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SUPREME COURT
OF THE STATE OF WASHINGTON

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In re:

BOND ISSUANCE OF GREATER WENATCHEE
REGIONAL EVENTS CENTER PUBLIC FACILITIES DISTRICT

GREATER WENATCHEE REGIONAL EVENTS CENTER
PUBLIC FACILITIES DISTRICT,

Appellant,

v.

CITY OF WENATCHEE, WASHINGTON,

Respondent.

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STATE OF WASHINGTON
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BRIEF OF AMICUS CURIAE WASHINGTON STATE TREASURER

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ORIGINAL

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I. INTRODUCTION

There is a difference between the meaning of “debt” in everyday usage and its meaning in Washington’s Constitution and in a century of decisions of this Court. As yet, there is no case from this Court that has held that debt issued by one municipality may be counted as the debt of another. If the Court concludes, even under very unique and specific facts, that the debt of one government may be counted as debt of another, very clear and specific guidance is needed to determine when such an event will occur. Absent very clear and specific guidance, ascertaining constitutional or statutory debt limits will become very difficult, local jurisdictions may be less willing to provide assistance to one another due to the uncertainty, and uncertainty will arise over the application of such a decision to numerous other contingent loan agreements currently in existence.

This appeal raises the question of whether a promise by one government entity to lend money, if needed, to another government entity for meeting shortfalls of principal and/or interest payments on the latter’s indebtedness, can ever constitute “debt” for the potential lender. In particular, this appeal focuses on the use of contingent loan agreements (“CLAs”). CLAs are a form of interlocal agreement used frequently by governments to provide additional security for debt issued by different

government entities. The former entity promises to be a contingent lender in the event the latter cannot meet its obligation to repay borrowed money.

The superior court below concluded that the proposed CLA constituted debt of the contingent lender. The decision is the first decision suggesting that the debt secured by these agreements can constitute indebtedness of the contingent lender. Given the unique facts presented to the court, it is now unclear under what circumstances a CLA might be deemed a “debt” of the contingent lender, thus potentially undermining the reliability of these agreements. At present, public facilities districts throughout the State have issued approximately \$271 million in bonds that are secured by CLAs. In addition to public facilities districts, other municipal entities, particularly housing authorities, have likewise issued debt secured by CLAs with cities and counties. The lack of clear guidance in the lower court’s ruling creates questions and uncertainty around when and to what extent a CLA might constitute indebtedness of the contingent lender.

To answer the question raised here, the Court must decide: a) under what circumstances, if at all, a contingent loan agreement counts against the constitutional and statutory debt limit of the contingent lender; and b) if a contingent loan agreement is to be counted against the contingent lender’s debt capacity, how much of the underlying debt is to

be counted? Clear answers will promote the certainty and reliability of CLAs as a mechanism to aid borrowing governments.

This brief suggests a roadmap for the Court to consider in evaluating these important questions.

II. STATEMENT OF THE CASE

The Greater Wenatchee Regional Events Center Public Facilities District (“the District”) is a public facilities district organized under RCW 35.57. CP 93. The District was formed in 2006 to finance, construct and operate the Greater Wenatchee Regional Events Center (the “Regional Center”). CP 93.

A 2006 Interlocal Agreement between the District and the City of Wenatchee (“the City”) provided that the City would enter into CLAs with the District under which the City would agree to loan funds to the District to meet the District’s debt service obligations if the District’s revenues were insufficient to meet those obligations. CP 119-20.

The facts of this case are unique. While CLAs to back long-term bonds are relatively common, this matter arose out of the issuance of short-term notes by the District. In the fall of 2008, precisely when financial markets were in turmoil, the District issued approximately \$41.8 million of short-term bond anticipation notes (rather than long-term bonds) to finance the purchase of the Regional Center. CP 94, 301-02. In

conjunction with the issuance of this short-term District debt, the City executed a CLA to secure payment of the annual interest payments under the bond anticipation notes. CP 675. Pursuant to that CLA, the City made payments of \$2,617,521.63 to cover interest obligations on the District's debt. CP 675.

The notes became due on December 1, 2011. The District and the City intended that long-term bonds would be issued by December 1, 2011 to refinance the maturing short-term notes, with those bonds payable from District revenues and further secured by the promise of the City to loan the District money to cover shortfalls, if any.

To facilitate the issuance of its long-term bonds, the District proposed to the City the 2011 Contingent Loan Agreement ("2011 Agreement"). Under the 2011 Agreement, the City would agree to loan the District sufficient funds to cover the difference between the District's immediately available funds and the amount of its next semi-annual debt service payment of principal and interest. CP 454-55. The 2011 Agreement provided that the District would repay all such loans, with interest, from the District's tax and facility revenues. That proposed agreement also provided that all debts of the District were the District's alone and that holders of the District's bonds would have no recourse against the City, its assets or its tax revenues, except to enforce the

obligation to make loans to the District. CP 454-55. Finally, under the 2011 Agreement, the City would have no obligation either to impose new taxes or itself borrow money to fund loans to the District. CP 455.

The City conditionally approved the proposed 2011 Agreement, subject to a declaration from the Chelan County Superior Court pursuant to the bond issue declaratory judgment statute, RCW 7.25 that the proposed 2011 Agreement with the District is a valid exercise of the City's authority. CP 95.

The Superior Court ruled that the agreement was *ultra vires* because the City's obligation to make loans to the District would constitute City "debt" subject to the limitations of Article VIII of the Washington Constitution and RCW 39.36. The trial court ruled that the total amount of the obligation would exceed the City's remaining non-voted debt capacity. CP 663-65. It based this finding in part on the uncontested assertion that the City likely would be required to make loans to the District since the District would be unable, at least in the near term, to meet all its debt service requirements. Moreover, the Court ruled that the "debt" incurred by the City under the contingent loan agreement equaled the entire amount that could possibly be loaned to the District to meet all of its debt service obligations, including *both* the principal and interest, regardless of how much was expected to be loaned over the term

of the bond issue. CP 664. Without the 2011 Agreement to support the issuance of new long-term bonds, the District was unable to refinance the short-term notes before they came due. On December 1, the District defaulted on the notes.

III. IDENTITY AND INTEREST OF AMICUS

The State Treasurer, a constitutional executive officer charged with duties relating to the fiscal management of the state, is responsible for the safety and security of state tax dollars including, *inter alia*, issuing and managing all state debt. The State Treasurer chairs the State Finance Committee that authorizes the issuance and establishes the terms, conditions and manner of the sale of all bonds, notes and other debt for the state to finance capital projects in the state's capital and transportation budgets. The State Treasurer also manages a consolidated borrowing program for local governments under Chapter 39.94 RCW.

The State Treasurer thus has a special interest in assuring the highest credit ratings for the State. The State Treasurer also has a general interest in the credit market's perception of Washington debt, including the debt of local municipal entities. The credit market's general perception can have an impact on the specific credit rating given to debt of Washington municipal entities and most importantly, on the cost of borrowing.

A key to positive credit markets for the State and Washington's local entities is clarity, transparency and reliability of public financings. Such clarity, transparency and reliability depend on clear legal rules. The trial court's order, rather than creating clarity, has created confusion and uncertainty. A clear rule regarding the legality of CLAs and their treatment vis-à-vis constitutional and statutory debt limits is critical.

Specifically, the State Treasurer has the following concerns. First, the use of CLAs as security for debt is a valuable mechanism for public entities to cooperate and achieve lower cost financing of projects statewide. Having an established and clear rule regarding the treatment of CLAs will allow public entities to consider the appropriate use of CLAs in the future.

Second, having clear rules regarding the use of CLAs allows the credit markets to properly assess their worth and reliability with regard to a given transaction and provides comfort in the use of such instruments. A lack of clarity regarding these agreements can render them ineffectual as there will be no certainty as to what, if any, value they add. If they are not seen as adding any value, borrowing costs for some entities may go up while others may be denied the ability to borrow at all.

These considerations apply equally to the 20 to 30 CLAs across the State executed by various cities and counties to secure the debt of various

public facilities districts, as well as city or county-created public development authorities and public housing authorities.¹ The trial court's ruling potentially raises questions regarding the validity of these CLAs. The State Treasurer has an interest in clear rules that can be applied to confirm the validity of existing CLAs throughout the State. Given the need for capital infrastructure throughout the state, the State Treasurer also has an interest in clear rules that will guide cooperation between local governments in support of such investment.

IV. ARGUMENT

In Washington, constitutional debt has been consistently defined as “borrowed money” or “debts created by the issuance of bonds.” *State ex rel. Wittler v. Yelle*, 65 Wn.2d 660, 670, 399 P.2d 319 (1965) (collecting cases). Relying on this authority, the District argues that any bonds secured by the 2011 Agreement cannot create indebtedness of the City because the City itself has not “borrowed money.” Dist. Br. at 24-25. The Taxpayer responds that the “borrowed money” definition does not apply because *Wittler* dealt with state debt under article VIII, section 1, not municipal indebtedness under article VIII, section 6. Taxpayer Br. at 13-

¹ The Court may take judicial notice of the existence of the various CLAs executed by various municipal entities and public facilities districts, as they are matters of public record.

14. The Taxpayer argues that the indebtedness of the City is subject to broader Constitutional limitations.

For the purpose of determining whether the CLA constitutes indebtedness, the court need not delve into this argument. There is no dispute that the District here seeks to issue bonds which constitute “borrowed money”; under case law decided under both clauses, there is indebtedness at issue. *See e.g., Wittler*, 65 Wn.2d at 670 (collecting cases where the issuance of bonds created state debt); *Comfort v. City of Tacoma*, 142 Wash. 249, 252 P.2d 929 (1927) (applying municipal indebtedness standard to local bonds).

The proper inquiry is not whether there is a distinction between article VIII, section 1 and article VIII, section 6, but rather whether the bonds issued by the District will become the *de facto* indebtedness of the City either because of the negotiating relationship between the parties or the nature of the City’s commitment. The answer to this question does not turn on any textual differences between section 1 and section 6 of article VIII.

Therefore, there are only two critical determinations that must be made by this Court in considering whether a contingent loan agreement constitutes debt of the contingent lender: 1) whether the parties to the agreement have an arm’s length relationship; that is, that the party issuing

the debt is not a mere instrumentality or controlled by the contingent lender; and 2) if the relationship is at arm's length, whether a true contingency exists. If the parties have an arm's length relationship and a true contingency exists at the time the agreement is entered into, neither the agreement itself nor any money paid in the future under the agreement should constitute debt of the contingent lender.

A. The Parties To The Agreement Must Have An Arm's Length Relationship.

Constitutional debt limitations were enacted to protect the integrity of the state's economy and in particular to protect future taxpayers "from the kind of improvidence that led to state and local government bankruptcies in the 19th century." *Dep't of Ecology v. State Fin. Comm.*, 116 Wn. 2d 246, 257, 804 P.2d 1241, 1246 (1991). In enforcing debt limitations, this Court has cautioned, "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 close our eyes to what is actually being attempted." *State ex rel. State Building Finance Auth. v. Yelle*, 47 Wn.2d 705, 715, 289 P.2d 355 (1955).

Although not relating to CLAs, in *Building Finance Auth.*, the Court invalidated a financing plan that would have exceeded the state's debt limit. There, the Legislature created a building authority to finance

the construction of buildings that were to be leased to state agencies. Those agencies would then pay rent directly to the authority. The authority had the power to issue bonds, set and collect rental rates, and to pledge all of its revenues as security for its obligations. The authority, and not the State, was obligated to pay the interest on the bonds. The Court held, however, that the arrangement “was 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 [debt] limitation.” *Id.* at 715. In particular, the Court noted the absence of an arm’s length relationship between the State and the Building Authority. *Id.* at 713.

A similar line of reasoning should also be applied to the use of CLAs that support the debt of an entity created or controlled by a contingent lender. Debt backed by a CLA between parties who do not have an arm’s length relationship should constitute debt of the contingent lender.

B. The Obligation Created Under the CLA Must Be Truly Contingent.

This Court has repeatedly ruled that contingent obligations are not “debt” for purposes of a municipality’s constitutional and statutory debt ceiling. *Kelly v. Sunnyside*, 168 Wash. 95, 11 P.2d 230 (1932); *Comfort*,

142 Wash. 249. The leading case on the contingent obligation doctrine in Washington is *Comfort v. City of Tacoma*. There, the Court upheld a guaranty fund created by the city to secure local improvement bonds. As with the District's proposed CLA, the city's guaranty would only be called upon if the special tax assessments were inadequate to meet debt service obligations. Though the Court acknowledged that historically local assessments had been insufficient to pay debt service, the Court also recognized new restrictions on the city's power to levy assessments and consequently refused to assume that future assessments would be insufficient. As such, the Court held that the city's obligation would be considered a contingent liability only, and therefore not debt. 142 Wash. at 259. *Kelly v. Sunnyside* sets forth a nearly identical holding. 168 Wash. 95.

Significant authority from other jurisdictions excludes truly contingent obligations from municipal debt limitations on the same grounds. *See, e.g., Fults v. City of Coralville*, 666 N.W.2d 548 (2003) (bonds subject to non-appropriation clause are contingent liability and not debt); *Columbia County v. Bd. of Trustees of the Wisconsin Retirement Fund*, 116 N.W.2d 142 (Wisc. 1962) (county obligation to pay into pension fund variable and not ascertainable, and therefore contingent and not debt); *Pearson v. Salt Lake County*, 346 P.2d 155 (Utah. 1959)

(guaranty fund for special assessment bonds contingent liability and not debt); *Woodmansee v. Kansas City, et al.*, 346 Mo. 919, 927, 144 S.W.2d 137 (1940) (city's guarantee of bonds used to finance modernization of public market contingent liability and not debt).

- 1. If the contingent lender reasonably concludes that, at the time the CLA is entered into, it will likely be called upon to pay all or a portion of the underlying debt, the portion it believes is reasonably likely to be required to be paid is not a true contingency as to that portion and that portion constitutes debt of the contingent lender.**

Public entities routinely collaborate to finance public projects, including providing security for another entity's debt. The State legislature has authorized municipalities, housing authorities, public development authorities and the State alike to collaborate to implement public projects. For example, the Interlocal Cooperation Act, RCW 39.34, authorizes municipalities to enter into interlocal agreements to finance and carry out joint endeavors cooperatively. Numerous other statutes provide for similar cooperation.² These projects are cooperative undertakings, presumably of value to all participants. Therefore, it is difficult to imagine

² For instance, RCW 35.59 authorizes municipalities to cooperate in the development and financing of multi-purpose community centers. The Housing Cooperation Law, RCW 35.83, authorizes cities and counties to cooperate with housing authorities in the financing of housing projects. The Community Renewal Law, RCW 35.81, authorizes municipalities to accept loans from other public bodies in furtherance of their community renewal authority. The state is likewise authorized to secure the credit of school districts pursuant to RCW 39.98.

how the debt of one of the members of the undertaking would not become that of the other member to the extent the other agreed to and reasonably believed it would be responsible for an ascertainable amount of the borrower's debt, for example, to fund a projected shortfall in revenue. More simply, if the contingent lender agrees to enter into a CLA with the contingent borrower to fund a cooperative project, knowing that it will be required to make loans for all or a portion of the underlying debt, this ascertainable amount is not truly contingent and should be counted as debt of the contingent lender.

This is not to say that if a contingent lender, upon entering into a CLA, believes it is reasonably likely to need to make sporadic payments at uncertain times and in uncertain amounts, that these amounts must be ascertained and then counted against its debt limit. Indeed, this is the precise nature of contingent agreements and such amounts should not be counted notwithstanding the fact that the contingent lender reasonably believed it would likely need to make such payments.

Based upon the relevant facts available to the contingent lender at the time it enters into the CLA, the contingent lender must make a finding that it is not reasonably likely to be called upon to make a payment. However, if the contingent lender cannot make this finding, and in fact, determines that it will likely be required to pay an ascertainable portion of

the underlying debt, it must make findings as to the amount and period during which such amounts are expected to be paid along with the facts and analyses it relied upon in reaching this determination. This portion of the underlying debt is not contingent and therefore cannot be excluded from the contingent lender's debt limit.

It should be noted that the trial court held that the amount of debt to be incurred by the City would be the entire amount of principal and interest over the life of the bonds. However, there is authority from Washington and other jurisdictions supporting the general rule that when a municipality issues bonds, the amount of indebtedness is equal to the principal amount of the bonds only. *See State ex rel. State Capitol Comm'n v. Lister*, 91 Wash. 9, 15, 156 P. 858 (1916); 15 McQuillin § 41:26; *Columbia County*, 17 Wis.2d at 329 (collecting cases).

2. The determination as to whether a true contingency was created must be made at the time the CLA is entered into and cannot be second guessed absent a showing that the determination was arbitrary and capricious.

A determination as to whether an obligation is truly contingent must be made and be binding at the time it is entered into and cannot be second-guessed or subjected to fluctuations throughout its life. For example, where an obligation is contingent on the day it is entered into, but nevertheless requires significant loans from the contingent lender in

the years following, the mere fact that significant loans had to be made will not convert a true contingency into debt merely because it was necessary to call upon the contingent obligation.

The determination of contingency and the amount and duration of debt incurred is legislative in nature and is "conclusive in the absence of proof of actual fraud or arbitrary and capricious conduct, as would constitute constructive fraud." *Public Utility District No. 2 of Grant County v. North American Foreign Trade Zone Industries, LLC (NAFTZI)*, 159 Wn.2d 555, 151 P.3d 176 (2007).³ Accordingly, the findings made at the time a CLA is entered would be determinative as to the impact of the CLA on the contingent lender's debt limit. Even if the projections of the contingent lender turn out to be incorrect in the future, and the contingent

³The role of legislative findings in the eminent domain context provides a helpful analogy. As proposed here, a reviewing court in an eminent domain action employs a reasonableness standard based on "the circumstances of the particular case." *City of Tacoma v. Welcker*, 65 Wn.2d 677, 683-84, 399 P.2d 330 (1965). In reviewing a declaration of public use and necessity, "the issue of whether the contemplated acquisition is necessary to carry out the proposed public use constitutes a legislative question, and a declaration of necessity by the appropriate legislative body will, by the courts, be deemed conclusive, in the absence of proof of actual fraud or such arbitrary and capricious conduct as would amount to constructive fraud." *Id.* at 684. "Action when exercised honestly, fairly and upon due consideration is not arbitrary and capricious, even though there be room for a difference of opinion upon the course to follow, or a belief by the reviewing authority that an erroneous conclusion has been reached." *Id.* at 684-85; *see also Central Puget Sound Regional Transit Auth. v. Miller*, 156 Wn.2d 403, 421, 128 P.3d 588 (2006) (noting that deference to legislative body's site selection decision is rooted in respect for the other branches of government and the institutional competence of courts); *City of Des Moines v. Hemenway*, 73 Wn.2d 130, 437 P.2d 171 (1968) (reversing lower court's determination that city acted arbitrarily where factual record did not support ruling).

lender makes bigger or smaller loans than anticipated over the life of the agreement, such result would neither invalidate the CLA retroactively nor reduce or enlarge the contingent lender's debt capacity going forward. Making this conclusive determination only once-- at the time the agreement is entered -- would provide stable, reliable information to the market and the cooperating entities. Absent this stability, a municipality's debt limit could fluctuate wildly depending on factors outside of its control. In addition, CLAs that are currently securing debt could also be in danger of being *ultra vires* even though at the time they were entered into, they were perfectly valid contingent obligations.

V. CONCLUSION

Guidance from the Court is needed to clarify the treatment of contingent loan agreements in the context of municipal debt limits. Adopting the two-pronged analysis above will retain flexibility for municipalities funding critical infrastructure projects while ensuring that the intent of the statutory and constitutional debt limitations is preserved.

DATED this 15th day of December, 2011.

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