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December 29, 2011

ATTORNEY GENERAL OPINION NO. 2011- 25

The Honorable Ray Merrick  
Senator, 37<sup>th</sup> District  
6874 West 164<sup>th</sup> Terr.  
Stilwell, Kansas 66085

Re: Constitution of the United States—Legislative Powers—Limitations on States; Laws Impairing the Obligation of Contracts; Annexation by Cities; Area in a Fire District; Refund of Ad Valorem Taxes

Cities and Municipalities—Additions, Vacation and Lot Frontage—Annexation by Cities; Area in a Fire District; Refund of Ad Valorem Taxes; Impairment of Contracts

Synopsis: 2011 Senate Bill 150 may violate the Contract Clause of the United States Constitution if the application of Section 12(a) results in a substantial impairment of a contractual obligation, and Section 12(a) is either not justified by a significant and legitimate public purpose, or if the substantial impairment of a contractual obligation caused by Section 12(a) is unreasonable in light of the significant and legitimate public purpose which justifies the law. Cited herein: K.S.A. 19-3623f; K.S.A. 75-704.

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Dear Senator Merrick:

As State Senator for the 37<sup>th</sup> district, you ask for our opinion regarding Section 12(a) of 2011 Senate Bill 150 (SB 150), which states:

If any land located within a fire district is annexed by a city and such land remains a part of the fire district beyond the current tax year, the owner of such land shall be entitled to a refund of all ad valorem taxes paid for fire service, including any tax levy for bond and interest payments from either

the city or the fire district, whichever entity levies taxes for fire service against the land but does not provide such service.<sup>1</sup>

This section of SB 150 is intended to prevent persons annexed into a city from having to pay taxes to both the city and the county for fire protection.<sup>2</sup> If the city begins providing fire service to a newly annexed area within a fire district, then landowners in that area are entitled to a refund of all taxes paid to the fire district, and will only pay taxes to the city for fire service. As a result, the property base subject to taxation for the purpose of paying fire district bonds would decrease. In your letter, you ask whether SB 150 violates the Contract Clause of the United States Constitution by retroactively impairing the contract rights of the fire district and its bond holders.

The Contract Clause provides that no state shall pass any law impairing the obligation of contracts.<sup>3</sup> This clause is intended to safeguard the contractual obligations of debtors and creditors, which are essential to “prosperous trade.”<sup>4</sup> The Contract Clause’s limitation on state legislative power is not absolute; it must be reconciled with the state’s right to assert the powers reserved to the states by the constitution, such as the power of eminent domain, and the police power to protect the health and welfare of the state’s citizens.<sup>5</sup>

The test for determining whether a Contract Clause violation has occurred starts with a determination of whether the state law has, in fact, operated as a “substantial impairment” of a contractual relationship.<sup>6</sup> Examples of substantial impairments to contracts include a state law that imposed retroactive compensation and pension requirements on private employers,<sup>7</sup> and the repeal of a statutory covenant pledged as a security for bonds.<sup>8</sup>

If the state law operates as a substantial impairment to a contractual relationship, the court then considers whether the state law is justified by a significant and legitimate public purpose.<sup>9</sup> Once a legitimate public purpose has been identified, the court will determine whether the state law’s impact on the rights and responsibilities of the contracting parties is reasonable and appropriate in light of the public purpose justifying the state law.<sup>10</sup>

In your letter, you express concern that a situation may exist in which a fire district issued bonds for the acquisition or construction of fire stations prior to annexation by the city. In this situation, bond holders may have purchased the fire district’s bonds in

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<sup>1</sup> L. 2011, Ch. 101, § 12(a).

<sup>2</sup> *Minutes*, House Local Government Committee, February 8, 2011.

<sup>3</sup> U.S. Const., Art. 1, § 10, Cl. 1.

<sup>4</sup> *Home Bldg. & Loan Assn. v. Blaisdell*, 290 U.S. 398, 427-428 (1934).

<sup>5</sup> *United States Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 22-24 (1977).

<sup>6</sup> *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978).

<sup>7</sup> *Id.*

<sup>8</sup> 431 U.S. at 29-32.

<sup>9</sup> *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400, 411 (1983).

<sup>10</sup> *Id.* at 412.

reliance on K.S.A. 19-3623f(e), which guarantees that property subject to a tax levy for a city-issued bond will remain subject to such taxes after the property is detached from the city.<sup>11</sup> While K.S.A. 19-3623f(e) does not address ongoing bond obligations of property *annexed* by a city, the statute plainly protects bondholders in the event of detachment.

We were not presented with information regarding a specific bond that may be impacted by SB 150, and our role is limited to providing opinions on questions of law.<sup>12</sup> As such, we opine that if SB 150 operates to substantially impair the contractual obligations between a bondholder and a fire district, and such impairment is not justified by a significant and legitimate public purpose, or if SB 150's substantial impact on such contract is unreasonable in light of the significant and legitimate public purpose justifying the law, then SB 150 would violate the Contract Clause.

Whether SB 150 violates the Contract Clause depends on the facts of a particular circumstance. The threshold inquiry in a Contract Clause challenge is whether state law in fact operates as a substantial impairment of a contractual relationship. If no substantial impairment exists, then a Contract Clause violation will not be found.<sup>13</sup>

Sincerely,

Derek Schmidt  
Attorney General

Sarah Fertig  
Assistant Attorney General

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<sup>11</sup> K.S.A. 19-3623f(e): "When the land annexed to such city is detached and excluded from such district the governing body of the district shall redefine the new boundaries of the district to exclude the land so detached. All general obligation bonds issued for the acquisition or construction of fire stations or buildings, the acquisition of sites therefor and the purchase of fire fighting equipment by a fire district which are issued prior to the detachment of such land shall continue as an obligation of the property subject to taxation for the payment thereof at the time such bonds were issued."

<sup>12</sup> K.S.A. 75-704.

<sup>13</sup> *E.g., Faitoute Iron and Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942).