



**Request for City Council Committee Action
From the City Attorney's Office**

Date: March 8, 2006

To: Public Safety & Regulatory Services

Referral to: Ways & Means

Subject: Analysis of the City of Minneapolis' authority to retain and utilize surplus revenue generated from its Automated Pawn System (APS) and similar proprietary intellectual properties and technologies.

Recommendation: That the Committee receive & file this report.

Previous Directives: At the January 18, 2006 meeting of the Public Safety & Regulatory Services Committee, the City Attorney was requested to report back with a legal analysis of the City's ability to retain and utilize surplus revenue generated from the licensing and marketing of its Automated Pawn System (APS).

Prepared or Submitted by: Joel Fussy & Lisa Needham, Assistant City Attorneys

Approved by: _____
Jay Heffern, City Attorney

Presenters in Committee: Joel Fussy & Lisa Needham, Assistant City Attorneys

Financial Impact (Check those that apply)

No financial impact - or - Action is within current department budget.
(If checked, go directly to Background/Supporting Information)

Action requires an appropriation increase to the Capital Budget

Action requires an appropriation increase to the Operating Budget

Action provides increased revenue for appropriation increase

Action requires use of contingency or reserves

Other financial impact (Explain):

Request provided to the Budget Office when provided to the Committee Coordinator

Community Impact (use any categories that apply)
Other.

Background/Supporting Information:

This Committee asked the City Attorney to analyze the legal propriety of the City's policy of retaining and reinvesting surplus revenue generated from the licensing and marketing of its Automated Pawn System (APS). On January 27, 2006 the City Council approved a request from the Police Department's Phil Hafvenstein, Manager of Intellectual Property Initiatives, reaffirming an earlier Council resolution (97R-084) which directed that an original \$489,560 appropriation to provide an initial operating budget for the APS program be recovered from revenue generated by the program and that excess revenue be reinvested in additional governmental technology and intellectual property initiatives.

Automated Pawn System (APS)

The Automated Pawn System (APS) is a copyrighted and trademarked intellectual property developed and owned by the City of Minneapolis. APS is designed to accept and store transaction information from pawn shops and secondhand dealers and to share such information with APS users. Since 1997, Minneapolis has licensed the use of APS by other political subdivisions, law enforcement agencies and certain commercial enterprises. All users pay an initial fee of either \$240 or \$1050 depending on whether they are contributing or query-only users of the system. Query-only users then pay an additional monthly fee between \$36 and \$72 based on their agency size while contributing agencies pay \$1 for each transaction uploaded onto APS. Minneapolis owns and markets use of this highly successful pawnbroker databank software across the region to over 150 law enforcement agencies.

Government-to-Government Solutions

The APS program has been a success and has reached the point of beginning to generate revenue in excess of its development and operational costs. Pursuant to past council-mandated direction Phil Hafvenstein, in his position as Manager of Intellectual Property Initiatives for the City, has commenced development of a broader "government-to-government solutions" concept with the goal of reinvesting such excess revenue from APS and similar intellectual property initiatives to fund a self-supplier strategy for Minneapolis and other prospective governmental consortium members with regard to similar sustainable, effective software solutions. In effect, the goal is to establish a network of participating governmental units that will enable the development and use of APS and other similar effective governmental software tools with increased operational efficiency and improved management and support at reduced costs to the governmental units and, therefore, reduced costs to taxpayers. In essence, the concept contemplates a sustainable and continuing consortium of self-supplied governmental

technology seeking to serve the public purpose of providing more effective and adaptive software solutions for participating government subdivisions at a reduced cost to the subdivision and, hence, to taxpayers.

Analysis

In analyzing the ability of the City to retain and reinvest excess revenues generated by its APS program as well as the potential to retain and reinvest revenue generated by its prospective participation in a government-to-government solutions consortium or business model of some type, it is important to examine the scope of municipal authority as it relates to a city participating in private business activity.

A. Engaging in enterprise activity as an implied municipal authority.

At the outset, it is clear that a municipal corporation has only such powers as are expressly conferred upon it by statute or by its charter, or those which are necessarily implied. Borgelt v. Minneapolis, 135 N.W.2d 438 (1965). The trend in Minnesota law over the past decades has been toward a less restrictive rule which upholds an asserted municipal power when the exercise of such power is necessary to aid a specific or implied charter or statutory grant. Id. at 441 (holding that a court will not generally interfere with a municipal assertion of public purpose if undertaken in good faith and resulting in substantial beneficial results flowing to the city, and if not undertaken as a subterfuge).

An examination of relevant statutes and the charter indicates that there exists no express authority for Minneapolis to license and market software as an intellectual property to other units of government. Authority, then, if there is any, must be traced to the implied powers of the city. The charter contains broad grants of power to the police department, other city departments, and to the city council to regulate businesses and to provide for the health and safety of the citizenry, including the licensing and regulation of pawnbrokers. These charter provisions include the following language, inclusive of and in addition to the general welfare clause of the charter which is embodied in the first paragraph:

Section 5. City Council--Power to Make Ordinances. The City Council shall have full power and authority to make, ordain, publish, enforce, alter, amend or repeal all such ordinances for the government and good order of the City, for the suppression of vice and intemperance, and for the prevention of crime, as it shall deem expedient, and in and by the same to declare and impose penalties and punishments, and enforce the same against any person or persons who may violate the provisions of any ordinance, passed and ordained by it, and all such ordinances are hereby declared to be and to have the force of law. Provided, that they be not repugnant to the laws of the United States or of this State, and for these purposes the said City Council shall have authority by such ordinances:

First.--To license and regulate exhibitions and shows of all kinds, including exhibitions of caravans, menageries, circuses, concerts, roller skating rinks, places of amusements and museums for which money is charged for entrance into the same, newspaper carriers and bootblacks, and theatrical performances, also to license and regulate all auctioneers, pawnbrokers, dealers in secondhand goods, junk dealers, keepers of employment offices and agencies, as well as all persons doing the business of seeking employment for others or procuring or furnishing employees for others, pool and billiard tables, bowling alleys, shooting galleries, taverns, restaurants, cafes and cafeterias, and all persons vending, dealing in or disposing of spirituous, vinous, fermented or malt liquors. Provided that no license shall be issued for any longer time than one year, and the City Council shall by ordinance determine the date of expiration of all licenses.

And provided further, that the power to regulate above given, shall be construed to include among other powers, the power to define who shall be considered as auctioneers, pawnbrokers, dealers in secondhand goods and junk dealers, and to compel each and every such person whether licensed or not to keep in such manner as it may direct open at all times for inspection, a record of all such property as it may designate, with the time when received, and the name, residence and description of the person from whom the same was received, and to make daily reports thereof to the police department of said city, as it shall direct. And also, among other powers, the power to require all persons doing the business of seeking employment for others, or procuring or furnishing employees for others, to keep open at all times for inspection, such records of their business as it [the council] may designate, and to furnish to every person with whom they may deal such written evidences of the transaction as it may designate, and to prescribe and punish all kinds of unfair dealings by such persons in the course of their said business, and to establish such rules of legal evidence as it may see fit for the proof of such unfair dealings....

See Minneapolis Charter § 5. It is clear that these charter provisions authorize the city to regulate pawnbrokers. In order for such regulation to occur in an effective manner it is necessary, especially in this modern age, to utilize technological and software solutions in order to most effectively store, retrieve, analyze and share data. From the existing case law and its development over time, it is likely that a reviewing court would view the development and utilization of self-supplied government-specific software tools as an implied municipal power. The Minnesota Supreme Court, in the seminal *Borgelt* case, framed its analysis of whether Minneapolis could lawfully operate a self-supplying asphalt plant under implied charter authority as follows:

It is not easy to define precisely what a municipal corporation may or may not do under its implied powers. At one extreme are those activities, clearly outside the performance of municipal functions, which will be restrained. Such is the case of *John Wright & Associates, Inc. v. City of Red Wing*,

93 N.W.2d 660, where we held that the operation of a moving picture theatre was not a legitimate municipal function. With respect to implied authority we there said: 'A municipal corporation or its agency is invested with full power to do everything necessarily incident to the proper discharge of its public functions. In the absence of express legislative authority, it may not engage in any private business enterprise or occupation such as is usually pursued by private individuals.'

At the other extreme are those activities which are clearly necessary for, or aid, performance of a municipal function. We believe that owning and operating an asphalt plant prior to 1943 would fall into this category, for during that period if the city was to obtain this type of material for its street improvement or repair it was essential that it furnish it to itself.

Between these two extremes lies a gray area where it may be desirable, but not necessary, to engage in the proposed activity. Such is the case of *Central Lbr. Co. v. City of Waseca*, 152 Minn. 201, 188 N.W. 275. The present case probably falls within that area. While the city points to advantages accruing to it from owning and operating its own mixing plant, and there undoubtedly are many, plaintiffs with equal logic point to reasons why the city should not spend large sums of public funds for this purpose as long as the material is available from private sources.

One of the main factors in determining whether a city should enter into an activity such as this is whether the city is in active competition with private enterprise. 12 McQuillin, *Municipal Corporations* (3 ed.) § 36.02. *John Wright & Associates, Inc. v. City of Red Wing*, *supra*, illustrates the type of case in which competition with a private enterprise was considered an important factor in holding that the city was not permitted to engage in that activity. There are, however, municipal activities that are permissible even though private enterprise could furnish the same service. As long as the city refrains from extending its activity into active competition with private enterprise *in dealing with others*, it should be allowed considerable latitude in providing for itself those things necessary to carry on a legitimate municipal function if there are valid reasons for becoming a self-supplier. Preparing its own asphalt material; mixing its own cement; digging its own gravel; preparing crushed rock; and other similar activities incidental to street work, we think, fall

within such permitted activity. Here, there is no direct competition with private enterprise in the true sense of the word. The only competition, if there is any, is a denial of the opportunity to furnish the city its requirements. In *Porto Rico Ry. Light & Power Co. v. Colom* (1 Cir.) 106 F. (2d) 345, 353, the court said: 'Furnishing services to oneself does not constitute competition, as that term is generally accepted, and furnishing power as contemplated for the insular government and the municipal purposes, is in effect a case of the insular government supplying itself.' Borgelt at 443-44

While it remains true that as a general rule municipalities may not engage in private business enterprises, there are a growing number of municipal activities that are permissible even though private enterprise could furnish the same service. See *McQuillin Municipal Corporations* (4th ed.) § 4.07. Since economic, industrial and technological conditions change, many municipal activities, the propriety of which is not now questioned, were at one time held to be of a purely private character. Id. at § 4.06. This explicit recognition of the malleable nature of the public purpose doctrine based on evolving economic and technological realities seems especially relevant to the City's desire to participate in a calculated program to self-supply and reinvest in government software solutions in conjunction with other units of government.

Furthermore, as recognized in the *Borgelt* case cited above, governments are generally allowed to furnish services to themselves in order to carry out implied statutory and charter responsibilities. The government software tools utilized and shared by Minneapolis and other units of government (inclusive of APS and potentially other tools to be developed through the pending government-to-government solutions enterprise) would likely be viewed in this rubric. Although the participating governmental units would be competing indirectly and even directly with private enterprise in furnishing software contracts and tools to other governmental units and to themselves, this would fall within the broad ambit of self-supply. The difference would likely be viewed as one of scope, and not one of substance, in that a multitude of governmental units would share in the self supplying activities furnished by the current provision of APS and the prospective provision of additional software products, as opposed to a single governmental subdivision.

An essential consideration that courts apply in determining whether a municipality possesses implied authority to engage in a particular activity or enterprise is whether the activity serves a public purpose. In order for an activity or an enterprise to constitute a public purpose, the activity must serve as a benefit to the community as a body and be related to the functions of government. Visina v. Freeman, 89 N.W.2d 635. Additionally, the activity must not be arbitrary, unreasonable or wasteful. As referenced above, the APS program and its prospective expansion into other similar government software initiatives arguably satisfies all of these requirements through increased operational efficiency, reduced costs and improved management provided by the effective software solutions. Furthermore, the program has recouped its initial start-up costs and is poised to begin returning excess revenues.

B. Excess revenue allotment.

The final part of the requested legal analysis of the APS program and its potential expansion must focus on the restrictions inherent with such municipal ventures into traditional private enterprise fields. The Minnesota State Auditor released an extensive report entitled *Municipal Enterprise Activity* on March 18, 2004 which examined these issues statewide. A review of this report and the above-referenced case law indicates that implied-authority public purpose enterprises such as APS and its successors would likely be characterized as generally restricted to cost recovery revenue generation plus any associated maintenance, renewal and replacement costs. See MN State Auditor's Report: *Municipal Enterprise Activity* at 1 (3/18/2004); see also League of MN Cities: *Handbook for Minnesota Cities* at 21-18 (11/2/2005). The revenue generated to this point by the APS program seems to fall well within these legal confines.

Additionally, since technology development and utilization life cycles are ever decreasing with the frantic pace of advancement, it would be reasonable that any software development initiative would be expected to recycle a large amount of its revenue into continued development, support and enhancement of the underlying systems. In this respect, it would be reasonable for the City to continue to funnel excess intellectual property initiative revenues into continued development, expansion and support of existing products and initiatives in order to maximize the efficiency and public benefit attributable to the self-supplying strategy. However, fee and pricing structures will need to be continually re-examined in order to comply with the legal requirement that the initiatives not be deemed "for-profit". Rather, excess revenues will likely need to be sunk back into continued support and development of existing and emerging initiatives. In this way, the public and the City will realize real economic advantages in the form of increased technological efficiencies leading to substantive service delivery improvements while not running afoul of general prohibitions against enterprise profit taking. In this manner, the public purpose of the program refrains from becoming muddled and susceptible to challenge.

Conclusion

In sum, the City's APS program, as well as the proposed expansion of the program into other technology and intellectual property initiatives, appears to comport with legal requirements in the areas of municipal authority and cost recovery and allocation. The City would appear to possess implied charter authority to furnish technological and software services to itself and other governmental subdivisions, so long as the initiatives continue to serve a public purpose and excess revenues are reinvested into continuing development and support expenditures.