

# OFFICE OF LEGISLATIVE LEGAL SERVICES

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**STATE CAPITOL BUILDING, ROOM 091  
200 EAST COLFAX AVENUE  
DENVER, COLORADO 80203-1782**

**TELEPHONE: 303-866-2045 FACSIMILE: 303-866-4157  
E-MAIL: OLLS.GA@STATE.CO.US**

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## LEGAL MEMORANDUM

**TO:** The Joint Budget Committee

**FROM:** Office of Legislative Legal Services

**DATE:** November 18, 2011

**SUBJECT:** Control over Federal Funds<sup>1</sup>

The purpose of this memorandum is to generally describe the authority of the General Assembly and the Governor to control federal funds that the state receives. The first part of the memorandum briefly describes the basic legal principles that are applicable, while the second part is a more detailed discussion of the Colorado Supreme Court's relevant decisions.

### I. Basic Legal Principles

The starting point for analyzing the issue of control over federal funds that the state receives is the doctrine of separation of powers. Article III of the state constitution specifies that:

The powers of the government of this state are divided into three distinct departments,--the legislative, executive and judicial; and no person or collection of persons charged with the exercise of powers properly belonging to one of these departments shall exercise any power properly belonging to either of the others, except as in this constitution expressly directed or permitted.

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<sup>1</sup> This legal memorandum results from a request made to the Office of Legislative Legal Services (OLLS), a staff agency of the General Assembly. OLLS legal memoranda do not represent an official legal position of the General Assembly or the State of Colorado and do not bind the members of the General Assembly. They are intended for use in the legislative process and as information to assist the members in the performance of their legislative duties. Consistent with the OLLS' position as a staff agency of the General Assembly, OLLS legal memoranda generally resolve doubts about whether the General Assembly has authority to enact a particular piece of legislation in favor of the General Assembly's plenary power.

While "[t]he dividing lines between the respective powers are often in crepuscular zones . . ." <sup>2</sup> the Colorado Supreme Court has identified a clear line relating to the power to spend: "[The] General Assembly's plenary power over appropriations applies only to state moneys, while the Governor retains control over those funds deemed custodial in nature." <sup>3</sup> Thus, the determination of who controls the state's federal funds is dependent upon whether the federal funds are custodial funds.

The Colorado Supreme Court has defined "custodial funds" as "funds not generated by tax revenues which are given to the state for particular purposes and of which the state is a custodian or trustee to carry out the purposes for which the sums have been provided." <sup>4</sup> In the most recent decision on the issue, the Supreme Court gave the following summary of how it identifies custodial funds:

In sum, when evaluating whether certain moneys constitute custodial funds, we have taken into account all the circumstances surrounding the funds, including, as pertinent here, the source of the funds, the degree of flexibility afforded to the state as to the process by which the funds should be allocated, and the degree of flexibility afforded to the state as to the funds' ultimate purposes. We have essentially distinguished between funds akin to state moneys, which allow the state broad flexibility in determining how such funds should be used, and therefore become part of the state's general fund, and custodial funds, which are to be used only in the manner specified and for the purposes designated by the federal government. While the former, as general fund moneys, are subject to the General Assembly's plenary power of appropriation, the latter fall outside the scope of legislative authority and instead are subject to executive control. <sup>5</sup>

Ultimately, the determination of whether federal funds are custodial funds must be made on a case-by-case basis. <sup>6</sup> As such, the remainder of the memorandum is a description of the Colorado Supreme Court's decisions, in chronological order, that involve disputes over whether certain moneys are

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<sup>2</sup> *MacManus v. Love*, 499 P.2d 609, 610 (1972).

<sup>3</sup> *In re Interrogatories Submitted by General Assembly on House Bill 04-1098*, 88 P.3d 1196, 1200 (Colo. 2004).

<sup>4</sup> *Colorado General Assembly v. Lamm*, 700 P.2d 508 (Colo. 1985).

<sup>5</sup> *In re Interrogatories*, 88 P.3d at 1202 - 1203.

<sup>6</sup> *Id.* at 1205.

custodial funds.

## **B. Specific Case Law**

### 1. *MacManus v. Love*, 499 P.2d 609 (Colo. 1972)

In this case, two state legislators sued the Governor over his veto of a provision in the Long Bill that "Any federal or cash funds received by any agency in excess of the appropriation shall not be expended without additional legislative appropriation."<sup>7</sup> The Colorado Supreme Court recognized that the General Assembly has plenary power over appropriations and that it can appropriate state moneys conditioned upon the receipt of matching federal moneys. However, the Court found that the Long Bill provision at issue did not involve any appropriation of state funds and that the General Assembly had attempted "to limit the executive branch in its administration of federal funds to be received by [the executive branch] directly from agencies of the federal government and unconnected with any state appropriations."<sup>8</sup> In holding that these federal funds were custodial funds and not subject to appropriation by the General Assembly, the Supreme Court stated:

"The power of the General Assembly to make appropriations relates to state funds. *Bedford v. People ex rel. Tiemann*, 105 Colo. 312, 98 P.2d 474 (1939). Custodial funds are not state moneys. *Stong v. Industrial Commission*, 71 Colo. 133, 204 P.2d 892 (1922). As we read *Bedford v. People, supra*, it supports the proposition that federal contributions are not the subject of the appropriative power of the legislature."<sup>9</sup>

### 2. *Anderson v. Lamm*, 579 P.2d 620 (Colo. 1978)

In this case, eight members of the General Assembly sued the Governor over his vetoes of portions of the Long Bill, including vetoes of the "M" and "C" headnotes, alleging the vetoes were improper item vetoes under the veto power given the Governor under Colo. Const. art. IV, sec. 12. The "M" and "C" headnotes regulated the amount of state money appropriated for programs for which federal funds were available and provided for a decrease in state funding in the event of an excess or a shortfall in federal funds.

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<sup>7</sup> *MacManus*, 499 P.2d at 610.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

In rejecting the Governor's argument that, under *MacManus*, the "M" and "C" headnotes violated separation of powers, the Court distinguished the underlying principle in *MacManus* that federal contributions are not subject to the General Assembly's appropriation power and held:

Despite the Governor's assertions, we do not perceive the same constitutional infirmities in the "M" and "C" headnotes. These headnotes purport only to condition the appropriation of state, not federal, funds. They do not limit the executive branch in its staffing, resource allocation, or general administration of the federal funds it receives. Nor do the headnotes repeal or amend any other piece of substantive legislation. They simply prescribe the amount of state funds which can be used when certain amounts of federal funds are available for use.

. . . The important point is that the legislature is exercising control only over the amount of state funds; no control is asserted in the Long Bill over how the money is to be allocated.<sup>10</sup>

3. *Colorado General Assembly v. Lamm*, 700 P.2d 508 (Colo. 1985), (commonly referred to as "*Lamm I*" or the "*Transfers Case*")

In this case, the General Assembly alleged, among other things, that the Governor's allocation of certain payments from Chevron Corporation pursuant to a federal consent order violated separation of powers under Colo. const. art. III and art. IV, sec. 2 and the General Assembly's plenary powers relating to legislation and appropriations under art. V, secs. 17, 32, and 33. The Court held that the Governor's direction of the expenditure of the Chevron payments did not violate the appropriation power of the General Assembly and that the Chevron payments were custodial funds because the state's entitlement to the payments was conditioned upon certifying that the payments would be used for one of the possible uses specified in the Federal Register and the money, whether from a private or federal source, "was required to be used for a purpose approved ultimately by non-Colorado authorities."<sup>11</sup> Further,

While the determination of which specific purpose among several options should be benefited was a determination which would inevitably affect the level of activity of some governmental

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<sup>10</sup> *Anderson v. Lamm*, 579 P.2d 620, 625-626 (Colo. 1978).

<sup>11</sup> *Lamm I*, 700 P.2d at 525. The Department of Energy and Chevron retained ultimate authority to approve any use of the funds.

department, the role of the state in administering the fund, as determined by the external source generating the revenue, was essentially custodial in nature. The fact that a discretionary determination had to be made concerning the object for which those non-Colorado sums would be spent is not the controlling factor in assessing the nature of the fund. We conclude that, under all the circumstances, this fund is most appropriately deemed a trust or custodial fund, to be administered in a trusteeship or custodial capacity. The Governor's exercise of authority over this fund does not, in our view, constitute an impermissible invasion of the General Assembly's right to appropriate public funds.<sup>12</sup>

4. *Colorado General Assembly v. Lamm*, 738 P.2d 1156 (Colo. 1987) (commonly referred to as "*Lamm III*" or "*The Block Grants Case*")

In headnotes to the 1982, 1983, and 1984 Long Bills, the General Assembly appropriated eight federal block grants that were designated for certain programs. The Governor vetoed the headnotes in each such Long Bill on grounds that the legislative appropriation of the federal block grants interfered with executive expenditure of federal funds and violated the principles restricting the appropriation of federal funds by the General Assembly set forth in *MacManus* and *Anderson*. Specifically, the Governor argued that the federal block grant funds were custodial since they were not significantly different from federal categorical grants which had a high degree of federal regulation and had been historically recognized as custodial funds that were not subject to legislative appropriation.

Federal block grants "were conceived as falling between the extensive federal control represented by categorical grants and the absence of federal control represented by revenue sharing."<sup>13</sup> The Court painstakingly examined each of the block grant programs at issue and focused particularly on the amount of discretion involved with each such program, concluding that federal law largely controlled the disposition of federal block grant funds and that "[S]tate involvement in many of the programs functions only as a conduit for funds that ultimately are received by the same entities that received them under the categorical programs. . . . The only significant change created by the block grant programs is the power of the state to transfer a certain percentage of

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<sup>12</sup> *Id.*

<sup>13</sup> *Lamm III*, 738 P.2d at 1159.

several of the grants to other block grants."<sup>14</sup>

The Court then held that, based on *Anderson*, to the extent that a vetoed headnote had the same effect as an "M" headnote relating to portions of federal grants that require state matching funds, the headnote did not violate separation of powers. Second, and most importantly, with regard to the portions of the block grants that federal law allowed to be transferred to other block grants, the Court stated:

We recognize that block grant funds subject to transfer are not state moneys, but we also recognize that the amount of flexibility allowed the state in determining the purposes for which the funds subject to transfer may be spent is inconsistent with a description of the governor's exercise of authority over the funds subject to transfer as "essentially custodial in nature." *Colorado General Assembly v. Lamm*, 700 P.2d at 525. The transfers alter the initial objectives of the federal government and affect the allocation of state funds for objectives similar to those affected by the transfer of block grant funds. Therefore, those portions of the block grants that may be transferred from one block to another as authorized by federal law are subject to legislative appropriation consistent with the requirements of federal law.<sup>15</sup>

However, the Court held that the funds derived from the remaining parts of the block grants that did not require matching funds and that could not be transferred between such grants were custodial funds and not subject to the appropriation power, stating:

The federal statutes authorizing the grants specify the purposes the state is directed to accomplish with the money, the manner in which the purposes are to be accomplished and the restrictions placed on use of the funds by the federal government. The block grants do not include the unrestricted spending feature of the now-expired federal revenue sharing program. Aside from the matching and transfer provisions, the remainder of all of the grants are encompassed within the description in *Anderson v. Lamm*, 579 P.2d at 623-625, of the executive's power to administer appropriated funds that includes the making of specific staffing and resource allocation decisions and the general administration of federal funds. The executive power to allocate resources includes 'the determination of which specific

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<sup>14</sup> *Id.* at 1167.

<sup>15</sup> *Id.* at 1173.

purpose among several options should be benefited' and is consistent with 'the role of the state in administering a fund that is essentially custodial in nature.' *Colorado General Assembly v. Lamm*, 700 P.2d at 525. Just as the governor's exercise of authority over the Chevron fund did not invade the general assembly's right to appropriate state funds, here too the governor's exercise of authority to administer the federal block grants in a manner consistent with federal purposes does not violate the doctrine of separation of powers.<sup>16</sup>

5. *In re Interrogatories Submitted By Colorado General Assembly on House Bill 04-1098*, 88 P.3d 1196 (Colo. 2004).

In this case, the General Assembly submitted two interrogatories to the Colorado Supreme Court regarding the definition of "custodial moneys" in House Bill 04-1098. House Bill 04-1098 was introduced after the state received federal funds pursuant to the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "Jobs Act").<sup>17</sup> Such funds were required to be used only to "provide essential government services or to cover the costs of unfunded mandates..." and "[a] State may only use funds provided under a payment made under this section for types of expenditures permitted under the most recently approved budget for the state."<sup>18</sup> The State was required to certify to the Secretary of the Treasury that "State's proposed uses of the funds are consistent with [the Jobs Act]".<sup>19</sup>

Governor Owens signed and filed the required certification form and the state received \$146.4 million from the federal government.<sup>20</sup> He then exercised control over the money and designated it for various programs and purposes. In response, members of the Joint Budget Committee introduced House Bill 04-1098, and the General Assembly submitted the interrogatories.

The first interrogatory related to whether the elements in the definition of "custodial moneys" set forth in the bill comported with specific provisions of the state constitution and the courts decisions related thereto. Though the definition of "custodial moneys" appeared to comport with constitutional

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<sup>16</sup> *Id.*

<sup>17</sup> Pub.L. 108-27, enacting 42 U.S.C. § 801 *et seq.*

<sup>18</sup> *Id.* at § 801 (d)(2).

<sup>19</sup> *Id.* at § 801 (e).

<sup>20</sup> *In re Interrogatories*, 88 P.3d at 1198.

principles, the Court declined to answer the first interrogatory because whether specific grants constitute custodial funds must be decided on a case-by-case basis.<sup>21</sup>

In the second interrogatory, the General Assembly asked whether House Bill 04-1098 could "constitutionally exclude from the definition of "custodial moneys" those moneys granted by the federal government to Colorado for the support of general or essential state government services of the type for which expenditures were made in the most recently approved annual general appropriation act, including but not limited to additional payments received by the state under the Jobs Act."<sup>22</sup>

The Court was able to answer the second interrogatory because of the fact that the exclusionary language of the bill was the same as the provisions of the Jobs Act and, therefore, there was "a concrete example of the type of federal grant implicated by House Bill 04–1098."<sup>23</sup> In applying its general legal principles, the Court held:

Therefore, we can state with a sufficient degree of certainty that funds distributed to the state in the manner described in House Bill 04-1098 at section (3)(b)(III), are not "custodial moneys." This is because funds such as those under the Jobs Act, disbursed to the state with such minimal guidance as to the process by which such funds shall be allocated and as to the purposes for which the funds may be spent, cannot fairly be described as "custodial" in nature. Rather, such funds are more appropriately deemed general fund moneys. Thus, House Bill 04-1098 may constitutionally exclude such funds from the definition of "custodial moneys." We therefore answer the second interrogatory in the affirmative.<sup>24</sup>

In support of this conclusion, the Court found that "the broad category of 'essential government services' is not a 'particular purpose,' but rather allows each state to use the Jobs Act funds as it sees fit, based on its own budgetary needs."<sup>25</sup> This conclusion was supported by the debate surrounding the bill, the fact that the Jobs Act originally included a list of specific programs and

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<sup>21</sup> *Id.* at 1205.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 1203.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 1204.

activities, which were removed from the bill, and the fact that there is no meaningful federal regulation regarding the use of the federal moneys.<sup>26</sup> As such, the court found that:

Based upon our consideration of all of the above circumstances, we find that the funds at issue today cannot be described as custodial. Unlike those block grants held to be custodial in *Lamm III*, the Jobs Act funds do not "specify the purposes the state is directed to accomplish with the money, the manner in which the purposes are to be accomplished and the restrictions placed on use of the funds by the federal government." 738 P.2d at 1173. We therefore affirm that House Bill 04-1098 is constitutional insofar as it expressly excludes from the definition of "custodial moneys" funds distributed in the same manner as those allocated pursuant to the Jobs Act.<sup>27</sup>

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<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 1204-1205.