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MUNICIPAL COMPETITION WITH PRIVATE ENTERPRISE MUST SATISFY PUBLIC PURPOSE TEST

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The October P&R editorial entitled "Put Merchandising in Your Bag of Tricks" encourages public park and recreation administrators to raise revenues in "the good old American spirit of private enterprise." As suggested by the editorial, "there is money to be made from selling goods and products, money that can be pumped back into our programs and facilities to better serve our citizens." However, any time there is money to be made by a public agency, law-related problems with disgruntled businessmen or taxpayers are more likely. As a result, entrepreneurial ardor must be tempered by an appreciation and understanding of state laws regulating public sector involvement in the marketplace. The following discussion of general legal principles and court cases introduces some likely factors to be considered in determining the legality of municipal competition with private enterprise. As indicated by the court decisions discussed herein, public agencies can oftentimes operate a revenue-producing business with state authorization in much the same fashion as a private entrepreneur.

GENERAL LEGAL PRINCIPLES

In the absence of express legislative authority from the state, a municipality has no power to engage in any independent business enterprise or occupation usually pursued by private individuals. In addition, a municipality cannot be authorized by the state legislature to expend tax funds for a private enterprise that does not primarily promote public purposes. The courts, however, are inclined to defer to the discretion and wisdom of the state legislature in authorizing particular types of business activities to achieve public purposes. (McQuillan, Municipal Corporations, 3 ed. §36.01 et seq.)

As applied to municipalities, the term private enterprise refers to proprietary functions, as opposed to those powers exercised in a governmental capacity. Proprietary or corporate functions are authorized by the state for the specific benefit and advantage of the inhabitants embraced within the boundaries of the municipality. When a municipality exercises such discretionary powers of local self-government or home rule for its own benefit or the advantage of its inhabitants, it is engaging in a proprietary function.

On the other hand, governmental functions are legal duties imposed by the state on municipalities to preserve and promote the general public health, safety, and welfare. The municipality receives no particular benefit or compensation for fulfilling such obligations. In practice, the facts of the individual case will determine whether a particular municipal activity is a governmental or a proprietary function (62 C.J.S. Municipal Corporations, *§* 110; 1955).

LEGISLATIVE AUTHORIZATION

A 1976 Arizona case, *Shaff er v. Alt,* 545 P2d 76, considered a resident taxpayer's challenge to an ordinance authorizing the sale of alcoholic beverages at a city-owned recreation complex. In reaching its decision, the state court reviewed the ordinance within the context of the state constitution, applicable state law, and the city's home rule charter: "As a charter city, Yuma may exercise all the powers authorized by its charter insofar as those powers are consistent with the Arizona Constitution and do not conflict with state legislative enactments which have appropriated the field in an area of general statewide concern."

Under separate articles of the state constitution, the city had the power to enact charter provisions to engage in any business or enterprise for which the municipality could confer a franchise and other industrial pursuits. This power, however, had to be exercised for a public purpose: "A municipal corporation, even in the exercise of its proprietary powers, must exercise those powers for a public purpose... . This is in accord with the fundamental principle that public funds may not be used for private gain. In the opinion of the court, the fact that the municipality would realize a profit from such proprietary activity did not necessarily "negate the underlying public purpose of the enterprise."

According to the court, the public purpose issue is "a changing question, changing to suit industrial inventions and developments to meet new social conditions." As a result, the court expressed their general willingness to defer to the municipality's determination regarding public purpose functions.

> The question as to whether the performance of an act or the accomplishment of a specific purpose constitutes a "public purpose," and the method by which such action is to be performed or purpose accomplished, rests in the judgment of the city council, and the judicial branch will not assume to substitute its judgment for that of the governing body unless the latter's exercise of judgment or discretion is shown to have been unquestionably abused.

The court, therefore, concluded that the ordinance authorizing the sale of alcoholic beverages at the city's recreational complex was consistent with the state constitution and applicable state statutes.

The court also considered whether the ordinance under consideration was consistent with the city's charter. Reiterating a general principle of municipal law, the court said: "Municipalities ... have no implied powers, except such as may be fairly implied from express powers." In this particular instance, the city charter authorized the city "to own and operate ... places of recreation." In addition, the city was given charter authority to provide for "the acquisition, construction, maintenance, and promotion of public facilities to consist of a baseball complex, an 18-hole golf course, a multi-purpose community center building, and *necessary and appropriate service and administrative facilities appurtenant thereto."* Given the city's wide discretion in determining the public purpose objectives of a proprietary enterprise, the court refused to

substitute their judgment for that of the city council, and say that "a facility serving alcoholic beverages may not be considered a necessary and appropriate service facility appurtenant' to a recreation complex which includes an 18-hole golf course."

> In the opinion of the citizens of the city of Yuma as expressed in their charter, the selling of alcoholic beverages at the recreation complex serves the convenience of the city's inhabitants as well as promotes the tourist industry with concomitant revenues to the city; this court will not substitute its judgment for that of the city's residents and their elected representatives.

PUBLIC PURPOSE TEST

In *Ace Ambulance Service v. City of Augusta,* 337 A.2d 661 (1975), the Supreme Judicial Court of Maine defined the state legislature's power to authorize municipalities to enter fields of endeavor already occupied by commercial enterprise. In this case, an owner of a private ambulance service challenged a proposed public ambulance service authorized by state statute. The plaintiff alleged unconstitutional competition by a municipal corporation with the existing private service.

To decide this case, the state court applied a two-pronged test developed in a 1914 Maine decision, *Laughlin v. City of Portland,* 90 A 318. According to the *Laughlin* court, the public purpose test for municipal enterprises requires that "the subject matter must be one of public necessity, convenience, and welfare, and that it must be of such a nature that the difficulty which individuals have in providing it for themselves constitutes a situation of exigency." According to the court, the legislature's determination of *public purpose* is presumably correct, but subject to judicial review. On the other hand the court said: "The question of determining *exigency* has long been considered to be a political decision for the legislature to make free from judicial review (unless it can be said there is no rational basis upon which exigency could be found.)"

In this instance, the court deferred to the state legislature's implied rationale for the statute authorizing public ambulance services. "The legislature has apparently concluded that the availability of adequate ambulance service is so vital to public health and welfare that the municipalities throughout the state should be permitted to assume responsibilities for providing it if and when their respective appropriating bodies elect to do so."

The plaintiff in this case also argued that municipal competition would cause a loss of profits and effect an unconstitutional taking of property without compensation. The court rejected this argument finding no municipal duty toward private competitors whose businesses suffer from public enterprises.

> We know of no principle of law which would require a city to reimburse private business for loss of profits suffered as a result of lawful competing municipal activity, at least in the absence of statutory requirements. .

> Nor is the fact that in operation the act may tend to lessen the profits of a few private dealers or even force them from business, a matter of consideration for the court. It is for the legislature to determine from time to time what laws and regulations are necessary to expedient for the defense and benefit of the people, and however inconvenienced, restricted, or even damaged, particular persons and corporations may be, such general laws are held valid unless there can be pointed out some provision in the State or United States Constitution which clearly prohibits them.

Three years before *Ace Ambulance Service,* the supreme Judicial Court of Maine in *Morrison v. City of Portland,* Me. 286 A2d 334 (1972) considered a dispute involving a city ordinance which limited the type of markers to be placed in a municipal cemetery. The ordinance provided that acceptable markers could be purchased, although not exclusively, through the municipal cemetery. Plaintiffs who were engaged in the business of selling cemetery markers and monuments for profit argued the ordinance was *ultra vires* because it placed the municipality as an active seller in unfair competition with private businesses. A municipal act is *ultra vires,* and consequently void, when it exceeds expressed or implied legislative authorization from the state.

As discussed above in *Ace Ambulance,* the court applied the two-pronged *Laughlin* public purpose test requiring the subject matter to be: (1) of public necessity, convenience, and welfare; and (2) individuals are unable to provide the commodity or service for themselves without difficulty. The court quoted extensively from the *Laughlin* decision which had allowed the city to supply heating fuel to constituents.

> The principle that municipalities can neither invade private liberty nor encroach upon the field of private enterprise should be strictly maintained. If the case at bar clearly violated that principle it would be our duty to pronounce the act unconstitutional, but in our opinion it does not. The purpose of the act is neither to embark in business for the sake of direct profits . . . not for the sake of indirect gains that may result to purchasers through reduction in price by governmental competition. It is simply to enable the citizens to be supplied with something which is a necessity in its absolute sense to the enjoyment of life and health, which could otherwise be obtained with great difficulty . . . whose absence would endanger the community as a whole.

Applying the above principles to the facts in this case, the *Morrison* court concluded that the selling of cemetery markers was properly left to the private sector. “It is apparent that bronze-type flush markers for cemetery lots, however desirable aesthetically, can scarcely be deemed necessary in the sense used by the *Laughlin* court and are in no way comparable to water, electricity, fuel, food, and other necessities of life.”

Although the *Morrison* court refused to view the selling of markers as “necessary or reasonably incidental to the operation or maintenance of a cemetery by a municipality,” a Michigan court faced with similar facts reached the opposite conclusion in *Inch Memorials v. City of Pontiac,*

286 NW2d 903 (1979). Under the applicable state authorizing statute, home rule cities could provide in their charters for the acquisition and operation of cemeteries and *for the costs and expenses thereof.* The city had argued that revenues from memorial sales were necessary to pay for the cemetery's operating costs.

According to the court, municipal power falls into three general categories: those granted in express words; those necessarily or fairly implied in or incident to the power expressly granted; and those essential to the accomplishment of the declared objects and purposes of the municipal corporation. Citing the fact that provisions of the Michigan Home Rule Cities Act must be liberally construed in favor of municipalities, the court concluded that the power to sell grave markers was reasonably related to the authority given municipalities over the costs and expenses associated with cemeteries. A dissenting judge in this case, however, relied upon *Morrison v. City of Portland* and the *Laughlin* public purpose test to reject "the city's late entry into the business. . . [wherein] need was traditionally met by private suppliers."

PUBLIC/PRIVATE BENEFITS

The Supreme Court of Michigan in *Gregory Marina Inc. v. City of Detroit,* 144 NW2d 503 (1966) considered whether a proposed $1365 million municipal marina in a city park met the public purpose test. Plaintiffs, private marina operators, challenged the project which would lease boat wells on a first-come-first-served basis to a limited number of boat owners. As a result, the general public would be excluded from the municipal boating facility situated in a city park.

Despite plaintiff's allegations that such limited public access failed the public purpose test, the court accepted the city's rationale that "the only practical way a marina can successfully operate is to allow renewal of leases year to year.

> [I]t is not essential that the entire community nor even any considerable portion should directly enjoy or participate in any improvement in order to constitute a public use.
>
> If it can be seen that the purpose sought to be obtained is a public one and contains the elements of public benefit, the question, how much benefit is thereby derived by the public, is one for the legislature and not the courts.

In *Keeter v. Town of Lake Lure,* 141 SE2d 634 (1965), a resident taxpayer challenged the town's decision to issue revenue bonds for the purchase of a large man-made lake with an electric generating plant from a private power company. The town intended to sell hydroelectricity from the power plant to a private utility and to operate a recreational and tourist business on the lake. In this instance, the town's resort and recreational facilities had developed around the privately owned manmade lake. The court, therefore, found that acquisition served a public purpose since "the existence of the town and the general and economic welfare of all its residents depends upon

the continued and full availability of Lake Lure . . . to all the residents."

According to the court, the fact that private lakefront property owners may benefit from the town's enterprises did not necessarily detract from the underlying public purpose of such expenditures.

> It seems clear that the acquisition of these properties by the town of Lake Lure by the issuance of revenue bonds will be essentially public and primarily for the general good of all the inhabitants of the town of Lake Lure, and in line with the recreational development of the town as a resort area, though there may be incidental benefit to private individuals, but incidental to private individuals would not in itself prevent a determination that the acquisition is for a public purpose and a proper municipal purpose.

SUMMARY CHECKLIST

The following checklist concerning municipal competition with private enterprise is based upon the preceding discussion. It is not meant to be all inclusive, rather, it simply suggests several areas open to judicial scrutiny. Affirmative responses to these points arguably increase the likelihood of a legal public enterprise. The ultimate decision to enter the marketplace and compete with private enterprise must obviously include a more detailed analysis by local counsel of the applicable authorizing legislation and pertinent court decisions in a given jurisdiction.

1. Is there expressed or implied authorization for the public enterprise in the state constitution, state laws, and/or local charter?

2. Is the enterprise a matter of public necessity, convenience, or welfare?

3. Are private individuals unable to provide the commodity or the service for themselves without great difficulty?

4. Have the courts in a given jurisdiction liberally construed state authorizing statutes or home rule powers in favor of municipal enterprises?

5. Are the benefits from the enterprise essentially public in nature, primarily for the general welfare of the city's inhabitants?

6. Are any benefits bestowed on private individuals or interests by the enterprise merely incidental to the underlying public purpose?

7. Has the state legislature determined that the particular enterprise will promote a public purpose?