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PUBLIC TRUST ISSUES

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Several occurrences during the past two years suggest that it would be timely to consider how municipalities use public trusts and how others view them. Three of these occurrences were opinions of the Oklahoma Supreme Court which did not even involve a public trust. They did remind us however why public trusts exist. These cases reaffirm the Supreme Court's long-established commitment to strictly enforce the constitutional debt limitation in Article 10 §26 of the Oklahoma Constitution. Muskogee Urban Renewal Authority v. Excise Board of Muskogee County, 64 O.B.J. 1924 (June 19, 1993), rehearing pending; City of Del City v. Fraternal Order of Police Lodge No. 114, 65 O.B.J. 44 (January 1, 1994), rehearing denied; City of Tulsa v. Public Employees Relations Board, 845 P.2d 872 (Okla.1990).

Public trusts, of course, exist because of Article 10 §26. That section of the Constitution forbids a municipality to incur long-term debt (ie. obligations payable from revenues of a future fiscal year) unless the debt is authorized by a vote of the people. It also restricts the municipality to incurring debt only in the form of general obligation bonds ("g.o. bonds"). Public trusts do not have such restrictions. They are nothing more than alternative financing mechanisms for municipal purposes. The enabling legislation for public trusts makes this clear. It defines--and limits--the public trust purpose:

(1.) "to issue obligations and to provide funds . . .

(2.) for the furtherance and accomplishment of any authorized and proper public function or purpose of the state or of any county or municipality or any combinations thereof . . .

(3.) with the state, or any county or municipality or any combinations thereof, as the beneficiary . . ." 60 O.S.Supp.1992 §176(a).

Within these statutory constrictions it is the trust indenture which establishes how a municipal beneficiary can use its public trust. It is important to note that a public trust is, in the first instance, an express trust as contemplated by The Oklahoma Trust Act, 60 O.S.1991 §171 et seq. and §175.1 et seq. See, Board of County Commissioners of Oklahoma County v. Warram, 285 P.2d 1034 (Okla.1955) and Morris v. City of Oklahoma City, 299 P.2d 131 (Okla.1956), which apply the general trust statutes to public trusts. This means that it is the trust indenture and not the statute which creates the trust. Whether the indenture states the trust purpose broadly or in narrow terms, the only thing that a public trust can do that a municipality cannot do directly is to provide multiple financing alternatives to g.o. bonds.

This alternative is available only because the public trust is a separate legal entity not subject to the constitutional debt limitation. The trust's independent status must be maintained even though the enabling legislation contemplates and, in some circumstances requires, a certain amount of control of the trust by its municipal beneficiary. As a result, it can be difficult to maintain the public trust's legal integrity without compromising its benefits for the municipality.

Sales Tax Exemption

For example, the Oklahoma Tax Commission recently challenged a sales tax exemption often claimed for public trust construction contracts. State law exempts sales to political subdivisions and certain agencies of the state ". . . or to any person with whom any of the above-named subdivisions or agencies of this state has duly entered into a public contract pursuant to law, necessary for carrying out such public contract or to any subcontractor to such a public contract." 68 O.S.1991 §1356, para. 10. The Oklahoma Tax Commission observed that public trusts were not among the enumerated entities whose contractors can claim the exemption. Although arguably sales to public trusts are exempt under §1361, para. 1, which exempts sales to ". . . any political subdivision of this state or any agency of a political subdivision . . .", sales to contractors are expressly not exempt.

Several public trusts have preserved the benefits of the exemption by making purchases for the public contract directly or through the municipality. Often the contractor is designated as a purchasing agent for the public body. A more straightforward approach is taken by House Bill 1926, which amends §1356, para. 10 to add public trusts to the list of entities whose contractors may claim the exemption. That bill is currently in conference committee. (See Appendix A: H.B. 1926).

Beneficiary Approval of "Obligations"

The tension between separateness and control was recently explored in the District Court of Garvin County. Oklahoma Municipal Power Authority v. Wynnewood City Utilities Authority, C-92-126.

The controversy in that case concerned the meaning of the word "obligation" in 60 O.S.Supp.1992 §176(e). This statute states in pertinent part: "No trust in which a county or municipality is the beneficiary shall hereafter create an indebtedness **or obligation** until such indebtedness **or obligation** has been approved by a two-thirds (2/3) vote of the governing body of said beneficiary." (Emphasis added).

The issue was whether obligations requiring the two-thirds approval of the beneficiary municipality encompassed more than bonds, notes or other evidences of indebtedness. At the hearing on preliminary motions, the assertion was made " . . . that you can't purchase a paper clip without a two-thirds vote." The word "obligation" was argued to include the hiring of a maintenance man or buying a box of screws.

The broader concern was whether such an inclusive construction of "obligation" would endanger the legal separateness of public trusts. The detailed involvement of the beneficiary in the minutia of public trust operations could constitute a merger of the estates under general trust principles. Also, the burdensome delays and inefficiencies of dual approval for daily expenses could undermine the ability of the public trust to fulfill its function. (See Appendix B, Brief of Amicus Curiae Oklahoma Municipal League, Inc.)

The District Court recently ruled that the word "obligation" is limited to bonds and other evidences of indebtedness. It is forseeable that the issue will arise again in other cases until the Supreme Court provides a definitive answer.

The Illusory Trust

A second issue before the District Court of Garvin County raised the specter of the "illusory trust". Although it did not prevail, the "illusory trust" argument reminds us that the issue continues to be pressed.

It was first announced in Roberts v. South Community Trust, 742 P.2d 1077 (Okla. 1986), which held that a hospital trust operating like a private business without accountability to the beneficiary city was illusory and outside the purview of the (then) Political Subdivision Tort Claims Act. Roberts appeared to be limited by its facts and the Court explained, "Our rational is analogous to the piercing of the corporate veil where one corporation is so organized and controlled that it is merely an adjunct or instrumentality of another." Id. at page 1083.

That sanguine reaction to Roberts was destroyed by Fowler v. Norman Municipal Hospital, 810 P.2d 822 (Okla.1991). Fowler broadened the "illusory trust" concept to apply to a hospital trust which was financed originally by g.o. bonds and which was subject to some oversight by the city council. Instead, Fowler applied the following criteria:

- Profits from the hospital did not go to the city treasury but instead were reinvested in the hospital.

- The city could not dictate who was hired or fired nor could it exercise any authority or control over any employee of the hospital.
- The hospital was self-operating and self-sufficient without financial aid from the city.
- The operation of the hospital was not subject to the city's approval.
- The city did not investigate or handle any claims against the hospital but instead forwarded any such claim to the hospital.
- The city did not plan financially for any outlay because of claims against the hospital.
- The hospital failed to put its patients on notice that it purported to be a political subdivision.
- In short, the hospital retained control of its finances and operations, neither of which were subject to approval by the city. Id. at page 825.

From these criteria the Court drew the conclusion that there was no intent to transfer. This conclusion is a reference to the fuller explanation in the Roberts case, which concluded from similar criteria that there was no intent by the settlor to transfer control over the trust property. In such a circumstance, the Court noted, the trust " . . . has no real substance and is in reality an incomplete trust." Roberts, supra at page 1083.

Although a footnote in Fowler states the Court's intention to limit its holding to inquiries under the Governmental Tort Claims Act, 51 O.S.1991 §151 et.seq., the fundamental holding of the Court is that there is no completed trust arrangement. Understandably, municipalities were uneasy about relying on a fiction that a trust exists

for some purposes and not for others. Municipalities also were faced with the "catch 22" presented by the criteria in Roberts/Fowler. Those criteria are virtually impossible to satisfy because they are in conflict with municipal finance laws and other trust principles and statutes. The dilemma arises from the fact that, in order to preserve the protections of the Tort Claims Act for public trusts, municipalities may become so involved in the operations of the trusts that they accomplish a merger of estates and destroy the benefits of the trust. This means that public trust operations other than hospitals are vulnerable to the "illusory trust" conundrum. (See Appendix C, Brief of Amicus Curiae Oklahoma Municipal League, Inc.).

It is no surprise, however, that the principle arose in cases involving municipal hospitals. Hospitals, in particular, could benefit from a legal audit in light of Roberts/Fowler. This is especially so where the administrative structure for the hospital includes not only the board of trustees of the public trust but also a virtually independent hospital board and/or a professional administrator or management company. On more than one occasion this writer has heard administrators of publicly-owned and financed hospitals state that, according to professional standards, the hospital should be as independent as possible from the public entity. Certainly, where there are many administrative layers between the public and the city council, it is more likely the Court will conclude that the hospital is not carrying out a function of the municipal beneficiary.

In the aftermath of Fowler, new legislation was enacted to protect public trust financing from the illogic that a trust can exist and not exist at the same time. The statute, 60 O.S.Supp.1992 §176.1, provides that, subject to certain conditions, ". . . a

public trust duly created in accordance with the provisions of §176 et.seq. of Title 60 of the Oklahoma Statutes shall be presumed for all purposes of Oklahoma law to:

(1.) Exist for the public benefit;

(2.) Exist as a legal entity separate and distinct from the settlor and the governmental entity that is its beneficiary; and

(3.) Act on behalf and in furtherance of a public function or functions for which it is created even though facilities financed by the public trust or in which the public trust has an ownership interest may be operated by private persons or entities pursuant to contract."

The statute goes on to create certain conditions which must be satisfied in order for the presumption of the statute to attach. The purpose of the legislation was to change the criteria which are applied to determine whether a public trust is "illusory" or "real".

It is submitted, however, that the legislation does not weaken the viability of the "illusory trust" argument for inquiries under the Governmental Tort Claims Act. This conclusion is based on Justice Opala's concurring opinion in Roberts and on Fowler's perfunctory application of Roberts' criteria and rationale. The concurring opinion emphasizes the Court's policy that immunities under the Tort Claims Act will shield only those entities that actually conduct public business for the public. Even though the Roberts/Fowler criteria are virtually impossible to satisfy, it may be that the "illusory trust" analysis will become more realistic if evidence of other facts shows that the trust is "a public service enterprise both de jure and de facto". Roberts supra at page 1084 (J. Opala, concurring.)

Accountability

In Burkhardt v. City of Enid, 771 P.2d 608 (Okla. 1989), the Court allowed a municipality to use its public trust to develop new ways to promote economic development in conjunction with private entities. Although the negotiated arrangements between the private and public sectors was complex and nontraditional, the Court held that it furthered a public purpose.

Contrast this with Roberts/Fowler's refusal to see a public purpose in those hospital trusts. Operating a hospital is just as much a traditional function of municipal government as economic development. See Ruth v. Oklahoma City, 143 Okl.62, 287 P. 406 (1930). So why the different results?

Perhaps the answer lies in Burkhardt's teaching that accountability is an essential key to establishing that a particular use of public resources is a public rather than a private enterprise. Accountability necessarily implies some degree of control, at least through legally-enforceable obligations to the public body. Id. at page 611.

The desire for accountability is the common thread in the recent developments affecting public trusts. More to the point, the issues discussed in this paper reveal a fear that municipalities do not secure sufficient accountability from their public trusts.

This fear led in part to the 1990 addition of §27B to Article 10 of the Oklahoma Constitution. The amendment authorizes cities and towns, for the first time, to issue

revenue bonds directly under certain circumstances. See the implementing legislation at 11 O.S.Supp.1992 §22-150. It was the stated hope if the amendment's principal author that public trusts would eventually become obsolete.

Advising Public Trusts

In the meantime, public trusts remain viable as the most accessible and versatile financing tool for municipal operations. The temptation also remains to gain accountability by blurring this trust's separate legal status. It may seem expedient in a particular circumstance to treat a public trust as a branch of the city or town, for example, to gain the use of the sinking fund to pay judgments against the public trust.

The office of the Attorney General experienced this temptation. It concluded that a public trust could not make donations to a private charitable organization--a desirable result. It reached this conclusion by applying the prohibitions against such donations by cities and towns in Article 10 §§15 and/or 17 of the Oklahoma Constitution--an analysis of broader consequence. Atty.Gen.Op. No. 81-120. The Attorney General acknowledged that §§15 and 17 do not expressly apply to public trusts. Even so, that office opined that a public trust is an agency of the state, which is governed by §15, and of the municipality, which is governed by §17. Therefore, the prohibition applies to public trusts. Unfortunately, the constitutional debt limitation also applies to public trusts under such an analysis.

A subsequent Attorney General Opinion substituted a proper analysis to reach the same result that a public trust cannot make donations to private entities. In so doing, Atty.Gen.Op. No. 86-131 provides a model for resolving public trust questions.

1. **It recognizes the independent legal status of public trusts.** It concludes from the face of Ok.Const. Art. 10 §§15 and 17 that these provisions do not apply to public trusts.

2. **It considers the trust purpose.** A public trust only has authority under its enabling statutes to act in furtherance of authorized and proper public purposes of its beneficiary.

3. **It considers the relationship between the trust and its beneficiary.** Under the prohibitions of Article 10 §17, donations to private entities can never be an authorized and proper purpose of the beneficiary municipality. Therefore, pursuant to 60 O.S. §176(a), such donations do not fall within the trust purpose.

4. **It preserves the function of the public trust.** The constitutional debt limitation is not implicated by this analysis, which is consistent with the trust's statutory function to provide financing for its beneficiary.

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