PUBLIC CONTRACTS

Public Contracts: Contracts & Agreements – Commission Powers

Frankenmuth Mutual Insurance Company v. Magaha,
769 S.2d 1012 (Fla. 2000)

NEW PRECEDENT

Government-contract obligations that exceed five years and are not authorized in compliance with Florida Statutes Section 125.031 (1999), but are executed and partially performed anyway, can be approved through the board of commissioner's subsequent acts and omissions. This decision defines the judicial standards for testing whether subsequent legislative conduct constitutes an approval or ratification.

• A contract clause (non-substitution) that prohibits a government from substituting computer equipment for that originally leased with an option to purchase violates Article VII, Section 12 of the Florida Constitution. This is particularly true when such a contract clause is linked to one that automatically terminates the obligations when the government does not appropriate funds (non-appropriation clause leads to contract termination) for the continuation of its original annual payments.

• Another clause (non-appropriation) that expressly disclaims that the county will not appropriate funds for the contract payments from ad valorem taxes is viewed, in conjunction with the preceding clauses, as a form of moral compulsion to use taxes to fulfill the contract, and is thus a violation of the government's duty to seek voter approval to legally authorize long-term capital-project financing.

• This decision can be expected to jeopardize other government leasing contracts, most of which have similar non-appropriation and non-substitution clauses. These clauses were the method by which long-term obligations were prevented from being legally characterized as debt, and thus, did not require voter approval.

FACTS

In the midst of an appeal to the United States Court of Appeals for the Eleventh Circuit, the court was faced with two issues of first impression under Florida law. This opinion provides the answers for that court. The basic conflict revolves around assertions that, because the Escambia County Board of Commissioners (Board) did not initially approve or ratify a seven-year lease-purchase contract for a mainframe computer entered into by the comptroller, the County could repudiate the agreement in its fourth year. To the contrary, however, if after the contract was executed, the government's actions appear to amount to a knowledgeable acquiescence or ratification of the contract, shouldn't the lease-holding creditor be entitled to its fourth annual payment?

Ordinarily, agreements committing tax resources require official approval prior to execution under Florida Statutes Section 125.031. However, in this instance, the Escambia Comptroller (comptroller) was considered a "fee officer" with an independent budget for specialized functions, herein the custodian of county funds. Fla. Stat. § 218.31(8) (1993). For example, the Clerk of the Circuit Court, who is a fee officer, did not need prior approval of contractual activities to have them deemed legal. Thus, it was not extraordinary that the comptroller's lease-purchase agreement was not pre-approved by a vote of the commissioners before this multi-year, multi-million-dollar obligation was signed. The commissioners knew about the contract, nonetheless, by facts showing that the comptroller had informed them in writing of the anticipated annual payments, labeled "Debt Service-Computer," approximately one year before each financial budget went into effect. Even without a formal vote of ratification, the Board approved without question the first three annual lease payments, voted to incorporate its computing functions into that of the comptroller's equipment, and never questioned the legitimacy of this arrangement until year four, when a stock market loss rocked the comptroller's office. The cumulative effect of the Board's acts and omissions caused the federal district court to find the equivalent of an effective approval of the lease-purchase agreement after its execution. *Frankenmuth Mut. Ins. Corp. v. Magaha*, 1996 WL 571042 (N.D. Fla. Aug. 30, 1996) [hereinafter *Frankenmuth I*].

This and other findings were appealed to the Eleventh Circuit Court of Appeals, which certified two questions of first impression to the Florida Supreme Court. The questions are

refined and broken into sub-parts for this summary.

QUESTIONS AND ANALYSIS

(A) Did the Board have the power to approve a previously-executed but unauthorized contract without passing a formal resolution of ratification? The answer to this question is found in the opening paragraph of this summary and at page 1019 of the opinion. To reach this conclusion, a series of questions needs to be answered.

(1) Was the comptroller a fee officer and thus acting under the mandate of the Judicial Branch, as is the case in most counties where the comptroller's duties are performed by the Clerk of the Circuit Court? Judicial-branch fee-officer budgets are established independently from the legislative branch and by law and practice do not require the approval of the elected commissioners. So, when Escambia County separated the financial duties from the Clerk's office twenty-years earlier, it was apparently legal for the comptroller to perform its duties through budget allocations without receiving legislative approval, as did the Clerk of the Court. For budgeting purposes, then, the comptroller was a fee officer.

However, even though the budget allocation for the computer debt was legitimate without the Board's approval, was the unapproved lease-purchase agreement creating the yearly payment legitimate? It was not because the comptroller, a constitutional officer, who derived authority and responsibility from Article V, Section 16 and Article VIII, Section 1(d) of the Florida Constitution, did not have unlimited authority. The comptroller and clerk of the circuit court were made directly subject to the legislative-branch requirement for getting approval of equipment obligations exceeding five years as stated in Florida Statutes Section 125.031. *Frankenmuth Mut. Ins. Corp. v. Magaha*, 769 S.2d at 1019 [hereinafter *Frankenmuth II*]. There was no independent authority for contract purposes. Thus, the comptroller's contract was not binding without the Board's approval or subsequent ratification.

(2) What precedential authority exists under which the Board could ratify the contract by implied acts of part performance? A board is empowered to ratify that which was entered by procedural error or unauthorized. *Tolar v. Sch. Bd. of Liberty County*, 398 S.2d 427, 429 (Fla. 1981); *Brown v. City of St. Petersburg*, 153 S. 140, 140 (Fla. 1933).

(B) Because there is no definition of "approve" in the statute, and because the Board never ratified the agreement by resolution, what standards can a court apply to the evidence of an implied approval or ratification of an unauthorized agreement of one's agent? Using the obvious dictionary definition, and precedent stating that a formal resolution is not a precondition of approval or ratification, the court determined that a three-factor test would be appropriate for measuring evidence of an after-the-fact ratification. *Deutsche Credit Corp. v Peninger*, 603 S.2d 57, 58 (Fla. Dist. App. 5th 1992). First, the County Commission must have the power to approve or ratify an unauthorized, executed agreement. Second, the Commission's acts of approval or ratification should be performed in the same manner in which they would have been done originally, including compliance with the Sunshine Law and any local ordinance. Fla. Stat. § 286.011(1) (1999); *Ball v. Yates*, 29 S.2d 729, 732 (Fla. 1946). Third, the Board must fully know the material facts relative to the agreement being approved. *Frankenmuth II*, 769 S.2d at 1022 (citing *G & M Restaurants v. Tropical Music Service*, 161 S.2d 556, 558 (Fla. Dist. App. 2d 1964)). This judicial test will be applied to the District Court's findings after this case is returned to the Eleventh Circuit.

(C) Upon repudiation under the non-appropriation clause, does the non-substitution clause that bars the County for two years from obtaining other computer services violate Article VII, Section 12 of the Florida Constitution? Understanding this question requires some familiarity with government-equipment-leasing agreements. These agreements for use or purchase of capital equipment have to be voter-approved if the payments exceed five years. Fla. Stat. § 125.031 (1999). Very little that qualifies as capital equipment for a government could be purchased by annual installments under five years. For example, the mainframe computer in this case originally cost over two-million dollars, to which another million was added for new hardware and software, bringing the total cost to roughly three-and-one-half million dollars, payable by installments over eight years. To avoid having to wait for an uncertain result in the next election, the agreement contains: (1) a clause that recognizes an immediate termination of obligations in any year that the government does not appropriate funds for the next annual payment (the non-appropriation clause), thereby creating the legal fiction that the obligation is merely year-to-year; (2) a clause

prohibiting the lessee-purchaser from renting or buying substitute equipment and services for two years after termination for non-appropriation (the non-substitution clause), thus creating an incentive for fulfilling the agreement; and (3) a clause by which (a) the government lessee foreswears the pledging of its full faith and credit or its ad valorem taxes to the fulfillment of the agreement, and (b) the equipment lessor relinquishes its legal rights to compel the lessee to honor its contractual commitment, thus adding to the illusion that the contract will not become an unpaid debt claim upon the government. The issues and reasoning of the federal district court were adopted in large part by the United States Supreme Court. The Court explained that the non-substitution clause taken together with the other clauses "transformed the agreement into a long-term certificate of indebtedness pledging ad valorem taxes." *Frankenmuth II*, 769 S.2d at 1024 (citing *Frankenmuth I*, 1996 WL 571042 at *5).

The Justices in this unanimous opinion reached their conclusion from the reasoning found in the district court opinion. They concluded that when faced with a shut-down in County operations for two years because daily functions of government had become dependent upon the computer, the County would be compelled to use its tax revenues for debt payment. In other words, the cumulative effect of these contract clauses, creating a legal fiction, was an illegal collateral method for circumventing voter approval for a government to incur long-term debt. With these three answers, the case was returned to the Eleventh Circuit.

RESEARCH REFERENCES

- *County of Volusia v. State*, 417 S.2d 968 (Fla. 1982) (exhibiting an illegal attempt to pledge county non-ad valorem taxes).
- *Escambia County v. Flowers*, 390 S.2d 386 (Fla. Dist. App. 1st 1980) (finding that the comptroller's office was subject to legislative prerogative).
- *Bach v. Fla. State Bd. of Dentistry*, 378 S.2d 34, 36–37 (Fla. Dist. App. 1st 1979) (holding that ratification by the principal must be with full knowledge).
- M. David Gelfand, *State & Local Government Debt Financing* vol. 1, § 3:17 (West 2001) (explaining the nature of lease-purchase agreements by local governments).

- Eugene McQuillin, *The Law of Municipal Corporations* vol. 10A, § 29.104 (Beth A. Jacobsthal & Mark S. Nelson eds., 3d ed., West 1999).

James J. Brown, Professor