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Treasurer's Trust Notes
Debts: Authority to Incur
State Debt

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JOSEPH E. BRENNAN
ATTORNEY GENERAL



RICHARD S. COHEN
JOHN M. R. PATERSON
DONALD G. ALEXANDER
DEPUTY ATTORNEYS GENERAL

STATE OF MAINE
DEPARTMENT OF THE ATTORNEY GENERAL
AUGUSTA, MAINE 04333

December 12, 1977

To: Leighton Cooney, Treasurer
From: Kate Clark Flora, Assistant Attorney General
Re: Treasurer's Trust Notes

You have asked the advice of this office regarding the constitutionality of and other potential legal problems arising from your proposal to increase the income from state funds held by the State Treasurer. From your explanation we understand the proposal generally as follows. Revenues of the State are held by the State Treasurer and are from time to time deposited or invested in various kinds of accounts in order that, while in the Treasurer's custody, such funds might generate additional income for the State. Among other things, some monies are invested in so-called certificates of deposit (C.D.). These C.D.'s are for a set term and interest and may, depending upon the amount held by any bank, be backed by other collateral of the bank. It is your proposal to issue a special kind of security, tentatively called a Treasurer's Trust Note, which note would be sold to investors at a rate of interest less than the rate of return on the pool of C.D.'s. The Treasurer's Trust Notes would be secured by the state owned C.D.'s and would not constitute a claim against any other assets or income of the State. This memo will address only the constitutional questions posed by this proposal. Other legal questions, including the authority of the Treasurer to issue such notes, will be treated in a future memorandum.

Summary of Conclusion

The constitutional question posed by the proposed project is whether issuance of Treasurer's Trust Notes constitutes a pledge of the credit of the State, in violation of Article IX, Section 14 of the Constitution of Maine, and whether a debt or liability is created within the meaning of the constitutional debt limitation. As the

discussion below demonstrates, the question is a difficult one which is made especially complex by the uniqueness of the proposal. The answer appears to be that the issuance of Treasurer's Trust Notes would involve no pledge of state credit or creation of a debt in the constitutional sense. However, in light of the uniqueness of the question, and the amount of money involved, and since Legislative action will be necessary to authorize this activity, it would be appropriate, when the Legislature considers the matter, to refer the question to the Supreme Judicial Court for an opinion.

Discussion:

Article IX, Section 14 of the Maine Constitution provides, in pertinent part:

"The credit of the State shall not be directly or indirectly loaned in any case The Legislature shall not create any debt or debts, liability or liabilities, on behalf of the State, which shall singly, or in the aggregate, with previous debts or liabilities hereafter incurred at any one time, exceed two million dollars"

The so-called "credit clause" provisions were enacted in the 19th century as a protective response to financial problems resulting from State guarantees of the financing of private internal improvement projects that resulted in tremendous State liabilities when the private sector became unable to meet their obligations. Maine adopted the amendment in 1847. In 1867, speaking of this amendment, the Supreme Judicial Court said:

"Prior to this amendment, there was no constitutional limitation to the power of the legislature to create debts in behalf of the State. The general design was to provide a check against rashness or improvidence. 'The credit of the State shall not be directly or indirectly loaned in any case.' This indicates the great purpose of the amendment." Opinion of the Justices, 53 Me. 587, 588, (1867).

The precise language of the "credit clause" varies from state to state, and even in states with similar clauses there is a split of opinion as to what constitutes a loan or pledge of state credit.

In determining whether the sale of a note backed by certificates of deposit purchased from current tax revenues is a pledge of State credit, it is possible to analogize it to a revenue bond. Revenue

bonds are not general obligation bonds^{1/} but constitute a pledge of specified revenues of the issuer. 64 Am. Jur. 2d, Public Securities and Obligations, § 13. Revenue bonds are restricted to a specific fund or source of funds for repayment, generally funds from the project they were issued to finance. It has been held that revenue bonds do not constitute a pledge of the credit of the State. See, e.g. Allen v. Tooele County, 445 P.2d 994 (Utah, 1968); Uhls v. State, 429 P.2d 74 (Wyo., 1967), City of Gaylord v. Beckett, 114 N.W.2d 460 (Mich., 1966). Although the reasoning differs from case to case, some of the reasons for finding that bonds issued against a specific fund do not violate the constitutional restriction on pledge of credit and creation of debt or liability are: (1) they do not constitute a general obligation subject to payment through the exercise of the taxing power, and provide no recourse against the issuer other than the particular fund, Uhls, supra; (2) the bonds create no indebtedness within the meaning of the debt limitation of the constitution, Bennett v. City of Mayfield, Ky, 323 S.W. 2d 573 (Ky. 1959); or (3) the issuer is only a trustee and not a guarantor, Faulconer v. City of Danville, 232 S.W. 2d 80 (Ky. 1950).

There is some precedent for an argument that the Maine court would find revenue bonds backed by a specific fund not to constitute a pledge of state credit. In Opinion of the Justices, 161 Me. 182 (1965) the court was asked for its opinion as to whether municipal securities redeemable only from the funds of a specific project constituted municipal debts or liabilities within the purview of the Maine Constitution. The court held that they did not, citing Sager et al v. Stanberry, 336 Mo. 213, 78 S.W. (2nd) 431, 438.

" . . . a city does not create an indebtedness within the contemplation of the constitutional proviso by obtaining or purchasing property which is to be paid for solely and exclusively from a special fund derived from the income of the property with no liability on the part of the city to pay such purchase price or any part thereof directly or indirectly with funds raised by taxation or from a fund which must be replenished by funds raised by taxation."

At least one writer has interpreted this opinion to mean that the Maine Court would hold that revenue bonds do not entail pledging of credit. See, e.g., Robert E. Beck, "The 1965 Maine Municipal Industrial and Recreational Obligations Act," 18 U. Maine L. Rev. 25, 41 (1966).

^{1/} General obligation bonds are bonds in which the taxing power of the State (or other issuer) is pledged for payment.

". . . [A]pparently the Maine court would have held that revenue bonds do not entail pledging of credit. In its 1965 Opinion the court cited cases from other jurisdictions which support this view, but without any reference to the cases contra."

Although an opinion is not binding on the Justices,^{2/} this lends support to the conclusion that revenue bonds do not constitute a pledge of the credit of the State.

The question of whether a pledge of state credit is involved is closely related to the question of whether the proposed activity creates a state liability or indebtedness in the constitutional sense. A qualification frequently expressed by the courts which have found revenue bonds not to constitute pledges of state credit or an indebtedness is that repayment of such bonds not come directly or indirectly from funds raised by taxation. Sager, supra, 438. In Davis v. Phipps, 88 S.W. 2d 1020 (Ark. 1935), addressing the question of whether issuance of bonds backed by other bonds with no recourse against the State constituted a pledge of the credit of the State, the court held that it did not, emphasizing the fact that the pledged securities were not being repaid by state's revenues. Because of this emphasis on repayment not coming from taxation, it is important to discuss this in some detail in relation to Treasurer's Notes.

The "credit clause" provisions were enacted to protect the State from excessive liabilities. The purpose of constitutional debt controls is to promote fiscal responsibility by limiting the power of the Legislature to pledge future revenues. It has been said that the test for whether an obligation is a state bond within the constitutional debt limit is whether or not the taxing power of the State can be called upon to service it. City of Oxnard v. Dale, 290 P.2d 859, 861 (Cal. 1955).

"Taxes or other public revenues are property of the sovereign, and when they are used to pay an obligation, the property of the State . . . [is] used, and its credit pledged to that end." Interstate Power v. McGregor, 296 N.W. 770 (Iowa 1941)

Incurrence of debt, within the meaning of the constitutional restriction on indebtedness, involves the commitment of future taxes, not current revenues.

"The debt referred to in the constitution is one which mortgages the future, and which must be paid by taxation in future years. It does not relate to obligations incurred in the ordinary way, which are to be paid by the current tax levy." O'Reilly v. Kingston, 161 N.Y.S. 632 (1916).

^{2/} opinions of the Justices are advisory only and not binding on the Justices. Martin v. Maine Savings Bank, 154 Me. 259 (1958).

To constitute a liability or "debt" falling within the constitutional limitation, the obligation incurred would have to involve a commitment of future taxes. This view appears to have been adopted by the Supreme Judicial Court.

The court addressed the question of creating a liability of the State in Opinion of the Justices, 146 Me 183 (1951) concerning the Maine State Building Authority. The court gave its opinion that the proposed financing arrangement of the State Office Building whereby the State, through its obligation on the lease, would be liable for the full cost of the building, created a liability by the Legislature on behalf of the State within the constitutional debt limit, "unless the entire amount thereof is to be paid pursuant to an appropriation presently made from funds or revenues currently available therefore." (188) Thus the Court indicated that a liability which involved a commitment beyond the current revenues would incur debt limitation problems.

In the instance of the Treasurer's Note, the problem of committing future taxes to repay the notes would not occur. The obligation to repay the purchaser of the note will be met by funds previously raised by current taxes already in the general fund and invested in Certificates of Deposit in accordance with the powers of the Treasurer to invest the State's monies.^{3/} Repayment of the notes will involve no future taxation of its people. It was this "future indebtedness" which is referred to in the Sager opinion, supra, which was quoted by the Supreme Judicial Court in its opinions. It would appear from the above cases that as long as the Treasurer's Trust notes are payable only from a specified source of funds, with no recourse against the State, and no potential that to refund repayment would require future taxation, that probably no pledge of State credit exists^{4/} and no debt or liability in the constitutional sense is created.⁻

It is necessary to consider, however, the contrary line of cases which have found a loan of State credit even given a specific fund for repayment and absent recourse to the State. In Village of Moyie Springs, Idaho v. Aurora Mfg. Co., 353 P.2d 767 (Idaho, 1960), the Court, despite the existence of a special fund for repayment, found a pledge of municipal credit stating:

3/ Assuming that there is no way, as the proposal is formulated, that additional taxes would be necessary to raise revenue for current needs because general fund monies were invested in C.D.'s and tied up as collateral, giving rise to indirect pledge of credit problems.

4/ Undeniably, a liability of the State in some sense is created since the State has taken the note purchaser's money in return for a promise to pay at a future date.

"It is obvious that one of the prime purposes of having the necessary bonds issued by and in name of a municipality is to make them more readily salable on the market. Thus, the credit of the municipality is extended in aid of the project, regardless of the limitations placed on the remedy of the purchaser." See also, State ex rel Saxbe v. Brand, 197 N.E.2d 328 (Ohio 1964); State ex rel. Beck v. City of York, 82 N.W.2d 269 (Neb. 1957).

These cases concerned themselves with the use of publicly issued bonds to finance private industrial projects. In part, the court's concern was with the "loan of the state's credit," i.e., its name, to aid marketability of the bonds to finance the project. The reasoning is somewhat applicable to the instance of the Treasurer's Trust Note, since one reason for their issuance is that the C.D.'s themselves are not always readily marketable. As these cases indicate, there is precedent for an argument that even in the absence of general liability, the use of the State's name and position to back a bond may constitute a loan of its credit.

Based on the foregoing discussion, I conclude that the proposal to issue Treasurer's Note, as I understand and described it herein, would probably not constitute a pledge of the credit of the State of Maine. However, you should be aware of the potential of the "moral" argument in favor of a pledge of state credit arising from the existence of state backing if such notes are issued. I would recommend that each note clearly indicate that it is payable from a designated source of funds, that it does not constitute a state debt or liability, and that it is not a pledge of the credit of the state. Because of the uniqueness of the proposal and its financial implication, and since legislative action will be necessary before such notes could be issued, in this instance I would suggest that the Legislature might wish to obtain an opinion from the Supreme Judicial Court.

Kate Clark Flora

KATE CLARK FLORA

Assistant Attorney General

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