

DO SECTIONS 1 AND 2 OF ARTICLE XI OF THE COLORADO CONSTITUTION
PROHIBIT A CITY FROM OPERATING
A BANK OR LENDING MONEY?

MEMORANDUM TO CITY OF ENGLEWOOD

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Issues:

- I. Does Article XI, section 1 of the Colorado Constitution, which prohibits a city from “lending its credit” to another person, prohibit the City of Englewood from operating a bank or lending money to third persons or to itself?
- II. Does Article XI, section 2 of the Colorado Constitution, which prohibits a city from making donations or grants to another person, prohibit the City of Englewood from operating a bank or lending money?

Conclusion:

- I. The plain meaning of the words in Article XI, §1 and Colorado case law clearly show that section 1 does not prohibit the city from operating a bank or lending money to another party or to itself, but only prohibits the city from lending its credit to another party, such as by guaranteeing payment of a loan on behalf of the borrower.
- II. Article XI, §2, which prohibits a city from making donations or grants to another person (with specified exceptions of an involuntary nature), does not prohibit the city from operating a bank or lending money to another person, because a loan by definition requires repayment and is not a donation or grant.

ANALYSIS

- I. Article XI, §1 does not prohibit a city from operating a bank or lending money.

Article XI, Section 1 of The Colorado Constitution, “Pledging Credit of State, County, City, Town or School District Forbidden”, reads as follows:

Neither the state, nor any county, city, town, township or school district shall lend or pledge the credit or faith thereof, directly or indirectly, in any manner to, or in aid of, any person, company or corporation, public or private, for any amount, or for any purpose whatever; or become responsible for any debt, contract or liability of any person, company or corporation, public or private, in or out of the state. (emphasis added) (effective August 1, 1876, see L. 1877, p. 60.)

First we will examine the section to determine the plain meaning of the words and whether they appear to prohibit the city from lending money to any person or

corporation, public or private. Then we will briefly look at the origin and history of this provision and similar provisions enacted in some 45 states. Finally, we will examine Colorado cases to see how they interpret this section and whether they provide any authority for concluding that the section prohibits the city from operating a bank or lending money.

1. Plain meaning of words in section. A careful reading of the entire section reveals that it does not mention the word “money” or “lending of money”, nor does it expressly or impliedly prohibit the state or any political subdivision from lending “money”. It only states that the city cannot “lend or pledge” its “credit or faith” directly or indirectly, to another person, company or corporation, public or private, or become responsible for the debt or obligation of another person. The verbs “lend” and “pledge” have as their objects the nouns “credit” and “faith”.

So we need to ask what it means to “lend or pledge” one’s “credit or faith” to another. *Merriam Webster* online provides a definition of the word “lend” that appears to fit this context as follows: “to make (something) available to (someone or something).” Using this meaning, the section prohibits the city from making its credit available to another person, company, or corporation, public or private.

We next consider the definition of the word “credit”. The first online definition of “credit” that comes up in a Google search appears to apply to this situation:

noun: credit

1. the ability of a customer to obtain goods or services before payment, based on the trust that payment will be made in the future.

In order to make its credit available to another, the city would need to guarantee a loan, or co-sign a loan to another party, or perhaps agree to indemnify another party against a loss caused by the party to whom the credit is loaned or pledged.

When the city guarantees a loan, the lender is relying upon the “loaned” credit of the city instead of solely upon the credit of the borrower. The term “lend one’s credit” or “pledge one’s credit or faith” would thus appear to apply to a situation where a city (or other governmental unit) uses its good credit, that is, its ability to obtain a loan, to enable another person to obtain a loan or other benefit, such as by guaranteeing payment of a loan made to that person.

2. The origin and history of state constitutional prohibitions against lending a government’s credit shows they do not prohibit banking or lending money.

An excellent summary of the origin of state constitutional prohibitions against lending the credit of the state or its political subdivisions shows that such prohibition was an outgrowth of the severe recession of 1837 (“State Constitutional Provisions Prohibiting the Loaning of Credit to Private Enterprise -- A Suggested Analysis”, 41 *U. Colo. L. Rev.* 135-151 (1969), by Arthur P. Roy). During the rapid westward expansion

of the United States in the nineteenth century, many cities had guaranteed bonds or loans and obligations of private railroad companies, and other communication and transportation companies so as to attract business and thereby strengthen the local economy. The nationwide economic collapse of 1837 left many of these cities obligated to pay loans that they were unable to pay, or holding worthless stock in private corporations (p. 137). As a result of that crisis and others that followed, 45 states eventually enacted provisions to prevent states and cities from lending their credit to private corporations, such as by guaranteeing such obligations.

When the State of Colorado was created in 1876, it included this protection in its Constitution as Article XI, section 1. This section has remained unchanged ever since. Colorado's provision is comparable to those in other states although it is broader in scope and its restrictions are more specific.

These types of restrictions generated "considerable litigation challenging programs which effectuate a partnership between public and private capital... the vast majority" of which involved municipal corporations (p. 136). The author stated:

From this historical background, it is evident that the purpose of this provision was to protect the property tax base from debts resulting from private mismanagement by preventing private speculation with public funds (p. 139).

The author goes on to cite numerous cases decided in Colorado and other states, all of which reflect a common purpose to prevent government from lending its credit to private enterprises. None of the Colorado or other cases would prohibit the state or a city from engaging in banking or from lending money to a private party, but only prohibit lending their credit.

During the 19th century, a number of states had publicly-owned banks. The drafters of the Colorado Constitution and other state constitutions could easily have added language to prohibit a state or political subdivision from operating a bank or from lending money. The fact that they did not do so makes it apparent that they did not intend to prohibit states from operating banks or lending money, but solely to prohibit them from lending their credit to a private company.

3. Colorado Case Law. Numerous cases have been decided in Colorado that interpret this section. These cases make clear that the prohibition applies only to the lending of the city's "credit" to another party. It prohibits the city from guaranteeing or co-signing a loan made to a third party. None of the cases suggests that the section might prohibit the city from operating a bank or lending money to another party. In a loan by the city of money to another party, the city's credit is not loaned or even involved; rather, the credit of the borrower is the only credit at issue in such a loan.

In the case *Bd. of County Comm'rs v. Humes*, 356 P.2d 910, 910 (Colo. 1960) the Colorado Supreme Court held that a county may not be a guarantor and that Article XI,

section 1 of the constitution prevents the county from standing in the position of a guarantor for the debts of an individual.

In *Witcher v. Canon City*, 716 P.2d 445, 448 (Colo. 1986) the Colorado Supreme Court held that “there was no pledge by the City of its credit” and thus the prohibition against lending its credit was not violated. The Court held:

Here, the contractual obligation to third parties for the construction of the improvements to the Royal Gorge Bridge is solely that of the Company and not the City. Although the City is participating in the modernization by allocating to the project a portion of the tax and toll revenue generated by it, this does not constitute an unconstitutional pledge of the City's credit to the Company. (716 P.2d at 454)

This case also confirms that the prohibition is directed against using the city's credit to aid a third party and is not violated when the sole obligation is that of a private company.

In the case *In re Colorado State Senate etc.*, 566 P.2d 350, 356 (Colo. 1977) the Supreme Court held: “When no debt or obligation of the state is created, the state cannot be said to have lent its credit in violation of article XI, section 1.” The Court also held that a proposed appropriation did not violate this section. In that case a proposed house bill appropriation was to be deposited in a capital reserve fund to secure obligations of the housing finance authority. The Court held that the appropriation did not constitute a pledge of the state's credit in violation of this section. Moreover, the case mentions the housing finance authority as the lender. The housing finance authority is one of a number of examples of the state or a political subdivision of Colorado lending money, with no suggestion that such lending violates Article XI, section 1, which only prohibits lending the “credit” of the state or political subdivision, not the lending of “money”.

In *Bradfield v. City of Pueblo*, 354 P.2d 612, 618 (Colo. 1960) the Court held: “The bonds here are those of the City. Art. IX, Sec. 1, cannot be so construed as to keep the state or any subdivision thereof from pledging its own credit for its own debts or obligations as may be permitted by law....” Thus, a city-owned bank in Colorado could “lend its credit” to guarantee a loan made to the City of Englewood.

In conclusion, the plain meaning of the words Article XI, section 1, the original purpose and history of the section, and Colorado case law make clear that the prohibition against lending or pledging the credit or faith of the city, i.e. its ability to pay its obligations, to another person or entity applies solely to cases in which the city guarantees or otherwise assumes the obligation of another party, unless the guarantee is for a public purpose, in which case it may lend its credit to another. There is no indication whatever that it would prohibit a city from operating a public bank or lending money to third parties or to itself.

II. Article XI, §2 Prohibition Against Donations or Grants

Article XI, § 2, “No Aid to Corporations - No Joint Ownership by State, County, City, Town, Or School District”, reads as follows:

Neither the state, nor any county, city, town, township, or school district shall make any donation or grant to, or in aid of, or become a subscriber to, or shareholder in any corporation or company or a joint owner with any person, company, or corporation, public or private, in or out of the state, except as to such ownership as may accrue to the state by escheat, or by forfeiture, by operation or provision of law; and except as to such ownership as may accrue to the state, or to any county, city, town, township, or school district, or to either or any of them, jointly with any person, company, or corporation, by forfeiture or sale of real estate for nonpayment of taxes, or by donation or devise for public use, or by purchase by or on behalf of any or either of them, jointly with any or either of them, under execution in cases of fines, penalties, or forfeiture of recognizance, breach of condition of official bond, or of bond to secure public moneys, or the performance of any contract in which they or any of them may be jointly or severally interested. Nothing in this section shall be construed to prohibit any city or town from becoming a subscriber or shareholder in any corporation or company, public or private, or a joint owner with any person, company, or corporation, public or private, in order to effect the development of energy resources after discovery, or production, transportation, or transmission of energy in whole or in part for the benefit of the inhabitants of such city or town. (emphasis added) (Colo. Const. Art. XI, Section 2)

This section prohibits the city from making grants to a private person. This would not prevent the city from operating a bank or lending money because a loan by its terms is not a grant or donation but is required to be paid back.

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