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CONTRACT — PURCHASE, ADDITIONAL MACHINERY FOR MUNICIPAL LIGHT PLANT — DEFERRED INSTALLMENTS TO BE PAID OUT OF NET PROFITS OF EXISTING PLANT, TOGETHER WITH MACHINERY — TITLE TO SUCH MACHINERY IN SELLER — INVALID — VIOLATES ARTICLE VIII, SECTION 6, CONSTITUTION OF OHIO.

SYLLABUS:

A contract by a municipality for the purchase of additional machinery for the light plant, which provides for the payment of deferred installments out of net profits of the existing plant together with such machinery, meanwhile leaving title to such machinery in the seller, is in violation of Article VIII, Section 6, of the Constitution of Ohio and is invalid.

Columbus, Ohio, November 6, 1942.

Bureau of Inspection and Supervision of Public Offices,
Columbus, Ohio.

Gentlemen:

Your letter requesting my opinion reads as follows:

"We are enclosing herewith two letters from one of our state examiners and the original of Ordinance No. 95 passed by the council of the village of Caldwell, Ohio, and original canceled certificate No. 1, for $636.24, as signed by the president and clerk of the board of trustees of public affairs of said village, all of which pertain to the financing of certain improvements, or extension of the village owned electric light and power plant.

Before requesting that you examine these enclosures and give us your opinion in answer to questions concerning the

legality of said financing, may we observe that the contract, or method of financing, or both, concerning this improvement by and between the village of Caldwell and Fairbanks, Morse & Company, appear to be identical with the contract between the village of Brewster and Fairbanks, Morse & Company, which was held to be illegal in the case of village of Brewster et al v. Hill, a taxpayer, 128 O.S. 343, with the possible exception that section 7 of Ordinance No. 95, carries a provision, to-wit:

'* * * however, such retention of title shall be as security only, and shall not in any wise give or grant to such seller, * * * any right, title, share, or interest in, or to said public utility, or any part thereof, or any other property of said village or in the revenues derived from the operation thereof, it being a provision of such purchase that upon the full payment therefor, the title to said generating machinery shall pass to the village free and clear of any liens or encumbrances thereon, * * *.'

It would also appear that certificate No. 1, as above referred to, is in the form of a note, or at least it and the additional certificates, were used in the manner of notes by the contractor in procuring money from bank through the sale thereof.

Now, may we request that you examine the enclosures and give us your opinion in answer to the following questions:

Question 1: Is the contract between the village and Fairbanks, Morse & Company, legal, as authorized by Ordinance No. 95, and which was apparently awarded to said company by the board of trustees of public affairs in accordance with the provisions of section 4328 G.C. but which also permits the company to retain title to the machinery until fully paid for by the village, although said machinery is housed in the municipal plant building?

Question 2: Is the board of trustees of public affairs authorized to obligate and bind the village to pay the certificates signed by its president and clerk, notwithstanding the provisions of the Uniform Bond Act, providing a different method of binding the municipality upon bonds, notes or certificates of indebtedness?

Question 3: If the answers to questions 1 and 2 should be in the negative, would the state examiner be authorized to render finding for recovery for moneys already paid upon the said contract and installment certificates?"

I note also the transcript of Ordinance No. 95, passed by the council of the village of Caldwell, authorizing the advertising for bids for additions to the electric light and power plant and providing for the erection of a building to house the same and setting out the terms and conditions upon which the contract is to be made.

Because of the similarity of this contract to that which was under consideration by the Supreme Court in the case of Village of Brewster v. Hill, 128 O.S. 342, 343, I have made a careful examination of the municipal ordinances adopted by the village of Brewster as found in the complete record of that case.

It is evident that unless the legislative proceedings in the Caldwell case and the terms of the contract authorized thereby differ essentially from those in the Brewster case, the decision of the court above noted would be a complete answer to your question and that the contract between the village of Caldwell and Fairbanks, Morse & Company must be held to be invalid. Upon a comparative analysis of the legislation of these two villages, I find that in both cases the proceedings were started by a proper resolution by the board of trustees of public affairs determining the necessity of acquiring additional machinery for the purpose above stated, and providing the necessary housing for the same, and adopting plans and specifications therefor. The ordinance of the village of Caldwell, declaring the necessity for making these improvements and authorizing the advertisement for bids upon the conditions stated therein, is the only step in the legislation of that village which has been submitted to me. I do not have before me any specific ordinance approving the award nor do I have the contract which was entered into pursuant thereto. There is submitted with your letter the original of one of the certificates issued by the board of trustees of public affairs, covering one of the deferred installments. From a notation thereon the certificate appears to have been paid.

Section 2 of the Caldwell ordinance approves the plans and specifications for the construction of the building and also for the generating machinery, as prepared and on file with the village clerk, the estimated cost of the building being stated as not to exceed $4,750.75, and not to exceed $52,000.00 for the generating machinery. (In the following quotations the emphasis is mine.)

Section 3 provides:

> "That the *entire cost* of the proposed new building as provided in said plans and specifications, shall be *paid solely from funds* now on hand in the *Electric and Power fund derived from the operations of said public utility* over and above the cost of operation thereof, not otherwise appropriated, now at the disposal of said board of trustees of public affairs in an amount adequate for said purpose."

Section 4 provides for the payment of the cost of the generating machinery as follows:

> "Five thousand dollars to be paid * * * five days after the Diesel engine arrives at the village light plant. The *balance of the contract price of said generating machinery shall be paid solely from the revenues derived and to be derived from the operation of said public utility* over and above the legitimate and necessary costs and expenses of the operation thereof, and from no other fund, *and the obligation to pay the same shall not be or become an indebtedness or general obligation of said village* or require payment from any general fund, but *shall be confined* solely to *a special obligation* to pay from the said net revenues derived as aforesaid."

Sections 5 and 6 of the aforesaid ordinance read as follows:

> "5. That, subject to the restrictions aforesaid as to the nature of the obligation and the funds from which payable, the *balance* of the contract price for the generating machine shall be payable *in seventy-two* (72) *equal installments,* payable monthly, commencing one installment on the 30th day after the completion of the installation of said machinery ready for operation, and a like installment on the like day of each consecutive month thereafter until fully paid, and that installments shall bear interest at the rate of five per cent per annum. Said interest is payable in monthly installments equal to the monthly average of the total interest on the unpaid balance of said purchase price at the rate of five (5) per cent per annum, from the date of the completion of installation of said generating machinery ready for operation, until maturity of the respective installment, interest to accrue at a like rate on said principal installment after maturity until paid."

> "6. For the convenience of the village and of the seller of said generating machinery *all deferred installments* of the principal of and interest on the price of said machinery payable as aforesaid, *shall be evidenced by a series of orders or certificates* signed in the name and on behalf of the board of trustees of public affairs of the village of Caldwell, Ohio, by the president and clerk of the board, stating briefly in substance the amount, maturities, terms, and conditions under which the respective installments are to be paid under the contract with the successful bidder, and the funds from which payment is to be made, and indicating by statement and reference the other restrictions and conditions applicable thereto."

The comparable provisions of the ordinance of the village of Brewster are as follows:

> "3. That the entire cost thereof shall be *paid solely from the revenue of said utility* after the payment of all legitimate and necessary expenses of the operation thereof, but not from

any other fund whatsoever *nor shall the obligation become a general obligation* of the village of Brewster except to pay for said machinery from the revenues as herein set forth, and the sum of thirty thousand dollars being the amount estimated as necessary for such purposes, as well as a sufficient amount to take care of the interest on the deferred payments herein referred to, be and are hereby appropriated from the Electric Light and Power fund and from the revenues from said utility after the payment of the legitimate and necessary expenses of the operation thereof.

4. The *deferred payments* which are to be made for the aforesaid machinery and equipment purchased for the Electric Light and Power Plant of said village shall bear interest at six per centum per annum from the date of the completion of the installation of the said machinery, and said interest payable semi-annually as it accrued, and *shall be evidenced by coupon revenue certificates,* payable to the successful bidder, signed by the president and clerk of the board of trustees of public affairs of the village of Brewster, in the name of said Board, each certificate showing on its face the amount of the respective portion of the purchase price which each certificate represents, the date upon which it should be presented for payment and that the amount evidenced by said certificate shall be payable only from the revenues of the Electric Light and Power System of the Village of Brewster, Ohio, after the payment of the legitimate and necessary expenses of the operation of said plant and not from any other fund whatsoever."

The Caldwell ordinance makes provision for the retention by the contractor of the title to the generating machinery until payment has been made in full. This provision is contained in Section 7 of the ordinance, which reads as follows:

"The successful bidder for the sale of the generating machinery to the village, shall by *way of security and not otherwise,* be permitted to retain title to said generating machinery until the price thereof and interest thereon, shall have become fully paid; *provided, however, such retention of the title shall be as security only, and shall not in any wise give or grant to such seller,* his or its successors or assigns, *any right, title, share, or interest in, or to said public utility,* or any part thereof, or any other property of said village *or in the revenues derived* from the operation thereof, it being a provision of such purchase that upon the full payment therefor, the title to said generating machinery shall pass to the village free and clear of any liens or encumbrances thereon, and that the *obligations assumed by the village are* to be *solely those necessary* to enable the village *to acquire such additional machinery* on deferred payments made from the net operating revenues of the public utility and *to give assurance to the successful bidder that said machinery will not be held or used by the village without being paid for out of the net revenues, if any, derived from the operation*

of said public utility, to which extent and no further, and without creating an indebtedness or liability to pay, *other than from the net revenues aforesaid, the village shall covenant* to and with the successful bidder substantially to the effect that until the principal of, and interest on said deferred payments shall have been fully paid or provided for, the village will continue to maintain and operate said public utility as a municipal public utility, will properly and economically maintain and operate the same, *and will charge such rates for all the products or service thereof,* furnished to the village or other customers of said public utility *as will be adequate to provide from said net revenues funds sufficient for the purpose."*

The provision of the Brewster ordinance as to retention of title is contained in Section 6, reading as follows:

"As security for the deferred payments, the board of trustees of public affairs is authorized to permit the successful bidder to *retain title* to the machinery and equipment furnished *until all deferred payments and interest thereon shall have been paid in full and satisfied* * * *."

It will be noted that the principal difference between these two ordinances in this respect are the words introduced into the Caldwell ordinances, apparently by way of safeguard, where it is provided that "such retention of the title shall be as security only and shall not in any wise give or grant to such seller, his or its successors or assigns, any right, title, share, or interest in or to said public utility, or any part thereof, or any other property of said village or in the revenues derived from the operation thereof." However, there is nothing in the reservation above quoted which seems to modify the express agreement on the part of the village to pay for the generating machinery so purchased out of the revenues of the utility. Note particularly the language "to which extent and no further and without creating an indebtedness or liability to pay other than from the revenues aforesaid, the village shall covenant," etc. There can be no question but that the village of Caldwell definitely obligated itself to pay for the generating machinery out of the revenues to be derived from the operation, which was exactly what the village of Brewster agreed to do.

Comparable with the last portion of Section 7, above quoted, wherein the village of Caldwell bound itself, until the principal and interest of said deferred payments should have been fully paid, or provided for, to "charge such rates * * * as will be adequate to provide from said net

revenues funds sufficient for the purpose," I find in Section 5 of the Brewster ordinance the following:

> " * * * *the village of Brewster will,* until all deferred payments and interest thereon under said contract are paid or a sinking fund established sufficient to pay them when due, *maintain rates for the product or service of said public utility* which will produce *sufficient revenue to insure the payment of the initial and all deferred payments of the purchase price* of said machinery and interest thereon, * * *."

I find in Section 11 of the Caldwell ordinance language which has no counterpart in the Brewster legislation. That section reads as follows:

> "That, said board of trustees shall and is hereby authorized and directed to make all such provisions in said contracts as may be necessary or convenient for and in the accomplishment of the intents and purpose hereof, and pay the respective contract prices therefor out of the funds severally hereinbefore described; *provided, however, that in the contracts hereby authorized, no provision shall be made whereby the seller of said machinery shall be or become a joint adventurer with, or partner of, the village of Caldwell, or entitled to share with said village any of the* properties, rights, privileges, *revenues, issues, or profits* of said public utility or concerning the same and any provisions in said contracts or specifications in conflict with the provisions of this section, whether provided or otherwise authorized by this or any other ordinance, shall be null and void, *without affecting the validity of the remainder of the obligation* of the contractor to perform the contract *or of the village to pay for the same."*

I turn to the case of Village of Brewster v. Hill, 128 O.S. 343, the syllabus of which reads as follows:

> "A village owning a distribution system for electric current, contracted with another to supply generating machinery for its system for the sum of $24,460.00, payable partly in cash and partly in deferred installments from the net revenues derived from the plant's operation. The title to the machinery was to remain in the seller until paid for, but the purchase price installments were not to be the general obligation of the village or payable from taxes. Upon its part the village agreed to provide housing for the machinery, to pay $5000.00 in cash upon arrival of the equipment and to pay the deferred installments out of the net revenues in sixty consecutive installments after erection. Held: The foregoing transaction between the village and the seller of the machinery contemplates the union of the property of the village with that of the seller in a common pool,

from which the net earnings of the joint enterprise would be paid to the seller. To the extent that the village devoted the whole of its own property to secure the seller, to that extent did it loan its financial credit to and in aid of the seller in violation of Section 6, Article VIII of the Ohio Constitution."

Judge Jones, speaking for the court, says at page 352 of the opinion:

"While it is true that the net revenues derived from the joinder of the properties were not to be realized from general taxes, but from the income from the plant; it is also true that the village's distribution system must originally have been raised by taxation. If such be a fact it follows that, by the contribution of the two properties, a part by the village and a part by the contractor, these properties were placed in a common pool from which the net earnings were to be paid to one member of the pool until its purchase price should be paid under the agreement. Let us assume that the village's distribution system has a value of $60,000, as indicated by counsel. Had the village advanced that amount in cash or credit, from which the net earnings of the joint enterprise would be first paid to the contractor in liquidation of his purchase, as stated by Johnson, J., on page 308 of his opinion in State, ex rel., v. Cincinnati, supra (97 O.S. 283), it would be 'in effect a lending of the city's (village) credit in aid of the company' (contractor). To the extent that the village devoted the whole of its own property to secure the contractor, to that extent did it loan its financial credit to and in aid of the contractor."

It will be noted that in preparation of the ordinance authorizing the contract under present consideration, the village undertook in Section 11, which I have quoted, to provide that in the contract authorized by said ordinance "no provision should be made whereby the seller of said machinery shall be or become a joint adventure with, or partner of, the village of Caldwell, or entitled to share with said village, any of the properties, rights, privileges, revenues, issues, or profits of said public utility," and that any provisions in said contract or specifications in conflict with the provisions of that section should be null and void. In my opinion this declaration does not have the effect of saving the contract from the charge of invalidity if, as a matter of fact, the contract in its essential terms does make the village a partner with the contractor or does amount to a loan of its financial credit to or in aid of the seller.

By the terms of the ordinance, the trustees of the board of public affairs were authorized to, and I assume did enter into a contract whereby they united the property of the village with that of the seller in a common pool from which the net earnings of the join enterprise was to be

paid to the seller, and a mere declaration on the part of the council that it was not its intention to do what the Constitution forbids would not change the effect of the contract.

I am unable to find any essential features in which the ordinance in question differs from the ordinance in the Brewster case, and in the light of the holding of the court in that case, I am compelled to find that a contract made by and between the village of Caldwell and the Fairbanks, Morse & Company, as authorized by Ordinance 95, and on the terms and conditions therein set forth, is invalid.

This conclusion seems to make it unnecessary to answer your second question.

Coming to your third question, as to the duty of the state examiner in the matter, it would seem clear that in the event it is found that money has been unlawfully expended by the village under a contract which is invalid because in contravention of the provisions of the Constitution, it would be your duty to make and file the report and take the steps required by Section 286 of the General Code.

Respectfully,

THOMAS J. HERBERT
Attorney General.