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The State of South Carolina

Opinion No 85-353

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State Reorganization Commission
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Dear Mr. Long:

On behalf of the State Reorganization Commission, you have asked "whether the use of lease-purchase financing for the construction of new prison facilities would have the same long term debt effect as the use of general bonds." We would advise that if the lease-purchase agreement contains a so-called "non-appropriations" clause, thereby binding the State only to the extent of currently appropriated revenues, such an agreement would not constitute a debt or indebtedness within the meaning of existing constitutional and statutory provisions and thus would not have the same effect as general obligation bonds. This conclusion is in accord with the case law of most other jurisdictions which will be reviewed in detail below.

Article X, § 13 of the South Carolina Constitution, as recently amended, provides in pertinent part:

> (1) Subject to the conditions and limitations in this section, the State shall have power to incur indebtedness in the following categories and in no others: (a) general obligation debt; and (b) indebtedness payable only from a revenue producing project or from a special source as provided in subsection (9) hereof.
>
> (2) "General obligation debt" shall mean any indebtedness of the State which shall be

> secured in whole or in part by a pledge of the full faith, credit and taxing power of the State.
>
> ... (5) If general obligation debt be authorized by (a) two thirds of the members of each House of the General Assembly; or (b) by a majority vote of the qualified electors of the State voting in a referendum called by the General Assembly there shall be no conditions or restrictions limiting the incurring of such indebtedness except (i) those restrictions and limitations imposed by the authorization to incur such indebtedness and (ii) the provisions of subsection (3) hereof. 1/
>
> (6) General obligation debt may also be incurred on such terms and conditions as the General Assembly may by law prescribe under the following limitations:
> ... (c) General obligation bonds for any public purpose including those purposes set forth in (a) and (b) may be issued: provided, that the maximum annual debt service on all general obligation bonds of the State thereafter to be outstanding (excluding highway bonds, tax anticipation notes, and bond anticipation notes) must not exceed five percent of the general revenues of the State for the fiscal year next preceding (excluding revenues which are authorized to be pledged for State highway bonds and state institution bonds.) (emphasis added).

See also, § 11-11-440 of the Code.

Thus, even in the absence of the applicability of subsection (5) of Article X, § 13, it still must be determined whether a so-called lease-purchase agreement for the construction of a prison facility constitutes an "indebtedness" similar to the issuance of general obligation bonds within the meaning of

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1/ Subsection 3 provides that "[g]eneral obligation debt may not be incurred except for a public purpose and all general obligation debt shall mature not later than thirty years from the time such indebtedness shall be incurred."

Article X, § 13's express limitations. The question does not as yet appear to have been squarely addressed by our own Supreme Court. Of course, until such time, this Office can only advise you as to the state of the law in other jurisdictions. There does exist an abundance of case law elsewhere which addresses your question, however.

CONSTITUTIONAL DEBT

By way of background, it is generally well recognized that:

> The state and the people of the state have the power by virtue of constitutional provisions to protect all funds belonging to the state from future debt, and where the constitution imposes limitations on the power of the state to incur indebtedness, no valid debt can be created except for the purposes and in the manner prescribed.

81A C.J.S., States, § 214. The purpose of a constitutional prohibition or limitation "is to protect all funds belonging to the state from future debt and to prevent any legislative act which would bind subsequent legislatures to make appropriations of monies in subsequent fiscal years." Id. Within the meaning of constitutional limitations upon the power of a state to incur indebtedness, a "debt" has been defined as "an obligation secured by the general faith and credit of the state ...". 81A C.J.S., States § 219. This general definition is in accord with that which Article X, § 13 employs. See also, Article X, § 14.

It is also well accepted that obligations for the necessary and current expenses of the government do not constitute "indebtedness" within constitutional limitations. 81A C.J.S., States, § 220. Article X, § 7(a) of the Constitution provides that

> The General Assembly shall provide for an annual tax sufficient to defray the estimated expenses of the State for each year. Whenever it shall happen that the ordinary expenses of the State for any year shall exceed the income of the State for such year, the General Assembly shall provide for levying a tax in the ensuing year sufficient with other sources of income to pay the deficiency of the preceding year together with the estimated expenses for such ensuing year.

Our Supreme Court has held that the limitation of the Constitution placed upon the power of the General Assembly to increase the public debt "does not extend to debt incurred for the ordinary and current business of the State...." Lott v. Blackwood, 166 S.C. 58, 61-62, 164 S.E. 439 (1932); see former Article X, § 11. Compare, Duncan v. Charleston, 60 S.C. 532, 39 S.E. 265 (1901).

LEASE-PURCHASE AGREEMENTS

While these general principles have been applied fairly uniformly to the more traditional forms of government financing, their applicability to the so-called lease-purchase agreement is more problematical. A lease-purchase agreement has been defined as a rental contract that provides "for passage of title to the lessee at the end of the lease either automatically or through exercising a nominal purchase option." Bisk, "State and Municipal Lease-Purchase Agreements. A Reassessment", 7 Harvard Journal of Law and Public Policy, 521, 522 (1983). Such an agreement is a relatively new form of government financing. It has been said that

> Lease-purchasing offers attractive financial benefits to the government lessee. Through a lease-purchase agreement, a governmental unit may acquire needed real or personal property, ranging from photocopying and computer equipment to offices and real estate. Periodic payments under the lease cover installments on the property's purchase price plus interest. The government unit increases its economic interest in the property with each "rental" payment. In effect, it is paying over time for the eventual right to purchase the rented property for less than its true market value. If the government lessee meets its rental obligations for the entire length of the lease ... title passes to the lessee at the lease end either automatically or by exercise of a nominal purchase.

Id.

CASES HOLDING LEASE-PURCHASES ARE DEBT

In the past, courts in other jurisdictions have sharply differed as to whether a lease-purchase agreement constitutes indebtedness for purposes of constitutional limitations upon incurring debt. Perhaps the leading decision concluding that a

lease-purchase agreement constitutes indebtedness is State ex rel. Kitchen v. Christman, 31 Ohio St. 64, 285 N.E.2d 362 (1972). There, a company obligated itself to construct a swimming pool on land leased to it by the city. The land was then to be leased back to the city for a period of ten years. The lease expressly provided that if the city failed to make any of the lease payments, the payment "shall continue as an obligation of the city." Id. at 366.

The Court analyzed that the agreement constituted nothing more than "an installment purchase contract." Id. at 365. As such, "the entire contract price is a present indebtedness of the city."

> The city has presently obligated itself to make future payments, and the Company has a present right to compel each succeeding administration to make those payments. The city's obligation under the contract is a continuing one, and no succeeding city council can refuse to appropriate available funds (generated by its taxing power) for payment. Had bonds been issued and the taxing power of the city pledged for their payment, a debt within Section 11 of Article XII would have been created. A pledge to make future appropriations of tax revenues must be treated no differently.

Id.

The Court further addressed the argument that a lease to be paid by annual appropriations from the general revenue fund is not "bonded indebtedness" within the meaning of Ohio's constitutional limitation.

> Literally speaking, a lease is not bonded indebtedness. However, it has already been determined that the instrument is not a lease but a contract to purchase a capital asset with a present obligation to pay future installments. The city has bound itself by a formal agreement to make specific future payments of money. Such a written agreement, obligating the city unconditionally to make such future payments constitutes a "bond" of the city, and thus creates a "bonded indebtedness."

Id. at 268. In short, since the agreement was deemed by the Court to be a contract of purchase, rather than a lease, "the

entire contract price is a presently incurred indebtedness even if the consideration is to be paid in installments over an extended period of time." Id., n. 7.

It is significant to note that the Court in Kitchen suggested that the particular facts involved were important to its holding. The Court clearly stressed in its analysis the "unconditional" nature of the city's financial commitment by virtue of the clause in the agreement relating to the city's continuing obligation and commented as follows:

> If such an unconditional obligation of did not exist, but instead, the city were free to periodically choose whether to continue to appropriate monies for the purpose of acquiring eventual complete ownership of the property in question, an entirely different question might have been presented.

285 N.E.2d at 367, n. 6.

A number of other decisions have followed the approach taken by the Court in Kitchen. See, City of Phoenix v. Phoenix Civil Auditorium and Convention Center Assn. 99 Ariz. 270, 408 P.2d 818 (1965); Bachtell v. City of Waterloo, 200 N.W.2d 548 (Iowa 1972); Martin v. Oregon Bldg. Auth. 276 Or. 135, 554 P.2d 126 (1976); Foster v. N. C. Med. Care Comm., 283 N.C. 110, 195 S.E.2d 517 (1973); Laramie Citizens v. City of Laramie, 617 P.2d 474 (Wyo. 1980); State ex rel. Wash. St. Bldg. Fin. Auth. v. Yelle, 47 Wash. 2d 705, 289 P.2d 355 (1955); Ayer v. Comm. of Adm. 340 Mass. 586, 165 N.E.2d 885 (1960); State ex rel. Simmons v. City of Missoula, 144 Mont. 210, 395 P.2d 249 (1964). See also, Bisk, supra at 545, n. 141. These cases generally stress the intent of the parties and the importance of the facts and circumstances surrounding the agreement as to whether the agreement is a true lease or, in reality, an installment purchase contract. Martin v. Oregon Bldg. Auth., 554 P.2d at 135. Important in the analysis are factors such as whether the "lease" payments are instead installments for purchase, whether the "purchase price" at the time the option is exercised is "nominal in relation to the value of the property", Id., and whether the otherwise legitimate vendor-lessor" is an alter ego of the State. Bisk, supra at 533.

CASES HOLDING LEASE-PURCHASES ARE NOT DEBT

On the other hand, courts elsewhere have concluded that lease-purchase agreements by virtue of their nature do not represent "debt" in the constitutional sense. A leading

decision following this line of analysis is Dean v. Kuchel, 35 Cal.2d 444, 218 P.2d 521 (1950). There, a contractor constructed a building for the State and leased it to the State for twenty-five years. At the end of the lease period, title to the property automatically vested in the State. It was alleged that the agreement violated the applicable debt limitation provision, but the Court concluded otherwise. The Court referenced City of Los Angeles v. Offner, 19 Cal.2d 483, 122 P.2d 14, 145 A.L.R. 1358, which had previously stated the following rule concerning whether lease-purchase agreements constituted debt:

> ... if the lease or other agreement is entered into in good faith and creates no immediate indebtedness for the aggregate installments therein provided for, but, on the contrary, confines liability to each installment, as it falls due and each year's payment is for consideration actually furnished that year, no violence is done to the constitutional provision.... If, however, the instrument creates a full and complete liability on its execution, or if its designation as a "lease" is a subterfuge and it is actually a conditional sales contract in which the 'rentals' are installment payments on the purchase price for the aggregate of which an immediate and present indebtedness or liability exceeding the constitutional limitation arises against the public entity, the contract is void.

218 P.2d at 522-523. The Court in Dean observed that the "essence of the Offner rule is that the payments are for a month to month use of the building." 218 P.2d at 523.

> Here the rentals ... must be paid but the state need not pay any more. We are satisfied therefore that the instant transaction qualifies as a lease for the purpose of the debt limitation.

Id.

The Dean case has been interpreted as follows by a leading authority:

> The court in Dean relied upon well-established common law principles to reach its conclusion. Precedent reaching back centuries establishes the general rule that

> leases do not constitute present indebtedness. Rent is viewed as a recurring obligation paid only out of current revenues.

Bisk, supra at 530-531. However, it is generally recognized that common law rules concerning lease obligations do not "address ... the peculiarities of state and municipal lease-purchase agreements." Id. Thus, many courts which have adopted Dean's line of reasoning have further examined the particular lease-purchase agreement for "some concrete proof of contingency." These courts have sought to determine whether the rental payment is equal to or lower than the fair market rental value of the property, thereby indicative that the payment is for the use value of the property. Id. As was stated in Alan v. County of Wayne, 200 N.W.2d 628, 678 (Mich. 1972),

> A true rent payment must be reasonable in that it must bear a direct relation to the economic or market value to the county of its actual use of the public improvement.

See also, Book v. State Off. Bldg. Comm. 149 N.E.2d 273 (Ind. 1958). Teperick v. North Judson San Pierre High School Bldg. 257 Ind. 516, 521, 275 N.E.2d 814, 818 (1971), cert den., 407 U.S. 921 (1971); Bulman v. McCrane, 64 N.J. 105, 114, 312 A.2d 857, 862 (1973); City of Pocatello v. Peterson, 93 Idaho 774, 775, 473 P.2d 644, 645 (1970); Eberhart v. Mayor of Baltimore, 291 Md. 92, 107, 433 A.2d 1118, 1125 (1981).

CASES WHERE A NON-APPROPRIATIONS CLAUSE IS PRESENT

Thus, it is clear that courts in other jurisdictions are sharply divided as to whether a lease-purchase agreement constitutes indebtedness. However, the authorities are virtually uniform that such an agreement does not create a debt where the agreement contains a so-called "non-appropriations" clause. Such a clause reserves to the governmental entity the right to terminate its legal liability under the lease if for any reason it chooses not to make the necessary appropriations for lease payments in a future fiscal year. Bisk, supra at 527. We believe that if a lease-purchase agreement contains such a clause, the courts in South Carolina will follow the reasoning of cases in other jurisdictions and conclude that the agreement does not constitute indebtedness for purposes of Article X of the Constitution. The authorities will be discussed below.

In Edgerly v. Honeywell Information Systems, Inc., 377 A.2d 104 (Me. 1977), the Maine Supreme Judicial Court reviewed a contract entered into between the State of Maine and Honeywell for the purchase of computer equipment. The Court noted that the contract "is replete with words and phrases indicative of an

intention to contract rather than a lease." 377 A.2d at 107. Honeywell agreed to install the equipment on the premises and furnish training personnel. A testing period for the equipment was established. The cost of the equipment was to be paid in installments. And significantly, title to the equipment passed to the State on the date of its installation.

However, the Court noted that there "was a specific provision that the state could return the equipment to Honeywell and be no longer liable for payments if ever the future legislatures failed to make the necessary appropriations." 377 A.2d at 108. The Court concluded that the presence of such a clause distinguished the case from a prior decision, Opinion of the Justices, 146 Me. 183, 189-90, 79 A.2d 753, 756 (1951).

> It is this latter provision ... that we see as distinguishing this case from that presented in the Opinion of the Justices, supra, which caused the justices to declare that one legislature cannot obligate succeeding legislatures to make appropriations and that a contract which obligates the state to pay money over a period of years for the purchase of property creates a liability. We see no constitutional violation resulting from this contract.

Id.

Another leading decision was rendered by the Wisconsin Supreme Court in State v. Giessel, 271 Wis. 15, 72 N.W.2d 577 (1955). In Giessel, the Court reviewed three separate lease-purchase agreements, two which dealt with the construction of university projects and a third which provided for the addition to the state office building. It is evident that the presence of non-appropriations clauses in each of the agreements was critical to the court's upholding them.

The complaint alleged that the agreements were, in reality, purchase agreements for the projects and thus clearly constituted an indebtedness of the State. The Court rejected the argument, however.

> With reference to the indoor practice building and dormitory projects, the leases provide that the obligation to pay rent is subject to available appropriations by the

> Legislature. Since there is no binding obligation on the part of the state to pay rent for the full term of the leases, it is inconceivable that a debt is incurred or that a purchase of the property is contemplated.

72 N.W.2d at 588. The Court further rejected the argument adopted by courts in other jurisdictions, that because an agreement constituted an installment contract, it therefore created an indebtedness.

> An installment purchase agreement does not necessarily create state debt. It has been determined in this state that no state debt is created where payments are to be made solely at the state's option....
>
> Similarly in the present matters, because the payments under the respective leases may be made at the option of the state, no debt is created. Were it to be held that the payments in the instant contracts constituted purchase installments instead of rentals, no debt would be created for reason that payments may be made at the option of the state.

Supra at 590.

Other jurisdictions are in accord. For example in St. Charles City-County Library Dist. v. St. Charles Library Bldg. Corp., 627 S.W.2d 64 (Mo. App. 1981), the Missouri Court held that a lease-purchase agreement which allowed the State to renew at its option each year did not constitute an indebtedness. Similarly in Gude v. City of Lakewood, 636 P.2d 691 (Colo. 1981), the Colorado court stated:

> Of particular importance to our conclusion that the city's rental obligations for future years do not constitute debt ... is the lease provision that those obligations are contingent upon exercise of the city's renewal options. We have held that discretionary or contingent obligations are not constitutional debt. "To constitute a debt in the constitutional sense, one

> legislature, in effect must obligate a future legislature to appropriate funds to discharge the debt created by the first legislature."

636 P.2d at 699. In Enourato v. New Jersey Bldg. Auth., 183 N. J. Super. 58, 440 A.2d 42 (1981), the New Jersey Court stated:

> L. 1981, c. 120 provides that future payments on the leases be subject to appropriations. There can be no doubt that this reservation is perfectly valid. While certainly we anticipate that future Legislatures will appropriate funds to pay the rentals nevertheless it is not deniable that they will be under no legal compulsions to do so.

440 A.2d at 49. In upholding the validity of a lease-purchase agreement, the Nebraska Supreme Court in Ruge v. State of Nebraska, 201 Neb. 391, 267 N.W. 748 (1978) stated that "[t]he fact is that the obligation of the state is conditioned upon an appropriations having been made before each rental period commences." 267 N.W.2d at 750. See also, United States Fire Ins. Co. v. Minn. State Zoological Bd. 307 N.W.2d 490 (Minn. 1981); Turnpike Auth. of Ky. v. Wall, 336 S.W.2d 551 (Ky. 1960).

In Glennon Heights, Inc. v. Central Bank & Trust, 658 P.2d 872 (Colo. 1983), the Supreme Court of Colorado examined in depth the validity of a lease-purchase agreement containing a non-appropriations clause. The lease-purchase agreement in question provided for the construction of group homes for the developmentally disabled. The Court first set forth the appropriate analysis for determining when debt is created.

> We have stated that some of the indications of a debt in the constitutional sense are that the obligation pledges revenues of future years, that it requires use of revenues from a tax otherwise available for general purposes, that it is a legally enforceable obligation against the state in future years or that appropriation by future legislatures of monies in payment of the obligation is nondiscretionary.

658 P.2d at 878-879. In concluding that the lease-purchase

agreement did not constitute debt, the Court stated:

> Under the present lease/purchase agreement, the bank has no legally enforceable right to require the general assembly to appropriate sufficient funds for renewal of the lease term every year or to require the state to exercise its option to purchase. The agreement provides that the Department of Institutions will use its "best efforts" to obtain funding every year for the rent payments, but that the appropriations of funds is a legislative act beyond the control of the department. Renewal of each term is specifically tied to appropriation of sufficient funds, and the lease terminates with no further obligation of the department if funds are not available. Nothing in the agreement limits the discretion of the legislature. The plaintiff's arguments that nonrenewal of the lease will ruin the credit of the state and will result in forced relocation of the disabled residents are matters that may affect the legislature's exercise of its discretion, but do not commit revenues available to future legislatures to the payment of rentals under the lease.

658 P.2d at 879.

In McFarland v. Barron, 164 N.W. 2d 607 (S.D. 1969), the Supreme Court of South Dakota concluded that lease-purchase agreements did not create a debt. The leases were required to contain a provision that rents shall be payable solely from appropriations to be made by the legislature and any revenues derived from the operation of the leased premises. The Court concluded that "[a]n appropriation of money which is to be satisfied out of current revenues for the year does not create an indebtedness." 164 N.W.2d at 609. The Court further noted that "the weight of authority" sustained the validity of the agreement. Id. at 610.

Likewise, the Supreme Court of Alabama, has consistently held that lease-purchase agreements containing non-appropriations provisions do not constitute debts of the State. In Opinion of the Justices, 178 So.2d 76 (1965), the Court upheld lease

agreements for the operation of correctional facilities authorized by legislative enactment. There, the Court stated:

> It is contemplated that the Corrections Institution Finance Authority will lease to the Board of Corrections or other agency the new prison facilities on a year to year basis, the rental therefor being paid from current income. All obligations by the State Board of Corrections or other state agency is strictly limited and can be payable only out of current revenues of the state for such fiscal year.

178 So.2d at 84. The Court's holding was consistent with prior Alabama decisions. See, In re Opinions of the Justices, 252 Ala. 465, 41 So.2d 761 (1949); Hillard v. City of Mobile, 253 Ala. 676, 47 So.2d 162 (1950).

WEST VIRGINIA CASES

One jurisdiction has, until recently, adopted the minority view regarding the presence of a non-appropriations clause in a lease-purchase agreement. In Hall v. Taylor, 173 S.E.2d 48 (W. Va. 1971), the West Virginia court held that a lease-purchase agreement constituted a debt regardless of whether the State had legally obligated itself to appropriate funds in future fiscal years. Concluded the Court,

> It is no answer to the invalidity of this statute and of the action of the Building Commission in issuing these bonds to say that some future legislature is not required to make an appropriation to one of these agencies or departments in order that the agency or department might make its payment of rent. The failure to make such an appropriation could result in the holders of the bonds taking over the buildings involved, and it is incomprehensible that any legislature would permit any such thing to happen. However, the test is not whether a future legislature is required to make such appropriations. The test is the authority to do so. Clearly the only source of income by which the bonds may be liquidated is the rent to be paid by the occupants of the buildings. Therefore, the reason for the invalidity of the statute lies in the authority of the legislature to

> make such future appropriations. It is not necessary for this Court to wait until some future legislature refuses to make an appropriation to make a determination of the legality of the procedure.

178 S.E.2d at 58-59.

However, only recently even the West Virginia court has rejected the reasoning in the Hall case in favor of the majority rule outlined above. In State ex rel. W. Va. Res. Recovery v. Gill, 323 S.E.2d 590 (W. Va. 1984), the court reviewed the validity of a "steam purchase agreement" as to whether such agreement constituted a debt. The West Virginia Board of Regents agreed to purchase steam generated by a state created authority over the period of twenty years. Purchase was made by the payment of monthly installments. Each party was permitted to suspend performance of the contract for any cause not within its control. The plaintiff in the litigation alleged that the agreement contemplated retiring the bonds issued for the project by proceeds from the sale of steam to the board over twenty years "with funds from the board's annual appropriation by the legislature." Thus, in reliance upon Hall v. Taylor, supra, plaintiff contended that the agreement created a debt in a contravention of the West Virginia Constitution.

The West Virginia Court in Gill expressly overruled the Hall case. In doing so, the Court observed:

> There is a world of difference between authorizing future legislatures to act and requiring them to do so. As Calhoun wrote, we had previously held that legislation does not necessarily violate the constitutional debt limitation simply because it anticipates future appropriations of public funds from year to year to effect the purposes of the act.

Quoting from a previous West Virginia case, State ex rel. Dyer v. Sims, 134 W.Va. 278, 290, 58 S.E.2d 766, 773 (1950), the court in Gill further stated:

> Ordinarily, the creation of a State board or commission which requires an appropriation of public funds to carry out its purposes is not treated as the creation of a debt, although it's generally contemplated

> continuation from year to year and for an indefinite period must necessarily involve future appropriations. Practically all agencies created by the Legislature require appropriations from time to time and that was necessarily contemplated at the time they were created.

323 S.E.2d at 595. Thus, said the Court in Gill, in adopting the reasoning of most other jurisdictions, the ultimate issue "is not whether the bonds may be paid from future legislative appropriations, but whether successive legislatures are obligated to make such appropriations." 323 S.E.2d at 596 (emphasis added).

Thus, while there is disagreement among courts regarding whether a lease-purchase agreement, standing alone, creates debt for purposes of constitutional limitations, the weight of authority elsewhere clearly supports the conclusion that the presence of a "non-appropriations" clause in the agreement prevents such an agreement from creating an indebtedness for such purposes. The critical factor in creating debt in such instances appears to be whether, by virtue of the present lease-purchase agreement, "successive legislatures are obligated to make appropriations" to effectuate that agreement. State v. Gill, supra; compare, State v. Christman, supra. Thus, so long as continuation of the agreement is expressly conditioned upon future legislative appropriations, no debt is created. In other words, the agreement should be "made conditional upon future appropriations." Bisk, supra at 527.

SOUTH CAROLINA AUTHORITIES

While our own courts have not yet squarely faced the issue of whether a lease-purchase agreement creates an indebtedness, we believe that our courts would adopt the majority line of reasoning outlined above; we believe that our courts would hold that the presence of a "non-appropriations" clause would prevent such an agreement from constituting indebtedness.

First, there is statutory support for this conclusion. The Consolidated Procurement Code, § 11-35-10 et seq., clearly anticipates that the State will enter into multi-year contracts for the purchase of supplies or services. Particularly, Section 11-35-2030 (1) provides as follows:

> ... Unless otherwise provided by law, a contract for supplies or services shall not be entered into for any period of more than one year unless approved in a manner

> prescribed by regulation of the board; provided, that the term of the contract and conditions of renewal or extension, if any, are included in the solicitation and funds are available for the first fiscal period at the time of contracting. Payment and performance obligations for succeeding fiscal periods shall be subject to the availability and appropriation of funds therefor. (emphasis added).

Subsection (3) further provides that "[w]hen funds are not appropriated or otherwise made available to support continuation of performance in a subsequent fiscal period, the contract shall be cancelled." (emphasis added). These statutory provisions clearly provide that, as a matter of law, every State contract for purchase of goods or services which is covered by the Consolidated Procurement Code and which extends beyond the first fiscal year, is conditioned upon there being an appropriation sufficient to meet payment and performance obligations; otherwise, the agreement is automatically cancelled. See, Op. Atty. Gen. No. 77-123 at 105 (April 27, 1977).

Of course, this statute is in conformity with the weight of case law concerning the presence of a non-appropriations clause, outlined above. And it is well known that the State enters into a number of lease-purchase agreements yearly. We must presume that the Legislature was cognizant of the existing authorities elsewhere and of the existing constitutional debt limitations contained in Article X. Thus, the requirements contained in § 11-35-2010 can be read as representing a legislative interpretation that Article X is not violated so long as each multi-year contract is conditioned upon future legislative appropriations. See, Opinions of the Justices, 178 So.2d 76, supra.

Moreover, Section 28 of the Permanent Provisions of Act No. 201 of 1985 (1985-86 Appropriations Act) expressly authorizes the State Budget and Control Board, after consultation with the Joint Bond Review Committee and the State Reorganization Commission,

> ... to enter into lease purchase agreements consistent with the Consolidated Procurement Code ... which would provide the State an economically feasible method of replacing the Central Correctional Institution (CCI), so long as these agreements (1) can be demonstrated to be comparably cost effective to traditional financing methods, (2) can

> result in long-term operational cost savings ... (5) that will minimize the wasteful expenditure of funds for further capital improvements to CCI, and (6) will be subject to the year-to-year appropriation process of the General Assembly. (emphasis added).

Again, this statutory provision can be read as a legislative recognition that the presence of a provision in a lease-purchase agreement that the agreement is "subject to the year-to-year appropriation process of the General Assembly" is necessary to avoid the creation of constitutional debt. We must presume the Legislature intended to comply with the Constitution.

Moreover existing South Carolina case law appears to be consistent with this majority rule. As stated earlier, our Court has recognized that the limitation of the Constitution placed upon the power of the General Assembly to increase the public debt "does not extend to debt incurred for the ordinary and current business of the State...." Lott v. Blackwood, supra, citing former Article X, § 11. See also, Haddon v. Cheatham, 161 S.C. 384, 159 S.E. 843 (1931). [County notes secured by a pledge of county taxes for the current fiscal year do not constitute bonded indebtedness.] As the Supreme Court of South Dakota similarly stated in McFarland v. Barron, supra, in concluding that a lease-purchase agreement containing a "non-appropriations" clause did not create debt, "[a]n appropriation of money which is to be satisfied out of current revenues does not create an indebtedness." Thus, based upon past holdings by our Court, a lease-purchase agreement which is expressly limited to payments from present appropriations, should not contravene the debt limitation provisions of our Constitution. See also, Briggs v. Greenville, 137 S.C. 288, 135 S.E. 153 (1926); Evans v. Beattie, 137 S.C. 496, 135 S.E. 538 (1926).

And in a previous opinion of this Office, it was concluded that Orangeburg County would not create an indebtedness by entering into a long term lease for the "proposed acquisition of office space." Op. Atty. Gen., July 15, 1981. Therein, it was concluded that the agreement would not constitute "general obligation debt" pursuant to Article X, § 14(3) of the Constitution, which employs an identical definition to that used in Article X, § 13.

The case of Duncan v. Charleston, supra is not inconsistent with this conclusion. In Duncan, the City of Charleston contracted with the Charleston Light and Water Company for a period of fifty years to provide services to the City. The

agreement provided that the city would pay $42,000 "for each and every year embraced in the period of said period of fifty years...." 60 S.C. at 535. The agreement further provided that the city would have the option to purchase the property of the Company.

The agreement was assailed on the ground that it created an indebtedness. Our Supreme Court held that it did.

> It seems to us that the paramount issue here involved is whether the $42,000 to be paid each year for fifty successive years from this date by the city of Charleston to the Charleston Light and Water Company under the contract between them is a bonded indebtedness. Is it a bonded indebtedness? It certainly is, and confessedly so by all the parties to these actions, an agreement to pay $2,100,000 within fifty years in annual installments of $42,000 made by the city of Charleston under its corporate seal. (emphasis added)

60 S.C. at 554-555. The Court went on to note that the agreement "incur[s] ... liability beyond the municipal income of the current year." Supra at 556.

It appears to us that the agreement in Duncan is similar to that struck down by the Ohio Court in the Kitchen case, discussed above. And for the same reason that the agreement constituted an indebtedness in Kitchen, i.e. that the agreement clearly committed future legislatures to pay the annual rent, the Court in Duncan had no real choice but to conclude that the agreement created a debt. As the 4th Circuit Court of Appeals has described the Duncan case in City of Georgetown v. Elliott, 95 F.2d 774, 776 (4th Cir. 1938)

> The pledge contained in the contract was not a pledge of current taxes or of taxes already levied, but of future taxes; and its effect necessarily was to increase for future years the burden upon the taxpayers under the general taxing power of the city.

In other words, the agreement in Duncan did not limit, by way of a non-appropriations clause, the city's liability to current revenues, but instead, attempted to obligate the city for fifty years into the future. For that reason, Duncan is distinguishable and is consistent with our conclusion herein.

CONCLUSION

In conclusion, we believe that the presence of an appropriately drafted "non-appropriations" clause in the lease-purchase agreement would prevent the agreement from creating indebtedness. Such a provision is indeed contemplated by § 11-35-2010 of the Consolidated Procurement Code, as well as permanent Section 28 of the 1985-86 Appropriations Act. So long as such a clause limits the State's obligation to the present fiscal year wherein the rental payment will be derived from current revenues and conditions the continuation of the agreement upon future legislative appropriations, a debt would not, in our judgment be created, even though the agreement is to endure for longer than one year. If such a clause is inserted into the agreement as is apparently required by state law, then there is no need to attempt to resolve the split of authority elsewhere which concludes that lease-purchase agreements are either per se valid or per se invalid. In other words, the presence of the non-appropriations provision should avoid questions as to the validity of the agreement.

As to the specific language of such a provision, we note that the cases cited herein have reviewed and upheld variations upon the wording of such a provision. 2/ The critical factor for

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2/ For example, one model clause provides as follows:

> In the event that the Lessee is unable to obtain funding for any renewal term, Lessee shall have the right to terminate this lease at the conclusion of the then current term of the lease and shall neither be obligated to make any lease payments due beyond the current term, nor to make any concluding payment whatsoever and this lease shall terminate as to the leased equipment. Provided, however, that in the event Lessee does not appropriate such funds, Lessee will use its good faith best efforts to acquire the necessary finding from other agencies or sources. Upon termination as provided for above, Lessor or its agents or assigns should have the right to take possession of the leased equipment and Lessee shall be liable to return the leased equipment to Lessor in full operational and good working order.

Bisk, supra at 527, n. 32. We merely provide this model language to you as information and make no recommendation as to its use.

purposes of determining whether the agreement constitutes indebtedness is not so much the precise verbiage used, as whether the provision substantively accomplishes the purpose of making the agreement conditional upon future appropriations.

Moreover, we would further note that, as a practical matter, the likelihood of non-appropriation with respect to a prison facility is remote because of the nature of the services involved. Clearly, the operation of a prison facility is an essential governmental function. See, Op. Atty. Gen. August 8, 1985. Therefore, while technically speaking, the State is not legally obligated to appropriate funds for such a lease-purchase project as a result of the insertion of the non-appropriations clause, and thus no debt is created, the importance of the governmental function involved in your question would make non-appropriation very unlikely.

Finally of course, we do not comment herein upon the validity of any particular lease-purchase agreement. Our opinion is intended to serve primarily as a compilation of the law regarding lease-purchase agreements, rather than as an attempt to advise as to the validity of any particular agreement. 3/ And it bears repetition that our court has not

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3/ We would simply call your attention to another provision sometimes included in lease-purchase agreements, and generally known as a "non-substitution" clause. This typically provides that the lease may not be terminated to acquire similar property or allocate funds to perform essentially the same function.

Conceivably, it could be argued that the presence of such a clause negates the purpose of the non-appropriation clause, thereby creating a debt or binding by contract the Legislature's ability to appropriate funds or exercise its sovereign power.

Of course, it is well recognized that no governmental agency can, by contract or otherwise, suspend or surrender its functions, nor can it legally enter into any contract which will embarrass or control its legislative powers. Nairn v. Bean 48 S.W.2d 584, 586 (Tex. 1932); Bowers v. City of Taylor, 16 S.W.2d 520, 521 (Tex. 1929); Vt. Elec. Power Co., Inc. v. Anderson, 147 A.2d 875, 883 (Vt. 1959). On the other hand, administrative or ministerial functions may be delegated even to private entities by contract. Op. Atty. Gen., August 8, 1985. While any contract which the State enters into inherently surrenders some attributes of sovereignty, Vt. Elec. Power Co. supra, and a governmental entity may by contract curtail its right to

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yet squarely addressed the issues raised herein and only a court could resolve with finality the validity of a particular lease-purchase agreement. Nevertheless, based upon the law in other jurisdictions and the South Carolina authorities cited, we believe our court would uphold a lease-purchase agreement containing an adequate non-appropriations clause.

Very truly yours,

Robert D. Cook
Executive Assistant for Opinions

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3/ Continued from Page 20

exercise proprietary functions, "it cannot surrender or contract away its governmental functions." State ex rel. Hammermill Paper Co. v. LaPlante, 205 N.W.2d 784, 811 (Wis. 1973); see also, Op. Atty. Gen., August 8, 1985.

Case law analyzing this type of non-substitution provision is sparse. The only authority which we can find which addresses this issue in the context of procurement of public property holds that a non-substitution clause is constitutionally permissible. See, Opinion of the Justices, 178 So.2d at 85 ["This limitation is a restriction on the freedom of action of the Board of Corrections and is clearly within the province of the Legislature and in no way could be considered to create a financial obligation on the part of the State."] See also, McCray v. City of Boulder, 439 P.2d 350, 355 (Colo. 1968). Until our court addresses the question to the contrary, we cannot say that such a clause would render the agreement unconstitutional.