Memorandum

TO: WeArePeople Here! Educational Fund
FROM: David P. Buchholtz
SUBJECT: City of Santa Fe Public Bank Proposal
DATE: September 25, 2015

In connection with your work advocating for the establishment by the City of Santa Fe, New Mexico (the “City”) of a bank to be owned by the City, you have asked us to address certain legal considerations which will need to be considered by the City in connection with this undertaking. We have identified six areas of consideration we believe would need to be addressed in connection with the City’s moving forward on this project. These issues are identified below, along with a discussion of our advice regarding solutions to these challenges.

1. **Home Rule Authority.** Our review of New Mexico statutes finds no specific legislation authorizing the establishment of a bank. However, Article X, Section 6 of the New Mexico Constitution and Sections 3-15-1 through -16 NMSA 1978, as amended, permits municipalities to adopt a charter granting them authority to become a home rule charter municipality. The City became a home rule municipality in 1997. Section 3-15-13(B) NMSA 1978, as amended, states that:

   “A municipality that adopts a charter may exercise all legislative powers and perform all functions not expressly denied charter municipalities by general law or charter. A liberal construction shall be given to the powers of municipalities to provide for maximum local self-government.”

The scope of the extent of home rule authority has been regularly evaluated by New Mexico courts. The courts apply a two-step analysis. In the first step, a court asks whether there is a state law which is a “general law”: one that applies generally throughout the state, relates to a matter of statewide concern and impacts inhabitants across the state. The second step requires determining whether the general law expressly denies the City’s power to take certain action. See *Smith v. City of Santa Fe*, 139 N.M. 410 (N.M. Ct App. 2006), aff’d, 144 N.M. 786 (2007).

Two recent cases, both involving the City, illustrate New Mexico courts testing local legislation against the scope of home rule authority. In *New Mexicans for Free Enterprise v. City of Santa Fe*, 138 N.M. 785 (N.M. Ct. App. 2006), the Court of Appeals upheld an ordinance of the City regulating the minimum wage scales. In *Smith*, supra, the Court of Appeals upheld an ordinance of the City regulating domestic wells. And on appeal, the *Smith* holding and rationale were affirmed by the New Mexico Supreme Court.
We believe that the holdings and rationale expressed in the New Mexicans for Free Enterprise and Smith decisions would outweigh and have a more persuasive effect compared to the earlier, more restrictive court rulings on home rule authority. These more recent decisions are grounds on which a court may hold that the City would be acting within its home rule authority in adopting legislation to permit the formation of a city owned bank.

We are not aware of any general state law dealing directly with this issue. There is legislation authorizing and regulating the establishment of a variety of state financial agencies -- for example, The Banking Act Sections 58-1-1 through -85 NMSA 1978, as amended, and the New Mexico Finance Authority Act Sections 6-21-1 through -31 NMSA, as amended. A distinction should be made between the possibility of denial of the City’s right to establish its own bank based on upon the existence of state financing authorities such as the NMFA, and the possibility of denial based upon the failure to comply with banking regulations that would likely still apply to the City’s bank under the Banking Act. In our view, and in light of Smith and New Mexicans for Free Enterprise, so long as the City’s bank complies with the Banking Act’s requirements, neither of these considerations should lead to denial of the City’s right to establish its own bank.

2. Public Purpose Issues. Related to the analysis of whether a home rule chartered community could adopt legislation authorizing the creation of a public bank, the question of whether such legislation would be within the government’s police power, that is, legislation to promote the health, public safety, morals and general welfare of the community, likely also will be considered. Early court decisions often limited the police powers of local government when new ventures were proposed. See, for example, Smith v. City of Raton, 18 N.M. 613 (1914) (suggesting that construction of an opera house not a public purpose within a narrowly drafted statute). Notwithstanding those older cases, we believe that modern law, and in particular a court’s interpretation of specific authorization, would view a bank as akin to permitted utility services which provide water, electricity, gas refuse and sewer service, all clearly public purposes. Moreover, the statutory developments on the state level, in promoting housing finance (see the Mortgage Finance Authority Act, Sections 58-18-1 through -27 NMSA 1978, as amended), and in promoting educational finance (see the Educational Assistance Act, Sections 21-21A-1 through -25 NMSA 1978, as amended), illustrate a legislative intent to allow government to participate in private finance matters. While not precedential for a New Mexico court, we think that the 97-year history of the Bank of North Dakota’s success, as well as recent trends in jurisdictions such as California, Pennsylvania and Vermont in promoting a public bank, might be persuasive in arguing the public purpose of a municipal bank.

3. Borrowing Considerations. Presumably the City will be faced with considerations relating to how it might capitalize a bank or similar financial institution that is owned and created by the City. While the City may appear, from a balance sheet perspective, to have other adequate resources to capitalize a bank, unlike the state (which has two large permanent funds with capital
available for long term investment), given the City's comparatively limited resources, these resources may in large part have to be invested with liquidity and safety as paramount considerations, and not be available for long term investment. Therefore, putting aside for the moment policy, political and outstanding contractual considerations in the assessment of borrowing for this purpose, the Revenue Bond Act (Sections 3-31-1 through -12 NMSA 1978, as amended, provides guidance and opportunity regarding the ability of the City to borrow for these purposes. Section 3-31-1(C), in the text following subparagraph 10, relating to purposes permitting borrowing against gross receipts tax revenues, provides:

The municipality may pledge irrevocably any or all of the gross receipts taxes ... to the payment of ... gross receipt tax revenue bonds ... for public purposes authorized by municipalities having constitutional home rule charters.

Further, Section 3-31-1(F) provides authority for the issuance of project revenue bonds, which permits the issuance of bonds in connection with the acquisition of a revenue producing project (presumably including a bank) with repayment made from the revenues of the project. While bonds issued under these provisions may have a relatively expensive interest component, due to the lack of a federal income tax exemption for interest paid on these bonds, and due to the speculative nature of the investment, the question of the City's authority to issue bonds for this purpose should be positively determined by the text of the permissive language of the statute and a conclusion regarding the public purpose of the bank as set forth in Section 2 above.

4. Investment Authority. Questions may be raised about the limitations placed on the investment of capital made available for bank capital purposes by provisions of the New Mexico Constitution and statutes. Article VIII of the New Mexico constitution provides in part:

All public money not invested in interest-bearing securities shall be deposited in national banks in this state, in banks or trust companies incorporated under the laws of the state, in federal savings and loan associations in this state, in savings and loan associations incorporated under the laws of this state whose deposits are insured by an agency of the United States and in credit unions incorporated under the laws of this state or the United States to the extent that such deposits of public money in credit unions are insured by an agency of the United States, and the interest derived therefrom shall be applied in the manner prescribed by law.

Following on that provision, Section 6-10-10 NMSA 1978, as amended, contains more detailed provisions regarding the deposit and investment of funds.

An important overlay to the restrictions imposed by the constitutional and statutory provisions above is the old Supreme Court case of Davy v. Day, 31 N.M 519 (1926). In Davy, the Court
construed this constitutional provision in light of the need of the Bluewater Toltec Irrigation Districts to keep funds on hand in an out-of-state bank for bond repayment purposes. In permitting this activity, the Court used sweeping language to limit the scope of the constitutional provision such that, rather than strictly construed, it be read in a way that gives accord to business methods and practices:

The constitutional provision simply means that the public funds, when not so used, shall be deposited for safe-keeping in the institutions named in the provision; but, when they are required to meet the public obligations, they may be expended in a business way, and according to business methods and practices.

It is important not to over read the statement of the Court in Davy, particularly in light of the circumstances in which it was made. Nevertheless, the Davy Court’s construction of the constitutional provision supports that there should be some discretion available to the City in the manner in which funds are put to use in the context of capitalizing the bank. We caution, however, that, the Davy Court’s reading also supports that the constitutional provision makes paramount the importance of the money’s safe-keeping. To comply with this constitutional provision and the statutory provisions under the Davy decision, steps should be taken to protect the safety of the capital in any case.

5. Anti-Donation and Similar Constitutional Provisions. New uses of funds by government inevitably raise questions about the applicability of Article IX Section 14 of the New Mexico Constitution, often referred to as the Anti-Donation Clause. This Section provides in part:

Neither the state nor any county, school district or municipality, except as otherwise provided in this constitution, shall directly or indirectly lend or pledge its credit or make any donation to or in aid of any person, association or public or private corporation.

While much debated, the clause prohibits gifts by the state and local governments and the pledging of credit for private purposes, but it is not a bar to a wide range of congressional activities. A recent federal district court case, City of Raton v. Arkansas River Power Authority, 600 F.Supp.2 1130 (DNM 2008), while not precedential on New Mexico state courts, presents an excellent explanation of Anti-Donation clause principles. In the context of denying a claim by the City of Raton that it be relieved of its obligations of supplying power to third parties under a power sales agreement, the court went to great lengths to outline the history of litigation relating to the clause. The clause is not intended to interfere with contractual relations so long as a governmental entity receives valuable consideration in return for its money. In particular, the court noted:
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The Court does not believe it should evaluate whether the agreement was a good or bad deal under the Anti-Donation Clause, but merely check for adequate consideration. The Anti-donation Clause does not exist to get New Mexico's public entities out of bad commercial agreements.

It is impossible to predict at this time the form or content of any financial arrangements relation to the capitalization of a public bank. It can be said that as long as the consideration is made in a way so that the terms of any governmental investment deliver consideration to the government, the investment should not be challenged by Anti-Donation principals.

6. **Financial Institution Regulations.** It is beyond the scope of this memorandum to present a roadmap of state and federal bank formation regulations with a view toward defining the steps to be taken to meet those requirements. Suffice it to say, both the Banking Act cited above, other state laws and regulations, as well as federal law and regulations, provide a myriad of provisions regarding the establishment and operations of financial institutions. Any financial institution formed on behalf of the City would need to be aware of and to adhere to those provisions concerning financial institution.

We hope this memorandum will be helpful to you in providing guidance on expected legal considerations relating to this proposal. We would be happy to visit with you, the City or other interested parties to help move this process along smoothly.