 Ark. 97, 847 S.W.2d 710 (1993), appears to depend for its result on the conclusion that default by the city would result in imposition of unacceptable penalties against the city, creating a practical obligation on the city's part to fund the full term of the lease. As noted above, no such practical compulsion would appear to exist with respect to the City's proposal here.

While self-governing local governments are specifically required to comply with general laws relating to "the budget, finance, or borrowing procedures and powers of local governments," Mont. Code Ann. § 7-1-114(1)(g), even general power municipalities have the authority, "subject to the provisions of state law," to acquire interests in real or personal property by lease. Mont. Code Ann. § 7-1-4124. In my opinion, the arrangement proposed by the City here would not violate the provisions of state law limiting the accumulation of debt by municipal governments.

II.

Mont. Code Ann. § 7-7-4221(1) requires an election before a municipal government may "issue bonds pledging the general credit of the municipality." For the reasons discussed above, even if the lease purchase arrangement proposed by the City were to be considered the equivalent of a bond issue, it would not be considered to have "pledg[ed] the general credit of the municipality" for purposes of this section. Mont. Code Ann. § 7-7-4221(1) clearly uses the term "bonds pledging the general credit of the municipality" to refer to the issuance of general obligation bonds. "General obligation" bonds are debt instruments for the retirement of which the issuing government body is obligated to levy taxes. Mont. Code Ann. § 7-7-4204; see Port of New York Auth. v. Baker, Watts & Co., 392 F.2d 497, 498 (D.C. Cir. 1968) ("While no judicial construction of the [Glass-Steagall] Act's term 'general obligations' has been found, the trade meaning of the term requires a full faith and credit obligation supported by the taxing power."); Rivers v. City of Owensboro, 287 S.W.2d 151, 154 (Ky. 1956) (same). The City's proposal as you describe it would not pledge the taxing power of the City to make the full term of lease payments, and it therefore would not qualify as an obligation for which the general credit of the City is pledged.

Your letter suggests that Attorney General Greely's opinion in 38 Op. Att'y Gen. No. 56 (1979) should be reconsidered. In that opinion, Attorney General Greely held that a clause allowing cancellation of a lease at the end of each year did not avoid the then-existing statute requiring an election on the incurrence of any county "indebtedness or liability for any single purpose" in excess of $40,000. See Mont. Code Ann. § 7-7-2101(2) (1979). The opinion reasoned that unless the total possible expenditures were aggregated prior to the expenditure, it would be impossible to determine whether the total amount to be spent for a "single purpose" would exceed $40,000, and the purpose of the statute--to require submission of such expenditures to the voters--would be thwarted.

None of the statutes that control the questions you have asked deal with a numerical limit on the incurrence of "indebtedness or liability for any single purpose." Rather, the statutes limit the creation of any "indebtedness" without abiding by the procedures and limitations found in the bonding process provided in Mont. Code Ann. title 7, chapter 7, parts 41 and 42. In light of my conclusion that a lease with a nonappropriation clause does not create municipal "indebtedness," the prior opinion, which construes a statute dealing with county finance and which includes language different from the statutes applicable here, should not be viewed as authoritative in the context of municipal finance. Since your questions arise in the context of a lease by a municipality, and not a county, I will leave it to another day to determine whether the prior opinion should be overruled in its entirety.

III.

For the foregoing reasons, the proposed lease purchase arrangement described in your letter would not create "indebtedness" under Mont. Code Ann. § 7-7-4101 or -4201, nor would it require a vote of the people under Mont. Code Ann. § 7-7-4221. I express no opinion as to the legality of the proposal under any other state or federal law.

THEREFORE, IT IS MY OPINION:

1. A long-term lease with an option to purchase containing a provision allowing the City to terminate the agreement without penalty if the governing body of the City, in its sole discretion, fails to appropriate funds to make payments due under the lease in any fiscal year, does not create indebtedness of the City under Mont. Code Ann. § 7-7-4101 or -4201.

2. A city may enter a long-term lease with an option to purchase containing a provision allowing the City to terminate the agreement without penalty if the governing body of the City, in its sole discretion, fails to appropriate funds to make payments due under the lease in any fiscal year without first putting the question to a vote of the people under Mont. Code Ann. § 7-7-4221.

Very truly yours,

MIKE McGRATH
Attorney General

mm/cdt/dm