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Memorandum

To: City of Independence, Missouri

From: Sarah E. Carnes, Special Counsel for General Municipal Matters

Date: January 6, 2021

Re: Summary of City of Independence vs Russell W. Pearson, et al.
("Bondurant Decision")

Issue:

The City of Independence brought action for declaratory judgment against six individual residents of the City and one corporation. The central issue is what benefit is the City entitled from the Power and Light Department?

The main points of contention are:

1. Funds paid for services provided by various City departments
2. Power supplied without charge to various City departments
3. Contributions by the Power and Light Department to a municipal office building
4. Payment to the city of a portion of the gross revenue of the Power and Light Department

Findings of Fact:

1. Power and Light Department provided electrical power to the City and various City departments without charge. This includes power for streetlights and traffic signals, which are calculated by various formulas. The value of the power supplied to the City without charge are:
 - 1974 - \$288,498
 - 1975 - \$388,754
 - 1976 - \$488,851
 - 1977 - \$550,648
 - 1978 - \$680,887
 - 1979 - \$908,133

- The Parties agree that inter-fund charges provided by Power and Light Department to other City departments for specific services rendered is not a benefit to the city, as long as those charges are reasonable.
- 2. City has been correctly calculating the payment in lieu of taxes correctly since 1963.
- 3. The City collected the following payments in lieu of taxes collected upon the following based upon gross revenues:

	Gross Revenue	Amount Charged
• 1974	\$11,362,881	\$1,078,111
• 1975	\$15,218,303	\$1,387,506
• 1976	\$18,789,177	\$1,790,149
• 1977	\$20,796,839	\$1,963,429
• 1978	\$25,203,470	\$2,407,036
• 1979	\$29,440,510	\$2,770,725

- 4. The City Council passed multiple ordinances requiring a withdrawal of funds from the Power and Light Department Surplus Fund as contribution to the municipal office building fund. During years 1972 through 1979, the Power and Light Department contributed about \$789,336.
 - The Parties agree that contributions made by the Power and Light Department for the municipal building fund were improper; and the City agreed to refund the contributions back to the Power and Light Department.
- 5. Pursuant to a report on cost allocation of the municipal office building by Ernst & Ernst, the City refunded all contributions to the Power and Light Department in excess of \$584,920.
- 6. The City agreed to refund the remaining \$584,920 of the Power and Light Department contributions.
- 7. Prior to 1978, inter-fund charges were based upon revenue produced, and not costs incurred.
- 8. In 1980, the City assessed a franchise tax of 10% of gross receipts, and a real property tax of \$1.91 per \$100.00 of assessed valuation, and a sales tax on purchases which are not exempt.
- 9. There had not been an assessment of the non-distributable real property controlled and used by Power and Light Department, therefore the amount in lieu of the real property tax cannot be determined.
- 10. There was no determination of which purchases by the Power and Light Department would be subject to sales tax, so that amount in lieu of the sales tax cannot be determined.
- 11. The Court estimated the property tax to be \$423,000 in 1978 and \$455,000 in 1979. The Court estimated the sales tax to be \$25,000 for 1978 and 1979.

Analysis:

Charter Analysis:

- Section 3.17 of the City Charter sets out basic rules to be followed by the Power and Light Department. The Court stated that the clear intent of this section was to establish a relationship between the City and the Power and Light Department, which would differentiate the Power and Light Department from other City departments. The court separated Section 3.17 into four prescriptive clauses describing the major elements of the relationship.
 1. That the Power and Light Department “shall be operated in a businesslike manner”.
 2. That the Power and Light Department “shall not be operated for the benefit of other municipal functions”
 3. That the Power and Light Department “shall not be used directly or indirectly as a general revenue producing agency for the city”.
 4. That the Power and Light Department “shall apply all annual profits to rate reductions”.
- The Court stated that these four prescriptive clauses indicate that the Power and Light Department is to be operated for the benefit of the ratepayers, not for the benefit of other municipal functions or as a general revenue producing agency. The only benefit to which the City is entitled to is that the Power and Light Department “may pay to the City an amount in lieu of such taxes as are normally placed upon private business enterprises.” (Section 3.17, paragraph 1)
- The Court went on to say that the City is not to benefit from the Power and Light Department, and profits are to be applied solely to rate reductions. The only benefit to which the City is entitled is a payment in lieu of taxes that are normally placed upon private business enterprises.
- The Court states that the verbiage regarding payment in lieu of taxes creates a limitation that encompasses all benefits to the City, including power supplied without charge, contributions to building funds, inter-fund charges and direct payment transfer to the City.

Funds paid for services provided by various City departments:

- The Court stated that inter-fund charges to Power and Light Department for services provide by City departments are reasonable if determined by a cost allocation study on an annual basis.

Power supplied without charge to various City departments:

- The Court stated that supplying power to the City without charge clearly is operating the electric utility for the benefit of other municipal functions. The form of direct payment or power supplied without charge is irrelevant and the difference is only bookkeeping entries.

Contributions by the Power and Light Department to a municipal office building:

- The contributions made by the Power and Light Department for the municipal building fund were a direct benefit to the City and improper.

Payment to the City of a portion of the gross revenue of the Power and Light Department:

- The Court makes a distinction in City's argument that they may collect "an amount in lieu of taxes which the City would receive were the Power and Light Department privately owned". The Court stated that the Charter allows the City to receive a payment amount in lieu of such taxes as are normally placed upon private enterprises. To restate, the City is authorized to take from the Power and Light Department, in whatever form it chooses, an amount in lieu of that franchise tax.
- In this case, the City was making the Power and Light Department create a "phantom balance sheet" depicting the Power and Light Department as a private business enterprise. Court stated that the City can take an amount in lieu of a franchise tax computed upon the actual gross receipts in the same manner as a private business enterprise. The City cannot inflate the gross receipts or charge a higher percentage.
- The Court interprets that the gross receipts includes the actual receipts, purchases, and property used exclusively by the Power and Light Department, as if it were the owner.

Conclusions:

1. The Power and Light Department is to be operated for the benefit of the ratepayers not for the benefit of taxpayers.
2. The Power and Light Department may not be operated for the benefit of other City departments.
3. The City is entitled to receive payment of an amount in lieu of taxes as are normally placed upon private business enterprises. This can be done in any form, such as direct payment, inter-fund charge, power supplied without charge, or other manner.
4. As used in the Charter, "such taxes as are normally placed upon private business enterprises" means such taxes as are normally placed by the City on private businesses which are similar in nature to the Power and Light Department.
5. The amount in lieu of the franchise tax is computed based upon:
 - the actual gross receipts which are the same character as the gross receipt of private companies subject to the franchise tax; and
 - an amount in lieu of the ad valorem tax computed by applying the City levy to the real property controlled and used exclusively by the Power and Light Department as if it were the owner of the property to the same extent as private businesses which are similar in nature to the Power and Light Department; and

- an amount in lieu of the sales tax that is computed based upon purchases of the Power and Light Department which are exempt from the sales tax only because the Power and Light Department is owned by the City, and which would not be exempt from the sales tax for any other reason.
6. The amount in lieu of such taxes as are normally placed upon private business enterprises includes only the portion of taxes which are assessed by the City only.
 7. The value of the power paid, in whatever form, for by the City may be included in gross receipts for purposes of computing an amount in lieu of the franchise tax.
 8. The value of power supply to the City without charge shall be excluded from gross receipts for purposes of computing an amount in lieu of the franchise tax.
 9. The City is entitled to charge the Power and Light Department for reasonable costs of specific services rendered, and property supplied by other City departments provided such charges are made pursuant to an ordinance or agreement setting forth the specific services to be rendered and property to be supplied.
 10. The City is not entitled to charge the Power and Light Department for the cost of general services or property rendered, such as police and fire protection.
 11. Allocation of costs by independent auditors on an annual basis is a reasonable method of determining costs of specific services rendered and property supplied to the Power and Light Department by other City Departments.
 12. The value of power supplied to the City shall be calculated at the same rate as is applied to other customers which consume similar amounts of power. The City's present practice of applying the rate for large industrial customers to value the power supplied to the City meets this requirement.

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