Feature

KEY POINTS

- The *vires* of a local authority in connection with commercial transactions remains a potential pitfall for commercial lenders.
- When entering into transactions with local authorities, commercial lenders will be well-advised to ensure that their due diligence includes consideration of the powers pursuant to which the local authority is purporting to act.
- Parties cannot rely on courts adopting a broad, purposive approach to construction of legislation granting local authorities the power to act. Ambiguity in such legislation may not be resolved in favour of an *intra vires* construction.

Author Joseph Sullivan

"Municipal purposes": the return of *vires* litigation

In this article, Joseph Sullivan considers a recent Privy Council decision which serves as an important reminder of the need for pre-contractual checks as to local authorities' *vires* before seeking financial assistance from them.

INTRODUCTION

In *Mexico Infrastructure Finance LLC v The Corporation of Hamilton*, the Privy Council held, 3-2, that the grant by the Corporation of Hamilton of a guarantee to support borrowing by a private developer was *ultra vires* and, accordingly, unenforceable. The case concerned the construction of the term "municipal purposes" in the relevant legislation.
The majority adopted a narrow construction, holding that the term was limited to activities by which residents were provided with a direct benefit. The dissenters adopted a broader construction, holding that the term included any action taken for the direct or indirect benefit of residents.

BACKGROUND

In 2012, the Corporation of Hamilton entered into an agreement with a private developer, PLV, for the construction of a five-star hotel complex. It was intended that the hotel would boost tourism in Hamilton and would provide enhanced revenues for associated service providers in the area. The Corporation would also receive rental income from the hotel operator and income from the use of a car park built as part of the complex.

PLV obtained a bridging loan of $18m from Mexico Infrastructure Finance LLC (MIF) in connection with the development. The Corporation provided MIF with a guarantee in respect of that loan, purportedly pursuant to a power under s 23(1)(f) of the Municipalities Act 1923 of Bermuda (1923 Act). When PLV defaulted, the lender called on the guarantee. The Corporation refused payment, arguing that the guarantee was *ultra vires* and unenforceable. This defence was allowed at first instance and in the Court of Appeal for Bermuda.

THE POWER

There was no express power to issue guarantees in the legislation by which the Corporation was created: if there was any such power, it had to be implied from other provisions. Section 23(1) of the 1923 Act gave the Corporation the power to levy rates for specific purposes, one of which (set out in sub-s (f)), was, "such municipal purposes, being purposes of an extraordinary nature, as the Minister may in any particular case approve".

FIRST INSTANCE

At first instance, Hellman J held that the issuing of the guarantee by the Corporation to MIF did not fall within the scope of the purpose set out in s 23(1)(f) of the 1923 Act because it was not a service provided by the Corporation to its ratepayers, even though it may have been of benefit to them. Accordingly, the guarantee was *ultra vires*.

COURT OF APPEAL

The Court of Appeal for Bermuda agreed with Hellman J's decision. It held that a development carried out by the Corporation which was of benefit to the entirety of Bermuda would be *ultra vires* as it would not relate to the functions of the local government of the city of Hamilton.

PRIVY COUNCIL

Argument

In the appeal before the Privy Council, MIF argued that the phrase "municipal purposes, being purposes of an extraordinary nature" must be given a broad construction.
It submitted that:

- The phrase clearly envisaged activities out of the ordinary run, since it referred to purposes of an "extraordinary nature", and it expressly required ministerial control and approval.
- The word "municipal" reflected two matters: a geographical component in the Corporation's powers (the City limits of Hamilton) and a local-interests component (the purpose must be in the interests of the locality and its inhabitants).

Whilst MIF acknowledged that the luxury hotel was not intended to be used by the inhabitants of Hamilton, it argued that it was of benefit to them since it would attract tourists and create associated needs for related services which inhabitants could provide for reward. It pointed out that the Corporation owned a theatre which provided performances not just for the inhabitants of Hamilton but also for visitors: no one suggested that the building of the theatre was *ultra vires*.

The Corporation argued that "municipal purposes" corresponds to governmental functions and largely involve the provision of "necessaries", in contradistinction to "luxuries". It relied on the local authority interest rate swaps case of *Hazell v Hammersmith and Fulham LBC* in support of its argument that, in order for a purpose to be a lawful purpose for a local authority,

Biog box
Joseph Sullivan ia a barrister at Quadrant Chambers.
Email: joseph.sullivan@quadrantchambers.com
https://www.quadrantchambers.com/barristers/profile/joseph-sullivan

it is not sufficient that the proposed action is convenient or desirable or profitable. On the facts, the hotel was designed to satisfy the needs of affluent travellers rather than local inhabitants and, accordingly, the provision of the guarantee was not a "municipal purpose" within the meaning of s 23(1)(f) of the 1923 Act.

Majority decision

Lady Arden, with whom Lords Reed and Briggs agreed, gave the opinion of the majority of the board. After dismissing, in short order, an argument that the power could be implied as being reasonably incidental to the Corporation's power to dispose of its interest in land, Lady Arden went on to consider the central issue in the appeal: the meaning of s 23(1)(f) of the 1923 Act. She held that the two-part test for "municipal" put forward by MIF was unsatisfactory:

- The geographical component throws little or no light on whether the purpose of the act is authorised or not.
- The local interest component did not properly reflect the limiting role of the word "municipal". The word must, in the case of a body with rate-levying powers, be interpreted by reference to its context and, here, the context is an authority which was established in order to benefit the inhabitants within the limits of Hamilton. The Corporation was not established to do an act simply because it may promote the prosperity of Hamilton and MIF's construction would deprive the word "municipal" of any relevant meaning: the word might just as well have been omitted since councillors are bound, in any event, to act in the interests of inhabitants.

The majority held that the words "of an extraordinary nature" simply mean that the purpose is one which is outside the normal run of the Corporation's purposes and activities. This phrase did not expand the scope of the phrase "municipal purposes". Moreover, they rejected the comparison with the Corporation's ownership of a theatre. They held that whilst they saw no reason in principle why in an appropriate case the provision of services should not be indirect, rather than direct, there is a distinction between a service provided partly for inhabitants and partly for visitors, such as the theatre, and a service provided exclusively for visitors, such as the hotel. Whilst provision of the former type of service might fall within the Corporation's legitimate objects, the latter would not.

On the facts, they held that it was clear that the guarantee fell outside the scope of the Corporation's purposes: it was no part of its role to act as banker to a developer.

Dissent

Lords Sumption and Lloyd-Jones dissented in the decision. Lord Sumption gave the minority opinion in brief form. He set out two reasons for disagreement with the majority:

- He held that "municipal purposes" are purposes calculated to benefit the current and future residents, permanent or temporary, of Hamilton in their capacity as such. That is the relevant limitation and there is no justification for distinguishing between benefits consisting in the direct provision of services or facilities to residents and expenditure on the promotion of the city's economic development which benefits the residents less directly. The test favoured by the majority gave rise to, "technical, functionally irrelevant and barely workable distinctions".
- The natural meaning of the phrase "being purposes of an extraordinary nature" is that the expenditure in question is expenditure of a kind which is incurred outside the ordinary course of a municipality's functions. This suggests that expenditure under this head was not expected to be confined to the ordinary provision of services directly to residents.

Lord Sumption also distinguished the decision in *Hazell*. He noted that his analysis of s 23(1)(f) did not mean that the Corporation had power to engage in free-standing business activity for earning profits with which to meet its expenditure, which was the perceived vice of the swap transactions which were held to be *ultra vires* in *Hazell*. The issuing of a guarantee to assist a development thought to be in the broader economic interest of the city was not a free-standing business activity.

DISCUSSION

This decision is something of a throwback to the local authority swaps litigation of the 1980s/90s. Commercial lenders may have been forgiven for assuming that the prospect of transactions being avoided by local authorities on the basis of *vires* arguments was a thing of the past, but this case demonstrates that it remains an important issue which should form part of a lender's due diligence when entering into such transactions.

The outcome of the appeal demonstrates that the courts may be prepared to take a strict approach to construing legislation by which local authorities are given power to act. Whilst the dissenting opinion demonstrates a more generous, purposive approach (perhaps in recognition of the unfairness of permitting the Corporation to escape a liability its councillors had willingly purported to enter into on its behalf), the majority opinion is rooted firmly in a textual approach to the construction exercise.

The practical result may simply be to increase transaction costs by reinvigorating a further level of pre-contractual checks which may have fallen into abeyance. Commercial lenders may also require legislation expressly to remove any doubt as to local authorities' *vires* before agreeing to provide them or associated private investors with financial assistance, or alternatively may require guarantees from central government. ■

Further Reading:

- Leaving Hammersmith and Fulham for Ceylon (2012) 9 JIBFL 557.
- Italian derivatives litigation: just another case of history repeating (2011) 3 JIBFL 166.
- LexisNexis Banking & Finance blog: Determining capacity to enter derivative contracts.