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Contracts: State's Contractual Obligation Contingent upon Legislative Appropiation Held Valid

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obvious reasons this criticism with regard to signatures is normally not valid with respect to a picture of the holder on the card except where an imposter is able to substitute his picture for that of the holder.

Issuers might argue that the above suggestions impair the convenience and popularity of the credit card arrangement. However, such requirements would not be detrimental to the holder. The detriment would accrue only to the issuer in that he might suffer economic loss in several ways: (1) he may have to keep account of his customers' balances on a continuous basis, (2) he may jeopardize his goodwill by disallowing the holder's son, daughter, wife, or any other transferee privileges of a credit card which is nontransferable, and (3) he may embarass his customer by examining the customer's signature and photograph appearing on the card. However, it should be stressed that effective safeguards to unauthorized use of the lost or stolen credit card, in the absence of either party's negligence, can be effectuated only by imposing certain burdens upon the issuer, since it is he and not the holder who deals with the imposter and thus he is the party who should take reasonable steps to ascertain the identity of the user of the card.[39]

Contracts: State's Contractual Obligation Contingent Upon Legislative Appropriation Held Valid

In October 1966, Minnesota's Commissioner of Administration executed a contract with the Walter Butler Company for architectural services for a state college building program.[1] At the time of execution there were no appropriated funds available for the project. In consideration of Butler's promise to perform preliminary work, the state agreed to engage the company for all other architectural and engineering work connected with the project, *when and if* an appropriation therefor

39. Again an analogy can be made to negotiable instruments where the party who bears the loss of a forged signature or indorsement is often the party who dealt with the forger. *See generally* UNIFORM COMMERCIAL CODE § 3-417.

1. The Butler Company had already done all the architectural and engineering work on Phase I of the project. Phase II, the subject of the contract in question, essentially involved additions to the structures built in Phase I. Payment for the preliminary work on Phase II was to be made from the contingent appropriation.

was made by the legislature. In March 1967, a new Commissioner of Administration notified the Butler Company that he considered the contract illegal and the state not bound thereby. Mrs. Butler brought a taxpayer's action to enjoin the state from making a contract for the same work with another architectural firm. The state appealed from the trial court's granting of a temporary injunction. The Minnesota Supreme Court *held* that the contract was valid as a reasonable exercise of the prior Commissioner's statutory authority, and affirmed the granting of the temporary injunction. *Butler v. Hatfield*, 152 N.W.2d 484 (Minn. 1967).

The statutes applicable to state contracts are part of the 1939 Reorganization Act[2] which was intended as a regulation of all phases of state spending. The Act sets up four separate procedures—appropriation, allotment, encumbrance, and payment. First, estimates of expenditures for each fiscal year of the future biennium are collected by the Commissioner of Administration from all departments, officials, and agencies of the state.[3] Based on these estimates, the appropriations are made by the legislature.[4] The appropriated amounts are then allotted to the various departments by the Commissioner, insofar as the respective estimates are within the amount and purpose of the appropriations.[5] By allotment, the lump sum appropriation is broken up into small amounts which are periodically given to the various departments, preventing a department from spending its whole appropriation in the first part of the biennium. Every "receipt, account, bill, claim, refund, and demand against the state" is examined by the State Auditor and, if they are valid and sufficient funds are still available, he marks the appropriate allotment "encumbered."[6] Upon demand for payment, the Auditor checks the allotment to see that there is a sufficient unencumbered balance and then issues his warrant which must be presented to the State Treasurer for actual payment.

One statute, not within the scheme of the Reorganization Act, seems applicable to the question before the court in *Butler*. This statute authorizes the Commissioner to have plans for buildings prepared, with funds for payment to come from the

2. Ch. 431, [1939] Minn. Laws 908.
3. MINN. STAT. § 16.14 (1965).
4. MINN. STAT. § 16.15 (1965).
5. MINN. STAT. § 16.16 (1965).
6. *Id.*

unappropriated residue in the state treasury.[7] However, the court ignored this statute since it applied only to the part of the contract promising payment for the preliminary plans[8] and cannot be used to support a decision on the validity of the state's contingent promise to award Butler the contract for all additional architectural work on the project.

The problem in *Butler* was one which had not been previously considered by the Minnesota Supreme Court.[9] Of the few states with comparable statutory restrictions[10] which have considered questions similar to that presented in *Butler*, a majority have reached a contrary result.[11] In so doing, these juris-

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7. MINN. STAT. § 16.32 (1965) provides:

> The commissioner of administration shall prepare plans for all . . . buildings costing more than $1,000, for which he may recommend an appropriation. These plans shall be paid for out of any money in the state treasury, not otherwise appropriated, but when appropriation has been made for the purpose of constructing such building, the fund from which payment for plans was made shall be reimbursed from such appropriation. . . .

8. To authorize this much of the contract, § 16.32 must be read as a standing appropriation or it would violate MINN. CONST. art. IV, § 12 and MINN. CONST. art. III, § 1. However, this statute—first passed in 1901 as an authorization for prison buildings, ch. 122, § 29, [1901] Minn. Laws 141—and § 3.24 of the Minnesota Statutes both indicate that § 16.32 is not a standing appropriation. Section 3.24, enacted in 1933, repealed all standing appropriations. This included § 16.32 if it was a standing appropriation. However, § 16.32 was re-enacted in 1965 when a subdivision relating to federal funds was added to it. Since the legislature manifested a policy against standing appropriations in § 3.24 it is arguable that the 1965 legislature, when re-enacting § 16.32, did not intend that it be construed as a standing appropriation. *See* State v. City of Duluth, 238 Minn. 128, 56 N.W.2d 416 (1953) (construing § 3.24 to create a strong legislative policy against all standing appropriations).

9. The court had held that money could not be paid out of the treasury in absence of an appropriation, even when the obligation to do so had been created by statute. County of Beltrami v. Marshall, 271 Minn. 115, 135 N.W.2d 749 (1965); State *ex rel.* Chase v. Preus, 147 Minn. 125, 179 N.W. 725 (1920). These cases are distinguishable from *Butler* since they involved obligations created by statute and the *validity* of the obligation itself was never in question.

10. Several jurisdictions with dissimilar statutory schemes have considered like questions. In O'Neil v. Goldenetz, 53 Ariz. 51, 85 P.2d 705 (1938), the court followed the basic reasoning of State *ex rel.* Armontrout v. Smith, 353 Mo. 486, 182 S.W.2d 571 (1944), *discussed in* note 14 *infra*, but since no statute requiring an auditor's certificate was involved, the question was whether there was statutory authorization to make the contract. The court in Peck v. City of New Orleans, 199 La. 75, 5 So. 2d 508 (1941), avoided the issue by summarily stating that a restriction on payment without appropriation does not affect the power to contract. *See also* Miller Ins. Agency v. Porter, 93 Mont. 567, 20 P.2d 643 (1933) (time limitations on appropriations); Charles Scribner's Sons v. Marrs, 114 Tex. 11, 262 S.W. 722 (1924).

11. In accord with the reasoning of these jurisdictions, it has been

dictions rely mainly on the plain meaning of the statutes involved,[12] and the desire to maintain the protections against fraud embodied in those statutes.[13] Only Missouri appears to have reached a result similar to that in *Butler*. In *State ex rel. Armontrout v. Smith*,[14] the Missouri court held that a valid

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stated that

> An award of a contract conditioned upon some other board or body making an appropriation or an additional appropriation is invalid. The appropriation must precede the contract in point of existence. So when an appropriation for only part of the cost of a contract exists, an agreement to enter into a contract to complete the work, when requested to do so, on condition that a further appropriation be made, is void.

J. DONNELLY, THE LAW OF PUBLIC CONTRACTS § 146 (1922).

12. *See, e.g.*, State *ex rel.* Point Towing Co. v. McDonough, 150 W. Va. 724, 149 S.E.2d 302 (1966), construing W. VA. CODE § 12-3-17 (1931), which provided: "It shall be unlawful for any State board, commission, officer or employee to incur any liability during any fiscal year which cannot be paid out of the then current appropriation for such year . . . ." The *McDonough* court said that the equity of the case was clearly with the plaintiff, but that "the law must be administered as it is written." *See also* State *ex rel.* Brooks Equip. & Mfg. Co. v. Evatt, 137 Ohio St. 125, 28 N.E.2d 360 (1940), construing OHIO REV. CODE ANN. § 131.17 (1966), which provides:

> No officer, board, or commission of the state shall enter into any contract, agreement, or obligation involving the expenditure of money, . . . unless the director of finance first certifies that there is a balance in the appropriation, not otherwise obligated to pay precedent obligations, pursuant to which such obligation is required to be paid.

13. In *Evatt*, the court stated that to hold the contract valid would encourage the practice of executing long-term contracts in one biennium with certification of the availability of funds postponed until subsequent biennia. It felt that such a practice would be conducive to fraudulent and wasteful state spending. *See also* Hinkle v. Philadelphia, 214 Pa. St. 126, 63 A. 590 (1906). *See, e.g.*, Williams v. New York, 118 App. Div. 756, 104 N.Y.S. 14, *aff'd mem.*, 192 N.Y. 541, 84 N.E. 1123 (1907). In *Williams* the plaintiff's bid was accepted subject to the approval of an appropriation of an additional $14,000. The appropriation was made but the city refused to award the contract. The court held the contract invalid because the board of trustees had no authority to award the contract before the full amount had been appropriated. The court reasoned that although there was no indication of fraud in the case before them, this was no reason to weaken the defenses against fraud.

14. 353 Mo. 486, 182 S.W.2d 571 (1944). In *Armontrout*, a Missouri statute provided reimbursement for cattle slaughtered in fighting Bang's disease. In the action for payment, the state claimed the contract was invalid since it had been made before funds were appropriated. The court stated that the Missouri Budget Law could not be construed to invalidate contracts expressly authorized by subsequent legislation, reasoning that an implied contract with the state for payment of the statutory amount was created when the plaintiff sent his cattle to slaughter. MO. STAT. ANN. § 33.040 (1949) provided:

> No expenditure shall be made and no obligation incurred by any department without the following certifications:

agreement could be made in advance of an appropriation if it was *expressly* authorized by statute.

The decision in *Butler* was based on two premises. The first was that the contract in no way obligated the state prior to an appropriation. The court stated that at the time notice of cancellation was sent, the Butler Company had no enforceable contract, but merely a "proposal" to receive enforceable rights *when and if* an appropriation was made.[15] The second premise was that the contract was a reasonable exercise of the Commissioner's statutory authority and in the state's best interests. The court pointed out that an architect was needed to prepare plans to support an application for federal aid, and that much valuable time would have been lost and additional expense incurred if the Commissioner had been forced to wait for the 1967 legislature to make an appropriation.[16] The court also stated that there had been no claim that the contract was entered into to further personal interests or that the work done was of inferior quality, nor had there been a showing that the contract was an unreasonable infringement on the powers of a successor in office. Apparently applying principles of estoppel, the court stated that the state had induced the Butler Company to render valuable services by a proposal seemingly within the authority of the Commissioner and, since the agreement was not invalid on its face, the state should not be allowed to repudiate it.[17]

By general principles of contract law, the court's first premise is questionable. Each party to a contract must obligate himself in some manner, at the time of execution of the contract, or his promise is illusory and may be repudiated. Therefore, if the state was not obligated until an appropriation was made, there was arguably no contract until that time, and the successor Commissioner should have been allowed to disavow the state's contingent promise, unless his actions had estopped him from making such a repudiation. However, the state's promise was not illusory as it had limited its sphere of permissible actions.[18]

. . .

(2) Certification by the auditor that the expenditure is within the purpose of the appropriation and that there is in the appropriation an unencumbered balance sufficient to pay it.

See County of Beltrami v. Marshall, 271 Minn. 115, 135 N.W.2d 749 (1965).

15. 152 N.W.2d at 496.

16. *But see* notes 7-8 *supra.*

17. 152 N.W.2d at 496.

18. *See* A. CORBIN, CONTRACTS § 149 (one vol. ed. 1952).

When the appropriation was made, the state was obligated to award the contract to the Butler Company and pay it for its preliminary work. This obligation, although contingent, was the kind of present obligation that is sufficient to form a binding contract.[19]

If there was a binding contractual obligation on the part of the state, the court should have dealt with the relevant sections of the Reorganization Act rather than merely citing them without discussion. Section 6.23 of the Minnesota Statutes provides:

> Unless otherwise expressly provided by law, *no* money . . . shall be *expended or applied* by any official, department, or agency of the state government . . . except under authority of an appropriation by law and an allotment relating thereto as herein provided and upon warrant of the auditor. (Emphasis added.)

This section has been indirectly construed as always requiring a legislative appropriation as a prerequisite to state liability.[20] The key word in this section is "applied" and it must therefore be decided whether the Butler contract had "applied" state money without either appropriation by the legislature or allotment by the Auditor. Since "expended" is used alternatively with "applied," it would seem that something more than mere cash expenditures was intended to be regulated by the section. Indeed, if only cash expenditures were meant to be restricted there would be no need for the regulations provided by the first three steps of the Reorganization Act—appropriation, allotment and encumbrance—as the problem would be adequately covered by the regulations in the payment step. The intended effect of the first three steps was to prevent prohibited claims from coming into existence, not simply to provide a method to avoid payment. Therefore, a contractual obligation is arguably an application of money under section 6.23 and, if so, the Butler contract would be invalid unless it was of a type "otherwise expressly provided [for] by law." Although section 16.32[21] may be viewed as express statutory authorization for the contract, the statute is, at best, only partially applicable. Therefore, the Butler agreement would not be excepted from the prohibition by the introductory language of section 6.23.

Further, section 10.17 provides: ". . . It is hereby made unlawful for any state board or official to incur any *indebted-*

19. *See* 3A A. CORBIN, CORBIN ON CONTRACTS § 728 (2d ed. 1960).
20. County of Beltrami v. Marshall, 271 Minn. 115, 121, 135 N.W.2d 749, 753 (1965).
21. See notes 7-8 *supra*.

ness on behalf of the board, the official, or the state *of any nature* until after an appropriation therefor has been made by the legislature . . . ." (Emphasis added.) This statute has been interpreted by the Attorney General to mean that monies appropriated for one purpose can be used for that purpose only, and cannot be used to satisfy even closely related debts.[22] The key to this section of the statute is the word "indebtedness." Normally this word is construed to mean only a present, due, financial indebtedness incurred by a contractual obligation.[23] Here, the fact that "indebtedness" is followed by the phrase "of any nature" arguably indicates that the state's obligation under an executory contract was meant to be included within the scope of the statute.

Lastly, section 16.16(8) provides:

> No payment shall be made and no obligation shall be incurred against any fund, allotment, or appropriation unless the state auditor shall first certify that there is a sufficient unencumbered balance in such fund, allotment, or appropriation to meet the same. Every expenditure or obligation authorized or incurred in violation of the provisions of Laws 1939, Chapter 431, shall be presumed invalid. . . .

If the Butler agreement is enforceable, it would seem that the state must have incurred an "obligation" within the terms of this section.[24] However, since there was *no* available fund, allotment, or appropriation at the time of execution of the contract, it was impossible for the Auditor to certify an unencumbered balance in that nonexistent fund. Indeed, the Butler contract was marked "unencumbered" by the Auditor. Clearly, the Butler contract appears to be invalidated by the above statute.

However, the Reorganization Act was enacted to prevent state officials from spending money without legislative approval and control. The Act is primarily concerned with the constitutional provision that no state money shall be expended in the absence of an appropriation. Because of the contingency involved in the Butler contract the legislature had not been de-

22. OP. MINN. ATT'Y GEN., 9-A-34, June 3, 1955; OP. MINN. ATT'Y GEN., 9-A-24, Dec. 15, 1947.

23. Farmers State Bank v. Sig Ellingson & Co., 218 Minn. 411, 16 N.W.2d 319 (1944); McCrea v. First Nat'l Bank, 162 Minn. 455, 203 N.W. 220 (1925).

24. MINN. STAT. § 16.10 (1965) provides that "no purchase order or contract shall be valid or effective without . . . the counter-signature of the auditor, who shall certify that the appropriation and allotment have been encumbered for the full amount of the contract liability." This statute makes clear that the "obligation" referred to in § 16.16(8) is meant to be the type of obligation incurred in an executory contract.

prived of its power to decide to what use state money shall be put, and no money will be paid out of the treasury before there is an appropriation. Therefore, it is arguable that the policies behind the provisions of the Reorganization Act are not violated by the *Butler* situation. However, in order to recognize this fact, the court had to ignore the above mentioned contract principles before it could avoid the language of the sections. Such a situation would seem to indicate a need for revision of the provisions of the Reorganization Act to accommodate the type of situation which *Butler* has presented.

Since the court did not use the statutes of the Reorganization Act in deciding the instant case, it had to determine whether or not the contract was a reasonable exercise of the Commissioner's authority and served the best interests of the state. In so doing it looked to whether these interests were served, rather than to whether a *Butler* type contract should be recognized as a valid way to serve these interests. This approach has left the validity of a *Butler* type contract to be decided on a case-by-case basis. The importance of determining the validity of the state's contracts requires more certainty than is afforded by such an approach. The court should have balanced the benefits of such a contract against the evils it might engender in order to determine the validity of the *Butler* class of contracts as a whole.

There is no doubt that a *Butler* type contract presents beneficial aspects for judicial consideration. This method of contracting gives the Commissioner of Administration additional freedom in contracting for the state.[25] This freedom, if judiciously used, could save the state both time and money. Under the present system the legislature is often forced to make appropriations without adequate preliminary information, since no work can be done before appropriated funds are available. The *Butler* type contract provides a method for compiling such preliminary information to aid the legislature in determining what amount should be appropriated for a project. Further, such a contract is beneficial in a time of ever increasing federal aid to states in that it provides a flexible way to prepare plans and estimates for submission to the federal

25. In W. ANDERSON & E. WEIDNER, STATE AND LOCAL GOVERNMENT 609 (1951), it is said that in this age of more responsible government more freedom should be given to the state as to how and where it can spend its money. "[T]ying up money in funds for purposes of no immediate need does not seem to be sound financing." *Id.*

government at any time, not merely when the legislature is in session.

However, there are negative aspects of a *Butler* type contract which must be balanced against its benefits. Such a contract presents an opportunity for one state officer to wrongfully bind his successor as well as affording an opportunity for graft and corruption in the highest echelons of state government.[26] Nevertheless, these are dangers which are present to some extent in all state contracts, and the court suggested an answer to these problems in its opinion when it stated that the legislature could negate the *Butler* type of agreement by specifying in its appropriation bill that no part of the funds should be applied for payment of past or future architectural services by the Butler Company.[27]

Such a solution, however, depends on knowledge by the legislature of the existence of the contract. Perhaps a concrete solution to this type of problem would be the enactment of a statute requiring that the legislature be informed of any *Butler* type contract which might affect pending appropriation bills. Such a statute would require the legislature to consider any such contract in light of whether or not it was in the state's best interest. Failing to pass the requisite "best interest" test, the statute would permit the legislature to affix the necessary disclaimer with regard to that particular contract. Alternatively, such a proposed statute could provide that all *Butler* type contracts are invalid unless the legislature affixes a clause to the appropriation bill specifically authorizing them. This solution would give stronger protection to the

26. The possibility that the *Butler* type contract will encourage corrupt lobbying is another problem which the court did not consider. Contracts made with a third party to influence legislation, with payment on a contingent fee basis, have consistently been declared void as against public policy by the United States Supreme Court. Hazelton v. Sheckells, 202 U.S. 71 (1906); Trist v. Child, 88 U.S. (21 Wall.) 441 (1874); Gesellschaft Fur Drahtlose Telegraphie M.B.H. v. Brown, 78 F.2d 410 (D.C. Cir. 1935). It has been said that such an agreement has a tendency to induce a lobbyist to attempt to corrupt or unduly influence legislators to pass the bill on which his fee depends. Grover v. Merritt Dev. Co., 47 F. Supp. 309 (D. Minn. 1942). The test applied is not what was done, but what the terms of the contract encouraged. *Id.* Although a *Butler* type contract would not be for the express purpose of lobbying, the policy reasons behind the prohibition of a contingent fee lobbying contract are equally applicable. The contractor's pay for his work product is contingent upon a legislative act, and therefore the same factors are present which have led courts to invalidate contingent fee lobbying contracts as against public policy.

27. 152 N.W.2d at 496.