TO: NESTOR NEWMAN, Assistant Chief Examiner
State Auditor's Office

FROM: MARY E. McCREA, Assistant Attorney General
Legal Fiscal Division, 0100

SUBJECT: Cellular Telephones and Municipal Employees

Nestor, Stacia Reynolds has referred your memo to me for response. With your memo, you provided the memo and attachments of Diane Supler. Diane asked several questions concerning cellular telephones and municipal employees which I paraphrase in the following question:

Whether agreements between local governments and phone companies where employees are able to purchase phones and use air time at government rates, even though the majority of calls are for personal use, and where the local government is ultimately responsible if an individual fails to pay their bill, violate the constitutional prohibition of article 8, section 7 against the lending of credit.

BACKGROUND

Cellular One and US West are offering the purchase of cellular phones and air time for volunteers of fire districts and employees of local government. The two companies are offering these services at the government rate even though the majority of the calls are for personal use. The companies send monthly bills for individuals to the local government and then the employees or volunteers make direct payment to the company. It is my understanding that since the contract is with the local government, the local government is ultimately responsible should the individual not make payment. Local governments have indicated that the reason they are encouraging employees and volunteers to have cellular phones is for the ability to communicate during emergencies.
The municipal entities have provided different mechanisms for ensuring that the individuals pay their own phone bills. For the City of Milton, employees must agree to garnishment of their wages or deduction from funds deposited in trust with the Fire Fighter's Association. For the Lake Tapps Fire Department, the member pays $50 to the Association and also agrees to garnishment of their wages in the case of non-payment. Pierce County Fire Protection District No. 5 has established that the mishandling of payment of phone bills will become a disciplinary matter and that any terminating employee will have charges deducted from their next check. For the City of Puyallup, the employee pays a $50 deposit and then the employee who leaves will have any unpaid last billing deducted from their check. Finally, for the Port of Tacoma, employees agree to garnishment of their wages should it become necessary.

**ANALYSIS**

Article 8, section 7 of the Washington Constitution provides as follows:

No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm, or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation.

There are two aspects of the agreements with the phone companies which may constitute a loan of credit. First, the employees are allowed to purchase and use the cellular phones at government rates. Second, employees are allowed to use their phones on a month-by-month basis and the bills are sent directly to the municipal entity, which is ultimately liable for the payment of the bills if the employee fails to make payment. I conclude that the use of governmental status, standing alone, is not a loan of credit. However, guaranteed payment of the employee’s bills is a constitutionally prohibited loan of credit.

A. **Use of Governmental Status**

The question whether the use of governmental status for the benefit of a private individual constitutes lending of credit has not been clearly resolved. In Health Care Facilities v. Ray, 93 Wn.2d 108, 605 P.2d 1260 (1980), the court considered whether the Washington Health Care Facilities Authority (Authority) was lending its credit by issuing tax-exempt bonds to assist two
private hospitals in building facilities and refunding existing high interest rate debts. The court stated:

[A] state or municipal corporation lends its credit whenever it allows its unique governmental status or authority to be utilized for the purpose of enabling a private corporation or individual to obtain property or money that it could not otherwise acquire for the same price. A state or municipality can "lend its credit" without incurring actual indebtedness.

Health Care Facilities, 93 Wn.2d at 113-114.

Under this view, the municipal entities would be lending their credit to volunteers and employees when they allowed them to buy cellular phones and to use them at the government rate. However, the court changed its position on this issue in two cases in 1985. In Higher Educ. Auth. v. Gardner, 103 Wn.2d 838, 699 P.2d 1240 (1985), the court held that bonds issued by the Washington Higher Education Facilities Authority for the benefit of private schools did not constitute a lending of credit. The court concluded that the State's tax-exempt status did not equal credit because it did not create a debt or a suretyship, nor did it establish a borrower-lender relationship between the state and the universities or the bond holders. Id. at 847. See also Council of Campfire v. Revenue, 105 Wn.2d 55, 711 P.2d 300 (1985) (The court rejected the contention that article 8, sections 5 and 7 precluded the Legislature from repealing taxes which are vested in the state prior to the effective date of the repealing statute. Tax money already collected could not be refunded, but where no money comes from the public treasury there is no lending of credit.)

Under the current state of the law, therefore, the municipalities are not lending their credit merely by allowing employees and volunteers to purchase cellular phones and use them at the government rate. However, the municipalities are lending their credit when they guarantee payment of an employee's phone bill.

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1 Health Care Facilities v. Ray was decided under article 8, section 5 of the Washington Constitution which provides "[t]he credit of the state shall not, in any manner be given or loaned to, or in aid of, any individual, association, company or corporation." Cases interpreting article 8, section 7 and article 8, section 5 are applicable one to another. Marriage of Johnson, 96 Wn.2d n. 1 at 261.
B. Guaranteed Payment of Employees' Bills

In Gruen v. State Tax Comm’n, 35 Wn.2d 1, 211 P.2d 651 (1949), overruled on other grounds, 62 Wn.2d 663 (1963), the court defined credit as a guaranteeing of a private debt by a public entity. When the government acts as a surety for a third party it has lent its credit to that third party. This is exactly the situation in the contracts between the phone companies and the municipal entities. The municipal entity is ultimately liable if the employee does not pay his or her bill, and therefore it has guaranteed the private debt of that employee and loaned its credit to that employee.

The remaining question is whether this action violates the constitutional prohibition. The court has taken various approaches in resolving similar questions. In Marriage of Johnson, 96 Wn.2d 255, 264, 634 P.2d 877 (1981), the court recognized it had taken a “checkered approach” to problems under article 8, section 5 and concluded that this approach mandated a reexamination of the area. The court concluded that evolution of the case law on article 8, section 5 had been contrary to the genesis of that constitutional section. The court returned to the drafters’ intent in determining a new course for applying article 8, section 5. The court noted that the provision:

[A]rose in the nineteenth century in response to reckless government subsidization of public and communication projects.” (Citations omitted.) State and local governments had purchased stock in such enterprises or acted as surety on issued bonds. (Citations omitted.) These private ventures failed, leaving governmental entities, and thus the taxpayer, either holding worthless stock or liable for large, inadequately secured debts. (Citations omitted.)

96 Wn.2d at 265-66.

The court thus recognized that the principal concerns of the drafters were to avoid subsidy of private enterprise and to protect public funds from excessive risk. The court reasoned, therefore, that section 5 (and also section 7) should prohibit only those activities which jeopardize state assets. “It would appear that if there are adequate protections for the security of such deposits (loans) from loss, the purposes and objectives of constitution article 8, section 7 would unquestionably be fulfilled.” Id. (Quoting State ex rel. Graham v. Olympia, 80 Wn.2d 672, 676-77, 497 P.2d 924 (1972).)

As a result the court has adopted a “risk of loss” analysis to determine whether a loan of credit is prohibited by article 8,
section 7 and 5. Under this analysis, the court asks three questions.

1. Does the program have safeguards that were absent in the schemes in the 19th century?

2. Do the safeguards ensure that the public controls the use of the State conferred asset and the extent of its liability?

3. Does the State retain the means to effectuate the project's public objective?

Housing Fin. Comm'n v. O'Brien, 100 Wn.2d 491, 495, 671 P.2d 247 (1983). Applying these factors to this specific situation, I conclude that the guaranteeing of payment would be prohibited as a loan of credit under article 8, section 7.

The first factor is whether the present program has safeguards that were absent in the schemes of the 19th century. The answer to this question is yes, to varying degrees. The safeguards range from deducting the phone bill from the final check of a departing employee, to the garnishment of wages of an employee, to the guaranteed payment from a fund of the Firefighter's Association, to the bonding of an association specifically to cover cellular phone charges. However, the safeguards do not ensure that the public controls the extent of its liability. The phones in question here will be used predominantly for personal phone calls. The municipality has no control during the month over the use of the telephones and will only determine the extent of its liability at the end of each month when it receives a bill.

Finally, the public objective of the cellular phones is for employees and volunteers to be able to communicate during emergency situations. The municipalities are not retaining the means to effectuate that public purpose. I note that only one agreement, that with the Port of Tacoma, requires that in consideration for the benefit of the use of the telephones, the employees agree to respond appropriately in emergencies.

I do not rule out the possibility that contracts could be created which would satisfy the risk of loss analysis. However, I do conclude that the agreements that I have reviewed, as written, do not satisfy the risk of loss analysis and, therefore, violate the prohibition on lending of credit.

If the municipalities want their employees to have cellular phones to use during emergencies, they may buy the phones for the employees and restrict their use to official business.
I hope this analysis will be helpful to you. As always, this memo reflects my legal opinion and is not an opinion of the Attorney General. If you have any questions or would like to discuss the subject further, do not hesitate to call.

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c: Sheila Geisler
    Diane Supler