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February 3, 2017

ATTORNEY GENERAL OPINION NO. 2017- 5

Seth Jones, City Attorney
City of Erie, Kansas
101 N. Main
Erie, KS 66733

Re: Cities and Municipalities—General Provisions—Corporate powers

Corporations—Limited Liability Companies—Citation of Act; Definitions; Member; City

Synopsis: A city may own shares in a limited liability company. Whether acquiring shares in a limited liability company violates the public purpose doctrine is a question of fact. The Interlocal Cooperation Act, K.S.A. 12-2901 *et seq.*, provides a framework for arrangements wherein a city intends to reduce financial risk by co-owning property with a third party. Cited herein: K.S.A. 12-101; 12-2901; K.S.A. 2016 Supp. 12-2904; 17-7662; 17-7663.

* * *

Dear Mr. Jones:

As city attorney for the City of Erie (City), you ask our opinion on whether a city may have an ownership interest in a limited liability company and whether creating a limited liability company for the purpose of transferring ownership of the Erie Energy Center to a third party violates the "public purpose doctrine" underlying K.S.A. 12-101. We will address each question in turn.

Background

You provided us with the following information:

> Several years ago, the City . . . built a peak power electrical generation plant as part of a joint venture with Westar Energy. Essentially, the City was to own the plant with Westar to pay for access to the additional capacity . . . . In order to build the plant, the City . . . issued several million dollars in bonds to cover the cost of construction. . . .
>
> Unfortunately, the plant has not been profitable for the City. Westar rarely runs the plant and the [cost of] maintenance and insurance exceeds the funds received from Westar. The City has been approached by a third party who has expressed interest in entering into an agreement in which the City . . . would transfer ownership of the plant to a limited liability company in which the City of Erie would be a minority member. In exchange for this transfer, the third party would pay off all outstanding bonds related to the plant. Further, the City would assign its contract with Westar to the newly-formed limited liability company.

We understand "peak power" to mean additional capacity added to the electrical grid during times of peak demand. We also understand "limited liability company" to mean a limited liability company formed pursuant to the Revised Limited Liability Company Act.[1]

Analysis

Cities are empowered by the Home Rule Amendment to the Kansas Constitution to "determine their local affairs and government."[2] The Home Rule Amendment overturned what is often referred to as the Dillon Rule, which prevented cities from engaging in business not explicitly authorized by statute, so that cities may now engage in business unless it is prohibited by statute, whether explicitly or by preemption.[3]

Moreover, state law explicitly recognizes that cities may "[p]urchase or receive, by bequest or gift, and hold, real and personal property for the use of the city."[4] Kansas law has long recognized that shares in a corporation are personal property,[5] and no provision of the Revised Limited Liability Company Act prohibits extending this conclusion to membership in a limited liability company. Indeed, the definition of a "person" that can be a "member" of a limited liability company includes "a . . . government, including a . . . county or any other governmental subdivision."[6]

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[1] K.S.A. 2016 Supp. 17-7662, *et seq.*
[2] Kan. Const. Art. 12, § 5(b).
[3] *See* Kan. Atty. Gen. Op. No. 2000-25 (discussing the adoption of the Home Rule Amendment).
[4] K.S.A. 12-101.
[5] *E.g.*, *Stevenson v. Metsker*, 130 Kan. 251, 267 (Kan. 1930) (Harvey, J., dissenting) (citing 14 C.J. 387 for the proposition that "it is now very generally agreed that shares of stock in corporations are personal property").
[6] K.S.A. 2016 Supp. 17-7663.

We have not found any reported Kansas cases discussing a city acquiring partial ownership of a company by purchasing shares of a corporation,[7] but we conclude the authority granted by the Home Rule Amendment, the plain language of K.S.A. 12-101, and the plain language of the Revised Limited Liability Company Act provide sufficient authority for the City to become a member of and acquire a limited liability company interest in a limited liability company.

We note, however, that a city may only expend public resources consistent with the public purpose doctrine.

> The public purpose doctrine . . . requires a unit of local government, in exercising the powers conferred upon it, to spend funds only for a public purpose. . . . [T]he question of whether a specific expenditure serves a public purpose must be determined in light of the specific circumstances.[8]
>
> Each case must be decided in the light of the existing conditions, with respect to the objects sought to be accomplished, the degree and manner in which that object affects the public welfare, and the nature and character of the thing to be done; but the court will give weight to a legislative determination of what is a municipal purpose, as well as widespread opinion and general practice which regard as city purposes some things which may not be such by absolute necessity, or on a narrow interpretation of constitutional provisions.[9]

Whether the specific arrangement you describe in your letter serves a public purpose is a question of fact beyond the scope of an Attorney General opinion.[10] We therefore decline to address your second question.[11]

Finally, we note state law may provide an existing framework for the City to pursue in this matter. Specifically, the Interlocal Cooperation Act[12] provides the mechanism for a

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[7] Compare *Mitchell v. City of Wichita*, 270 Kan. 56, 58 (2000) (noting the City of Wichita acquired a privately owned water company and integrated the company's pipelines into the city water supply).
[8] Kan. Atty. Gen. Op. No. 1985-52 (concluding the acquisition and development of real property as an industrial park is a legitimate exercise of a county's power of local legislation where the legislature's authorization of economic development through the creation of industrial districts demonstrated a public policy to promote economic and industrial development).
[9] Kan. Atty. Gen. Op. No. 1982-229 (citing 64 C.J.S. Municipal Corporations, § 1835 [1950]).
[10] *See* Kan. Atty. Gen. Op. No. 1991-89 (noting that while a public benefit may be derived from a proposed expenditure that is not *per se* prohibited, the existence of a public benefit cannot be conclusively determined); Kan. Atty. Gen. Op. No. 1991-66 (whether oil and gas lease which committed hospital funds to oil and gas well maintenance costs—presumably to maintain revenue—was a legitimate public purpose was "ultimately a question of fact" which could not be conclusively settled)
[11] Attorney General's Statement of Policy Relating to the Furnishing of Written Legal Opinions, ¶ 8 (only questions of law will be answered).
[12] K.S.A. 12-2901, *et seq.*

city to "cooperate with other localities, persons, associations and corporations on a basis of mutual advantage."[13]

Although your question was whether the City can hold an ownership interest in a limited liability company, the specific arrangement you describe—where the city transfers its ownership of the plant to a third party in exchange for assumption of the bond obligation, but the City remains a minority owner partly responsible for any losses and, presumably, partly to gain from any profit—is in the nature of the "joint or cooperative undertaking"[14] contemplated by the Interlocal Cooperation Act.

In summary, we conclude the City may acquire shares in a limited liability company. Because we cannot conclusively determine whether the arrangement you describe serves a legitimate public purpose, we decline to offer an opinion on that question of fact.

Sincerely,

/s/Derek Schmidt

Derek Schmidt
Kansas Attorney General

/s/Craig Paschang

Craig Paschang
Assistant Attorney General

DS:AA:CP:sb

[13] K.S.A. 12-2901.
[14] *Cf.* K.S.A. 2016 Supp. 12-2904(e)(1).