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Court of Appeals of New York, Local Government Assistance Corp. v.
Sales Tax Asset Receivable Corp.

Cover Page Footnote

21-1

COURT OF APPEALS OF NEW YORK

Local Government Assistance Corp. v. Sales Tax Asset
Receivable Corp.¹
(decided May 13, 2004)

During the 1970s, New York State created the Municipal Assistance Corporation (MAC) and provided it with authority to issue bonds to help New York City avoid potential bankruptcy. In 2003, another fiscal crisis threatened the city's ability to retire this debt. Again, the state provided relief – the MAC Refinancing Act²

¹ 813 N.E.2d 587 (N.Y. 2004).

² The Act amended the Public Authorities Law by adding a new section, § 3238-a, and amending existing § 3240. N.Y. PUB. AUTH. LAW § 3238-a (McKinney 2003) stating in pertinent part:

Notwithstanding any inconsistent provision of law, the corporation shall transfer to the city of New York one hundred seventy million dollars from the resources of the corporation pursuant to section thirty-two hundred thirty-nine of this title. Such payment shall be made during each city fiscal year. Such payments from the corporation shall be made from the fund established by section ninety-two-r of the state finance law and in accordance with the provisions thereof.

The city of New York, acting by the mayor alone, may assign all or any portion of such amount to any not-for-profit corporation incorporated pursuant to section fourteen hundred eleven of the not-for-profit corporation law and, upon such assignment, the amount so assigned shall be the property of such not-for-profit corporation for all purposes. Following notice from the city of New York to the corporation and the comptroller of such assignment, such payment shall be made directly to the city's assignee.

N.Y. PUB. AUTH. LAW § 3240 (McKinney 2003) stating in pertinent part:

1. Not less than one hundred twenty days before the beginning of each fiscal year of the corporation (but not later than October first, nineteen hundred ninety, for the fiscal year ending March thirty-first, nineteen hundred ninety-one) the chairperson of the corporation shall certify to the state comptroller and to the governor a schedule of cash

(the Act) would funnel payments to the city through the Local Government Assistance Corporation (LGAC), a public benefit corporation authorized to issue bonds funding public services. New York City would be permitted to assign these payments to a new nonprofit development corporation, the Sales Tax Asset Receivable Corporation (STARAC). Because of concerns regarding the nature of its role as defined by the Act and possible subordination of its own debt obligations, LGAC commenced a declaratory judgment action challenging the constitutionality of the Act.

LGAC claimed the Act violated New York State Constitution Article VII, Section 11³ and Article VIII, Section 2⁴ as well as United States Constitution Article I, Section 10.⁵

requirements for such fiscal year. The total amount so certified for such fiscal year shall be equal to the total amount of the debt service then due on the bonds and notes of the corporation, including payments of interest and principal (including sinking fund payments) including payments required to be made pursuant to section thirty-two hundred thirty-eight-a of this title

5. The agreement of the state contained in this section shall be deemed executory only to the extent of appropriations available for payments under this section and no liability on account of any such payment shall be incurred by the state beyond such appropriations. . . . Provided however, this subdivision shall not apply for payments made pursuant to section thirty-two hundred thirty-eight-a of this title.

³ N.Y. CONST. art. VII, § 11 stating in pertinent part:

Except the debts or refunding debts specified in . . . this article, no debt shall be hereafter contracted by or in behalf of the state, unless such debt shall be authorized by law, for some single work or purpose, to be distinctly specified therein. No such law shall take effect until it shall, at a general election, have been submitted to the people, and have received a majority of all the votes cast for and against it at such election

Article VII, Section 11 of the New York State Constitution requires that all debt be subject to public referendum while Article VIII, Section 2 requires that municipalities honor their indebtedness. The Federal Constitution prohibits a state from passing laws that impair its contractual obligations. The lower court found that the Act was valid.⁶ LGAC appealed to the Supreme Court, Appellate Division. The Act's constitutionality was affirmed, but a portion of the Act construed to violate the state constitution was severed and declared unnecessary to the legislative intent of the Act.⁷ LGAC again appealed; STARC and the City of New York cross-appealed.⁸

The Court of Appeals restored the New York Supreme Court's decision declaring the Act, including the portion severed by the Appellate Division, constitutionally valid.⁹ Payments to STARC were conditioned upon legislative appropriation; the City had no debt obligation imposed upon it through the issuance of STARC bonds, and since STARC bond obligations were subordinate to LGAC's obligations to its bondholders, there was no impairment of contract.¹⁰ In arriving at its decision, the court emphasized LGAC's "heavy burden to overcome the strong

⁴ N.Y. CONST. art. VIII, § 2 stating in pertinent part: "No indebtedness shall be contracted by any county, city, town, village or school district unless such county, city, town, village or school district shall have pledged its faith and credit for the payment of the principal thereof and the interest thereon."

⁵ U.S. CONST. art. I, § 10, providing in pertinent part: "No State shall . . . pass any . . . Law impairing the Obligation of Contracts"

⁶ *Local Gov't Assistance Corp.*, 813 N.E.2d at 593.

⁷ *Id.*

⁸ *Id.* at 594.

⁹ *Id.*

presumption of constitutionality that attaches to every statute.”¹¹ It concluded that LGAC did not prove beyond a reasonable doubt that the Act was constitutionally impaired.¹²

MAC bonds created to stem a default of New York City’s short-term debt obligations were financed utilizing New York City’s share of state sales tax revenue.¹³ “In 2003, with \$2.5 billion left to pay on the MAC debt service (then due at a rate of \$500 million annually for the remaining five years), the City faced another fiscal crisis.”¹⁴ To help the City satisfy this debt, “the Legislature enacted the Municipal Assistance Corporation Refinancing Act”¹⁵ which “allowed the City to receive the sales tax revenue that was being diverted to MAC and thereby retain the remaining \$2.5 billion that it owed on the debt service, while requiring the State to make . . . payments to the City . . . of \$5.1 billion.”¹⁶ These thirty annual payments of \$170 million each would in turn finance bonds retiring the MAC debt¹⁷ and LGAC was to be the vehicle for channeling these payments.¹⁸ Additionally, the Act permitted the mayor of New York City to assign the payments to STARC, a nonprofit local development corporation that would issue bonds, financed by the payments, to

¹⁰ *Id.* at 596, 598, 602.

¹¹ *Local Gov’t Assistance Corp.*, 813 N.E.2d at 594.

¹² *Id.* at 595.

¹³ *Id.* at 589-90.

¹⁴ *Id.* at 590.

¹⁵ *Id.*

¹⁶ *Local Gov’t Assistance Corp.*, 813 N.E.2d at 590.

¹⁷ *Id.*

¹⁸ *Id.*

retire the City's MAC debt.¹⁹ However, LGAC's own bonds, consistent with general bond resolutions, comprise contracts with its bondholders and promise these bondholders first priority on the debt service funds available to LGAC.²⁰

Each year LGAC's chairperson "must certify to the Governor and the Comptroller its debt service requirements . . . for the upcoming fiscal year. Upon annual appropriation by the Legislature, the funds needed are transferred" ²¹ LGAC's funds are "derived from state sales and compensating use taxes, one percentage point of which must be deposited in the Local Government Assistance Tax Fund (Tax Fund)."²² Only upon receipt of its funds, in accordance with the procedures described, may the monies in the Tax Fund be distributed to the State Treasury general fund; thus, providing a strong incentive to make the annual appropriations as requested.²³

During August of 2003, LGAC's problems regarding its obligations under the Act led it to decline participation in the STARC transaction until its concerns were satisfied through litigation or legislative action.²⁴ At about the same time, the City issued a prospectus offering STARC bonds; in the circular, the City acknowledged LGAC's position, stated that the payments to STARC were not a debt of the City or the State, and that STARC

¹⁹ *Id.* at 591-92.

²⁰ *Id.* at 590.

²¹ *Local Gov't Assistance Corp.*, 813 N.E.2d at 590.

²² *Id.*

²³ *Id.* at 590-91.

²⁴ *Id.* at 592.

bond obligations were subordinated to LGAC's bond obligations.²⁵ Nevertheless, LGAC commenced its action "seeking judgment declaring the MAC Refinancing Act unconstitutional."²⁶ "LGAC also sought a preliminary injunction to prevent STARC from issuing its bonds."²⁷

As determined by the New York Court of Appeals, the portion of the Act (§ 3238-a) "providing for multiyear payments pursuant to annual legislative appropriations does not create a debt within the meaning of Article VII, § 11, and is not subject to the public referendum requirement."²⁸ To satisfy this provision of the state constitution, these payments must be subject to annual legislative appropriations.²⁹ Contrary to LGAC's contention, amended Section 3240(5) does not abrogate the necessity for appropriation.³⁰ The Act is subject to State Finance Law Section 92-r,³¹ which unequivocally states that the payments are contingent upon appropriation.³² The "intent of the Legislature is clear: to enact a constitutionally sound statute pursuant to which the State

²⁵ *Id.*

²⁶ *Local Gov't Assistance Corp.*, 813 N.E.2d at 592.

²⁷ *Id.* at 593.

²⁸ *Id.* at 595.

²⁹ *Id.*

³⁰ *Id.* at 596.

³¹ N.Y. STATE FINANCE LAW § 92-r (McKinney 2004) stating in pertinent part:

5. (a) Upon receipt by the comptroller of a certificate or certificates from the chairperson of the local government assistance corporation submitted pursuant to section thirty-two hundred forty of the public authorities law, that such corporation requires a payment or payments, from the local government assistance tax fund, the comptroller shall pay from such fund pursuant to an appropriation on or before the date specified in such certificate

would assist the City in meeting its debt obligations to MAC by providing for annual payments to the City through legislative appropriations channeled through LGAC.”³³

LGAC’s promise to its bondholders with first priority over other bondholders was not compromised by the Act. Nor did the Act impair LGAC’s contract with its bondholders or contravene the Federal Constitution’s “obligation of contracts.” As noted by the United States Supreme Court, “[i]t long has been established that the Contract Clause limits the power of the States to modify their own contracts as well as to regulate those between private parties.”³⁴ However, states may repeal or amend their laws or even enact legislation with retroactive effects without running afoul of the Contract Clause.³⁵ For example, the State of New Jersey modified a contract with municipal bondholders by refunding the bonds and adjusting their interest rate when the municipality defaulted on its debt service payments.³⁶ The adjustment plan was challenged as an impairment of the municipality’s original contract obligation.³⁷ “Impairment of an obligation means refusal to pay an honest debt”³⁸ No such refusal to pay existed in that situation nor did it exist in *Local Government Assistance Corp.*

³² *Local Gov’t Assistance Corp.*, 813 N.E.2d at 596.

³³ *Id.*

³⁴ *United States Trust Co. v. New Jersey*, 431 U.S. 1, 17 (1977) (citing *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 137- 39 (1810)).

³⁵ *Id.*

³⁶ *Faitoute Co. v. City of Asbury Park*, 316 U.S. 502, 505-507 (1942).

³⁷ *Id.* at 507.

³⁸ *Id.* at 511.

The MAC Refinancing Act, the subject of the instant case, in no way hinders the ability of LGAC to pay its bondholders. Unlike *United States Trust*, dealing with the repeal of a covenant limiting subsidy of rail passenger transit from funds earmarked for debt service,³⁹ the Act in this suit contained no “expressed legislative intent to limit or repeal the State’s guarantees to LGAC’s bondholders”⁴⁰ nor did it attempt to change the priority of LGAC’s payments due.⁴¹ STARC payments are subordinate to LGAC’s obligations to its bondholders.⁴² “Reading the statute as a whole, it is apparent that the Legislature intended the size of the Tax Fund and the trapping mechanism to assure LGAC’s payments to the City, not an alteration to the lien status of the LGAC bondholders.”⁴³ No impairment of contract will occur.⁴⁴ Thus, the Act does not infringe United States Constitution Article I, Section 10.

*Schulz v. State of New York*⁴⁵ clearly provided the court with grounds for rejecting the state constitutional challenge based upon Section 11 of Article VII. The referendum requirement grew out of a movement to reform public borrowing practices, “in an effort to protect the State from the . . . possibly disastrous consequences of incurring future liabilities.”⁴⁶ Voters received

³⁹ *United States Trust*, 431 U.S. at 3.

⁴⁰ *Local Gov’t Assistance Corp.*, 813 N.E.2d at 601.

⁴¹ *Id.*

⁴² *Id.* at 602.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ 639 N.E.2d 1140 (N.Y. 1994).

⁴⁶ *Id.* at 1144-45.

“the power to determine, by referendum, whether a proposed law creating debt would take effect.”⁴⁷ Eventually, public benefit corporations were created “to insulate the State from the burden of long-term debt.”⁴⁸ However, the State was free to give money, as gifts, to the corporation without binding itself.⁴⁹ Since these entities did not exist when Section 11 of Article VII was adopted, the referendum requirement was not directed at the public benefit corporations’ debt commitments.⁵⁰ Therefore, it did not apply in *Local Government Assistance Corp.*

Relying on *Wein v. City of New York*,⁵¹ the *Local Government Assistance Corp.* court found that the City had incurred no debt.⁵² In *Wein*, the Court said that Stabilization Reserve Corporation (SRC) bonds, even though issued to assist the city in its fiscal crisis, were neither a debt of the city nor the state.⁵³ The act establishing the SRC was promulgated by the state legislature and specified that SRC could sell bonds “without a pledge of the full faith and credit of either the City or State of New York.”⁵⁴ The City could contribute to SRC’s fund, but was not obligated to do so.⁵⁵ Indeed, if SRC could not collect funds from the City, or its other sources, the City would not be liable to SRC’s

⁴⁷ *Id.* at 1145 (citing CHARLES Z. LINCOLN, 2 CONSTITUTIONAL HISTORY OF NEW YORK 73-84 (1906)).

⁴⁸ *Id.* at 1146.

⁴⁹ *Id.* at 1147.

⁵⁰ *Schulz*, 639 N.E.2d at 1147-48.

⁵¹ 331 N.E. 2d 514 (N.Y. 1975).

⁵² *Local Gov’t Assistance Corp.*, 813 N.E.2d at 593, 593-94.

⁵³ *Wein*, 331 N.E. 2d at 516.

⁵⁴ *Id.*

⁵⁵ *Id.* at 518.

bondholders.⁵⁶ A debt can arise only if there is an obligation to fund the debt service upon a default.⁵⁷ “It is not questioned, as indeed it may not be, that the city has an absolute right, following the receipt of any State-aid moneys to pay a portion thereof to a public benefit corporation”⁵⁸ This “does not create any illegality, and . . . no lien is thereby created on that fund.”⁵⁹ Unlike the legislation creating SRC, the MAC Refinancing Act of the instant case “does not specifically state that the City incurs no obligation with respect to STARC’s bondholders, [but] it does not impose such an obligation.”⁶⁰ *Wien* is dispositive in refuting a violation of the New York State Constitution Article VIII, Section 2.

Assignment of payments to STARC, as delineated in the current action, does not offend the “faith and credit” obligation of New York State Constitution Article VIII, Section 2. “[T]he City has no legal obligation either to STARC or to its bondholders should LGAC fail to make payments to STARC.”⁶¹ Absence of a debt obligation is reiterated in STARC’s certificate of incorporation, the assignment agreement between the City and STARC, and in the preliminary offering circular on STARC’s

⁵⁶ *Id.*

⁵⁷ *Id.* at 517.

⁵⁸ *Wein*, 331 N.E. 2d at 519.

⁵⁹ *Id.*

⁶⁰ *Local Gov’t Assistance Corp.*, 813 N.E.2d at 598.

⁶¹ *Id.*

bonds.⁶² Consequently, New York's "faith and credit" constitutional provision did not apply to the present litigation.⁶³

Both *Wien* and an earlier case, *Comereski v. City of Elmira*,⁶⁴ state that monies funneled by the State to a public benefit corporation are permissible.⁶⁵ *Comereski* also dealt with the question of a city assuming the credit obligations of a public corporation. Stating that the legislature made clear that an assignment of funds available to the city to make up for a deficit of the corporation did not constitute indebtedness on the part of the city,⁶⁶ the court stressed that this type of arrangement was necessary to solve modern urban problems.⁶⁷ "Since the city cannot itself meet the requirements of the situation, the only alternative is for the state, in the exercise of its police power, to provide a method of constructing the improvements and of financing their cost."⁶⁸ Such arrangements do not violate New York State Constitution Article VIII, Section 2.

Contract impairment concerns appear to have little to do with the New York State constitutional issues of "faith and credit" and public referendum for state borrowing. Yet, there is a significant relationship between the federal requirement and each of the state constitutional provisions. Generally, a statute is

⁶² *Id.*

⁶³ *Id.*

⁶⁴ 125 N.E.2d 241 (N.Y. 1955).

⁶⁵ *Local Gov't Assistance Corp.*, 813 N.E.2d at 599 (citing *Wien*, 331 N.E.2d at 518 and *Comereski*, 125 N.E.2d at 242-43).

⁶⁶ *Comereski*, 125 N.E.2d at 244.

⁶⁷ *Id.*

⁶⁸ *Id.*

“treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature In addition, statutes governing the interpretation and enforcement of contracts may be regarded as forming part of the obligation of contracts made under their aegis.”⁶⁹ Therefore, the guarantee of “faith and credit” in a municipality’s debt obligation may be construed as a contract and, as such, is subject to the Contract Clause. Additionally, public referendum of state debt obligations also devolves to a contract issue. When the legislature enacts a law to increase the debt burden of a state, it often, through taxation, increases the financial burden of its citizens. Public approval of the increased debt establishes acceptance of a contract between the state and its citizens whereby the state is allowed to borrow, and possibly to tax, and the citizens receive public services in return for their permission. State constitutional provisions such as these may be viewed as a subset of the federal provision. Viewed in this light, the three provisions challenged in this case are inextricably intertwined.

Hannah Abrams

⁶⁹ *United States Trust*, 431 U.S. at 18, n.14.

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RIGHT AGAINST SELF-INCRIMINATION

United States Constitution Amendment V:

No person shall . . . be compelled in any criminal case to be a witness against himself

New York Constitution Article I, Section 6:

No person shall . . . be compelled in any criminal case to be a witness against himself