CHAPTER 7: ENTERPRISES

One of the more important safe harbors in TABOR is the "enterprise" exception. The first years of TABOR implementation saw special attention focused on the subject of enterprises at both the state and local level, and it was the subject of much speculation both in legal and financial circles.[1] TABOR excludes from its limitations any qualified "enterprise;" however, the term presents many difficult interpretive questions. TABOR § 2 (d) defines an "enterprise" to be

> *a government-owned business authorized to issue its own revenue bonds and receiving under 10 percent of its annual revenue in grants from all Colorado state and local governments.*

Municipalities have always maintained a wide variety of "enterprise funds," the nature and operation of which traditionally has been defined by generally accepted accounting principles (GAAP). It is important to recognize, however, that the definition of "enterprise" contained in TABOR is not cross-referenced to any traditional definition. An entity or activity that may have been considered an enterprise under an earlier analysis may not qualify under TABOR and, conversely, an enterprise that meets the TABOR definition may not conform to an auditor's concept of the term under GAAP. A careful analysis and understanding of the TABOR definition is critical because it will determine whether large portions of municipal revenue and spending are to be included in the municipal base, and therefore has the potential to dramatically affect the municipality's ability to keep and spend other revenues for other purposes.

Some have suggested that an enterprise simply exists by operation of law if it is an activity that currently meets the TABOR definition. At least one federal district court judge adopted this view in holding that a municipal natural gas operation was an enterprise under TABOR even before the city council acted to designate it as such.[2] Furthermore, as discussed below, TABOR § 7 (d) suggests that the activity may lapse in and out of being considered a qualified enterprise whether or not the governing body takes some action to certify or decertify the enterprise.

However, one of the more fundamental questions associated with enterprises is whether the municipality must or should take some affirmative action to designate an enterprise. The better view is that each municipality can and should take some formal action to designate which of its activities it intends to recognize as enterprises (and to disqualify any activity that ceases to be an enterprise in the future). While it generally may be advantageous to use the enterprise exclusion to shield certain municipal operations from the restrictions of TABOR, there may be equally valid reasons for wanting to keep so-called enterprise revenues in the municipality's base. This was especially true in the original base year, 1992. For example, if a particular municipal operation generated a high amount of revenue in 1992, but was expected to have consistent or declining revenue in future years, it may have been preferable to include it in the base to establish a larger overall municipal base upon which to grow.

There are differences of opinion about whether municipalities in general and statutory municipalities in particular need any enabling authority from the state legislature to begin designating enterprises. TABOR purports to be self-executing and seems to contemplate that enterprises can and will exist at every level of government. Arguably, statutory municipalities need no additional permission from the General Assembly to begin recognizing enterprises that qualify under TABOR. The Colorado Court of Appeals apparently accepted the fact that a county could have an airport enterprise under TABOR, notwithstanding the fact that the airport enabling statutes have never been amended to address the enterprise status of such entities.[3] Almost certainly, home rule municipalities can recognize enterprises as a matter of local concern.

On the other hand, some have argued that a clear statutory procedure for establishing and governing enterprises and, most importantly, for the issuance of enterprise revenue bonds would be helpful to resolve any doubts. The legislature did pass one enterprise enabling bill directed at local governments the first year after TABOR was adopted, SB 93-130, which specifically authorizes water, sewer, and drainage enterprises but leaves open the larger question of how other types of "government-owned businesses" may be treated.[4] Although, by its own terms, the statute relates only to water

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1 *See*, e.g., Amy Kennedy and Dee P. Wisor, "Enterprises Under Article X, § 20 of the Colorado Constitution," 27 *Colo. Law.*, No. 4, p. 55 (April 1998); and 27 Colo. Law., No. 5, p. 65 (May 1998).

2 *Nebraska Public Gas Agency v. City of Fort Morgan*, 97CV3118 (D.Neb. 1997). This case did not result in a reported decision and was not taken up on appeal.

3 *Bd. of Cnty. Comm'rs of Eagle Cnty. v. Fixed Base Operators*, 939 P.2d 464 (Colo. App. 1997).

4 C.R.S. §§ 37-45.1-101, *et seq.*; see also, Gregory J. Hobbs, Jr., "Water Activity Enterprises," 22 Colo. Law. No. 12, p. 2555 (Dec. 1993); recommended reading in light of the fact that the author is now a justice on the Colorado Supreme Court.

activity enterprises (and though it does not even purport to provide the exclusive procedures for creating water enterprises), a review of this statute is instructive for any municipality contemplating any type of enterprise simply because the statute is the most extensive treatment of the subject. In later years, there has been other ad hoc legislation[5] recognizing certain types of local government enterprises; however, to date, the General Assembly has never adopted any sort of broad and generic enterprise enabling authority for local governments.

In a close case, the courts may tend to liberally construe the authority of local governments to create enterprises under TABOR on the theory that the more services are offered through qualifying "government owned businesses," the less governments will have to rely on taxes to provide those same services.

GOVERNMENT-OWNED BUSINESS

TABOR permits an enterprise to consist of any "government-owned business," but does not further define what such a business might be. Under even the strictest interpretation, such businesses would seem to include the kinds of activities that have some counterpart in the private sector, e.g., utilities, airports, parking facilities, certain recreational facilities, certain transportation services, etc. In the absence of a more specific definition, however, municipalities may have even broader discretion to determine what qualifies as a government-owned business. Notice, however, that TABOR does not appear to grant municipalities any new substantive authority to engage in any service or activity that is not otherwise authorized by law. This point is especially important for statutory municipalities. Before rushing headlong to create a new enterprise, the threshold question for any municipality is whether the municipality has legal authority to engage in the type of "business" that is being proposed.

The meaning of "government-owned business" was argued extensively in the landmark case of *Nicholl v. E-470 Public Highway Authority*,[6] in which the litigants and the courts debated whether a public toll road could be considered an enterprise under TABOR. The trial court held that the E-470 Public Highway Authority (Authority) did not qualify as a business. The court of appeals held that it did.[7] Then the Supreme Court held that it did not (but only because the Authority had the legal power to charge a tax). Although the Supreme Court ultimately reversed the court of appeals on this point, the two courts agreed more than they disagreed on the fundamental question of what constitutes a "business" and it is helpful to read the two decisions together to appreciate the consistency of the analysis. Essentially, the courts eschewed an analysis that would focus on whether or not the activities of the enterprise are "essentially governmental" in nature.[8] Instead, the courts focused on the straightforward question of whether or not the entity operated on a fee-for-service basis. Both courts agreed that a public road financed by tolls and motor vehicle registration fees would meet this basic test.[9]

The Supreme Court parted ways with the court of appeals, however, because the Authority also enjoyed the statutory power to impose various types of taxes. The high court found the power to tax to be incompatible with the concept of a business, even if the power lay dormant. Interestingly enough, after the opinion came down, the General Assembly immediately repealed the taxing powers of highway authorities generally and declared their intention that a highway authority should qualify as an enterprise.[10] The E-470 Public Highway Authority then returned to the district court and obtained a declaratory judgment that the entity now indeed qualified as a TABOR enterprise.

The ruling in *Nicholl* regarding tax powers was a very important clarification for Title 32 districts such as water and sanitation districts and similar entities. Ever since the adoption of TABOR, there has been considerable speculation about whether or not such entities could qualify as TABOR enterprises. Since special districts have the authority to assess a property tax, it is now clear that the district itself cannot be considered a "business." However, the conventional wisdom still maintains that a special district can "own" subsidiary activities or entities that meet the enterprise definition.

The *Nicholl* case also contained a couple of important rulings on what it means to be "government-owned." The Supreme Court held that being "government-owned" is a function of ownership of assets and control of the entity by the government that claims to own it, and that an enterprise can be owned by more than one government at the same time.[11] Significantly, the court stopped short of saying that an enterprise has to be some sort of separate legal entity. Since the adoption of TABOR, much speculation has centered on just how "separate" an enterprise must be or whether it suffices that the entity more or less exists on paper, is not dissimilar from any other municipal department, and is

5 *See*, e.g., HB 97-1273 creating authority for "rural transportation activity enterprises. C.R.S. §§ 43-4-601, *et seq.*

6 *Nicholl v. E-470 Pub. Highway Auth.*, 896 P.2d 859 (Colo. 1995).

7 *Bd. of Cnty. Comm'rs of Arapahoe Cnty. v. E-470 Pub. Highway Auth.*, 881 P.2d 412 (Colo. App. 1994).

8 *Nicholl*, 896 P.2d at 868, n. 9.

9 *Nicholl*, 896 P.2d at 868.

10 SB 96-173; C.R.S. § 43-4-502.

11 *Nicholl*, 896 P.2d at 868.

controlled by the same officials who govern the municipality itself. Apparently, the more liberal attitude has prevailed, as few if any municipalities have made an affirmative decision to sever their enterprises as separate legal entities with a separate corporate existence.

Beyond *Nicholl*, the Colorado attorney general also has opined twice on the closely related question of whether or not it is legitimate for an enterprise to do business with the government that owns it. One formal opinion addressed so-called "internal service" enterprises at the University of Colorado: a telecommunications center, co-generation facilities, insurance operations, and an animal resource center. It is instructive, among other things, for showing the types of tensions that may arise between auditors and attorneys in interpreting TABOR:

> *The next inquiry regards whether the designated enterprises at issue here constitute "businesses." The Office of State Auditor has opined that in order to meet the constitutional definition of "business", the designated enterprise must be self-sustaining and economically viable based upon revenue received in market exchanges for a product or service provided to customers external to the organization. In other words, those activities that are internal service organizations that predominately provide services for a fee to the University itself, rather than to students or other external customers, cannot be considered "businesses", and thus are excluded from enterprise designation under TABOR. Although the Auditor's concern for potential misuse of enterprise designations is a serious one, TABOR does not mandate the State Auditor's restrictive interpretation of the term "business."*[12]

The attorney general later opined that the General Assembly could make a direct appropriation to a state enterprise for services rendered (i.e., to pay a correctional services enterprise for license plates manufactured for the Department of Revenue) without violating the principle that the enterprise is a business.[13] In both opinions, however, the attorney general expressed concern that enterprises not be used as a "subterfuge" to escape the basic applicability of TABOR to the state and local governments. For example, if a municipality purported to turn over one or more of its traditional government operations to a so-called enterprise, and then "pay" the enterprise for services rendered with tax monies, such an arrangement might be viewed as a subterfuge to completely evade TABOR.[14]

In 2010, the General Assembly took an expansive view of "government-owned business" when it created two enterprises to finance road and bridge construction and provided that they would be funded by mandatory motor vehicle registration fees.[15]

GRANTS TO ENTERPRISES

Another elusive factor in determining whether an enterprise qualifies under TABOR is understanding what may or may not be considered a "grant" for purposes of the 10 percent limitation. The Supreme Court observed in *Nicholl*, "The purpose of this restriction must be to distinguish a purported enterprise from a government unit."[16] Interpretations of "grant" have run the gamut from quite narrow (e.g., the term only includes the kind of grants that a municipality may receive through application to some sort of formal grant program) to extremely broad (e.g., includes any kind of support, tangible or intangible, direct or indirect, cash or in-kind, which the government may give to an enterprise). Several different grant definitions appeared in the enterprise bills passed by the legislature after the adoption of TABOR. The one that received the most attention was contained in SB 93-74,[17] and is apparently intended to apply to state enterprises:

- "Grant" means any direct cash subsidy or other direct contribution of money from the state or any local government in Colorado which is not required to be repaid.

In SB 93-74, "grant" does not include:

- any indirect benefit conferred upon an enterprise from the state or any local government in Colorado;
- any revenues resulting from rates, fees, assessments, or other charges imposed by an enterprise for the provision of goods or services by such enterprise (according to the opinions of the attorney general noted above, this exception would include payment for services rendered to the government that owns the enterprise); nor
- any federal funds, regardless of whether such federal funds pass through the state or any local government in Colorado prior to receipt by an enterprise.

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12 Formal Opinion of Gale A. Norton, Attorney General, No. 95-7, Dec. 22, 1995.

13 Formal Opinion of Gale A. Norton, Attorney General, 97-1, March 11, 1991.

14 Arguments both pro and con on this sort of creative use of an enterprise were made in the case of *Campbell v. Orchard Mesa Irrigation Dist.*, 972 P.2d 1037. However, the case was decided on other grounds.

15 SB 09-108; C.R.S. §§ 43-4-801, *et. seq.*

16 *Nicholl*, 896 P.2d t 869.

17 C.R.S. § 24-77-102 (7).

The General Assembly has adopted similarly narrow definitions of the term "grant" in other legislation.[18] Although these definitions do not necessarily apply to municipal enterprises, it may be helpful to consider the details of the approach that has been taken by the state.

First, the definition clearly contemplates that "grants" include only cash money, not any of the various sorts of in-kind assistance or intangible subsidies that a government may provide to an enterprise. Second, it clearly distinguishes grants from loans and provides that loaned money will not be considered within the 10 percent limitation. Third, it excludes from the definition any payments that a government may make to an enterprise for goods or services rendered by the enterprise to that government. Fourth, since the 10 percent limitation only applies to state and local grants, it clarifies that federal monies will never be counted as a grant and will retain their character as federal monies even if they are passed through another government. Each of these interpretations are reasonable on the face of TABOR and are consistent with the intent of TABOR as explained by its author prior to Nov. 3, 1992.[19]

Despite the fairly literal interpretations of the term "grant" in the statutes, some concerns about the breadth of the term persist. For example, if a municipality uses utility bill credits as a way to affect a refund of TABOR excess revenue and then reimburses its utility enterprise for making the refunds, is the reimbursement a grant? (Arguably, it is a form or payment for services rendered by the enterprise, and therefore would not create a problem under the enterprise definition.) The court of appeals reviewed a case in which the plaintiff claimed that a county airport enterprise that primarily derived its revenue from "passenger facility charges" (PFCs) added to airline tickets was somehow receiving a "grant" from the county because it was the county that had received permission from the federal government to assess the PFCs in the first place. The court rejected the theory that imputing the PFCs to the enterprise constituted a grant from the county.[20]

TRANSFERS FROM ENTERPRISES

While the 10 percent grant criterion obviously places a limit on the type of money flowing into an enterprise, there is no restriction in TABOR for how money might flow out of an enterprise. Thus, for example, there is no restriction on enterprise revenues subsidizing a municipality's general fund, for an enterprise transferring money to another enterprise, or an enterprise making "loans" to the municipality that "owns" it (although this last scenario may raise some intriguing questions about whether or not a municipality can, in effect, make a multiyear "financial obligation" to itself by pledging to repay an enterprise fund from its general fund over time).

ENTERPRISE REVENUE BONDS

The third prong in the definition of "enterprise" is one that also may pose problems in implementation of the enterprise exception. According to TABOR, a qualified enterprise must be "authorized to issue its own revenue bonds." If taken absolutely literally, this requirement is troublesome for several reasons. At the time TABOR was adopted, there seemed to be almost no government-owned business in the state that truly issued its "own" revenue bonds. Instead, the common practice was — and is — for government entities to issue bonds, secured by enterprise revenue, in the name of the government itself. Therefore, consistent with historic custom and practice, it may be reasonable to interpret the enterprise revenue bond requirement somewhat broadly to encompass any situation in which legal authority exists to issue bonds secured by enterprise revenue, and not to expect revenue bonds to be issued in the name of the enterprise itself.

The General Assembly treated this issue inconsistently in the various enterprise bills adopted in 1993. In some cases, revenue bonding authority was delegated directly to the enterprise itself; in other cases, revenue bonding authority was reserved to the government that owned the enterprise.

One proposed rationale for seeking additional enterprise-enabling legislation for local government enterprises would be to clarify certain revenue bonding questions. It has been suggested, especially for statutory municipalities, that unless express authority for revenue bonding for a particular type of municipal activity is included in the statutes, then the municipality may have a difficult time qualifying that activity as an enterprise. On the other hand, some argue that revenue bonding is an inherent financial power that can be exercised in furtherance of any activity that the municipality is otherwise legally authorized to pursue. The ultimate resolution of this issue may require further legislation or a test case or both.

18 E.g., in the water activity enterprise bill, SB 93-130; in the Colorado Tourism Authority bill, SB 94-208.

19 Testimony of Douglas Bruce at the "review and comment" hearing on TABOR, April 23, 1991.

20 *Eagle Cnty. v. Fixed Base Operators*, 939 P.2d at 468.

QUALIFICATION AND DISQUALIFICATION OF ENTERPRISES

To repeat, CML has always recommended that municipalities take some affirmative action to formally designate enterprises for TABOR purposes. Formal action by the governing body indicating that the municipality has consciously considered the question and has found that the activity qualifies under the TABOR definition will serve the municipality well if it is ever challenged in court over the question. As a practical matter, bond counsel may require the municipality to formally adopt an enterprise ordinance before issuing bonds (without a vote) secured by enterprise revenues. Particularly when some sort of financing is involved, it is essential that all parties to the transaction be satisfied that all constitutional requirements have been met. Appendix E contains representative examples of enterprise laws in several municipalities.

In many municipalities, the assumption that certain activities qualify as TABOR enterprises may be reflected simply in the budget and financial statements for the municipality.

During the sessions following the adoption of TABOR, the General Assembly adopted a case-by-case approach to formally designating enterprises. Although SB 93-74 contained a general definition of "enterprise" and "grant," the legislature went on to adopt five separate bills in 1993 alone specifically addressing certain types of activities as enterprises and considered but rejected several others.

TABOR § 7 (d) provides, "Qualification and disqualification as an enterprise shall change district bases and future year limits." The most likely reason a qualified enterprise would become disqualified would be that it received in excess of 10 percent of its revenue in "grants" in a particular year. TABOR § 7 (d) apparently means that, for the year the enterprise was disqualified, the fiscal year spending "base" of the municipality automatically would ratchet up by the amount of revenue associated with the erstwhile enterprise. Significantly, the inclusion of the enterprise revenue is seen as an adjustment to the base itself, not as a spike in "fiscal year spending" that would have to be squeezed within the municipality's fiscal year spending limits. Then, when the municipality applies the inflation and local growth factors to determine its allowed fiscal year spending limit in the subsequent year, it can apply those growth factors to the higher base that was brought about as a result of including former enterprise revenue in the calculation.

Conversely, if a segment of the municipality's operations begins to qualify as an enterprise in a particular year, the municipality's base will ratchet down for that year as the enterprise revenue and spending are removed from the calculation and "future year limits" will be calculated on the smaller base.