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Limitations on Municipal Indebtedness

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LIMITATIONS ON MUNICIPAL INDEBTEDNESS

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I. The Restrictions—Their Nature and Purpose

Not a single state has seen fit to leave its cities unrestricted in the amount of indebtedness each might incur.[1] Assuming that the nature of a proposed expenditure is such that it is recognized as a legitimate municipal expense,[2] the limitations imposed upon total indebtedness may yet prevent extension of a city's credit. Thus, a city may have a particular financing scheme invalidated simply because of the circumstance that its present indebtedness is so close to the limit that the contemplated increase would force the total amount to exceed the maximum allowable.

Three sources of limitation are commonly found today. By far, most states have a constitutional provision which expressly restricts the amount of indebtedness which their cities may incur. Others by statute impose a similar limitation; still others declare an upper limit by way of the charter of the particular city. Except for the ease with which a specific limitation may be varied, they raise essentially the same problems; they will, therefore, be considered together. It should be apparent, however, that a statute or a charter may further restrict a constitutional limitation, although they cannot, of course, increase it.[3]

The most frequently employed device to restrict indebtedness is the so-called "debt-to-property ratio." In general, this limits the amount of indebtedness which a city may incur to a specified percentage of the assessed valuation of the taxable property within the city.[4] No uniformity exists as to

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1. See generally on the entire topic, 1 Abbott, Municipal Corporations §§ 149-168 (1905); Elliott, Public Corporations §§ 248-52 (Rev. ed. 1910); Fordham, Local Government Law 548 (1949); 1 Jones, Bonds and Bond Securities §§ 75-137 (4th ed., Bowers, 1935); 15 McQuillin, Municipal Corporations §§ 41.02-41.40 (3d ed., Smith, 1950). For treatments with emphasis on particular states, see Hoyt and Fordham, *Constitutional Restrictions upon Public Debt in North Carolina,* 16 N.C.L. Rev. 329 (1938); Lovett, *Legal Development of the Borrowing Power of Kentucky Municipalities,* 31 Ky. L.J. 55 (1942); Snyder, *Computing Municipal Indebtedness under Pennsylvania Constitutional Limitations,* 7 U. of Pitt. L. Rev. 198 (1941); Notes, 17 Notre Dame Law. 46 (1941), 6 Ohio St. L.J. 297 (1940); 25 Ind. L.J. 325 (1950).

2. There is some contention that a more restricted view of this pbase of the problem would decrease the importance of debt limitations in general. See Williams and Nehemkis, *Municipal Improvements as Affected by Constitutional Debt Limitations,* 37 Col. L. Rev. 177, 181 (1937).

3. City of Stamford v. Town of Stamford, 107 Conn. 596, 141 Atl. 891, 896 (1928). See also Note, 29 Calif. L. Rev. 779 (1941). See Note, 106 A.L.R. 231 (1937).

4. *E.g.,* "No . . . city . . . shall be allowed to become indebted in any manner or for any purpose, to an amount, including existing indebtedness, in the aggregate exceeding five per centum on the value of the taxable property therein. . . ." Ill. Const. Art. IX, § 12. See 15 McQuillin, Municipal Corporations § 41.08 (3d ed., Smith, 1950), citing numerous cases discussing the various types of "debt-to-property" provisions found in the constitutions.

the allowable percentile rate; Washington,[5] with a 1½% basis, appears to have the lowest; the 18% permitted in Virginia[6] is the highest. The remainder of the states using this form of limitation apply rates within the range between these two,[7] with 5% being the most commonly found.[8]

In spite of its numerical superiority, the percentage rule has received much adverse criticism.[9] Its critics point out that ". . . there is no necessary relationship between the assessed value of property and a municipality's need for public improvements or its ability to finance such improvements."[10] It is also a well-known fact that the evaluation process varies among the cities of a given state. One city may place its assessments at something like actual values, in order to enjoy a low tax rate; another may leave its evaluations a great deal less as a result of pressure against the assessor by property owners. Thus, the city which keeps its assessed values at a low mark may find itself unable to authorize a needed public improvement even though its soundness is clearly indicated. Again, a city may increase its assessments in boom times and find itself with no remaining borrowing power if it subsequently reduces them in hard times.[11]

Another form of limitation encountered occasionally is one which limits the indebtedness of a given year to the income and revenues provided for that year.[12]

In addition to these two types of absolute limitation, there are numerous modifications. Occasionally, a state combines the two.[13] Many states spe-

5. WASH. CONST. Art. VIII, § 6.

6. VA. CONST. Art. VIII, § 127.

7. *E.g.*, ALA. CONST. Art. XII, § 225 (5% for cities under 6,000; 7% for others); ARIZ. CONST. Art 9, § 8 (4%); COLO. CONST. Art. XI, § 8 (3%); GA. CONST. Art. VII, c. 60 (7%); IND. CONST. ART. 13, § 1 (2%); IOWA CONST. ART. XI, § 3 (5%); LA. CONST. Art. XIV, § 14(f) (10%); ME. CONST. Art. XXII (5%), amended by Art. XXXIV (7½% for cities of 40,000 or more population); MONT. CONST. Art. XIII, § 6 (3%); N.M. CONST. Art. 9, § 13 (4%); N.D. CONST. Art. XII, § 183 (5%); PA. CONST. Art. IX, § 8 (7%; Philadelphia-10%); S.C. CONST. Art. X, § 5(8%); S.D. CONST. ART. XIII, § 4 (5%); W. VA. CONST. ART. X, § 8 (5%); WISC. CONST. ART. XI, § 3 (5%); WYO. CONST. Art. XVI, § 5 (2%).

8. *E.g.*, Alabama, Iowa, Maine, North Dakota, South Dakota, West Virginia, and Wisconsin. See note 7 *supra.*

9. See FORDHAM, LOCAL GOVERNMENT LAW 548 (1949); SHATTUCK, MUNICIPAL INDEBTEDNESS—A STUDY OF THE DEBT-TO-PROPERTY RATIO (58 Johns Hopkins Univ. Stud. Hist. & Pol. Sci. 1940).

10. Williams and Nehemkis, *Municipal Improvements as Affected by Constitutional Debt Limitations,* 37 COL. L. REV. 177, 182 (1937).

11. See BROMAGE, INTRODUCTION TO MUNICIPAL GOVERNMENT AND ADMINISTRATION 489 (1950).

12. *E.g.*, "No . . . city . . . shall incur any indebtedness, or liability, in any manner, or for any purpose, exceeding in that year, the income and revenue provided for it for such year. . . ." IDAHO CONST. Art. VIII, § 8. See also KY. CONST. § 157. For cases dealing with this type of provision, see 15 MCQUILLIN, MUNICIPAL CORPORATIONS § 41.10 (3d ed., Smith, 1950). See also note, 122 A.L.R. 330 (1939).

13. *E.g.*, OKLA. CONST. Art. X, § 26 states that indebtedness shall not exceed income and revenues for the year unless approved by 3/5 of the voters and in no event shall exceed 5% of assessed valuation.

cifically except from the operation of the limit a debt incurred for one or more specified purposes.[14] Several states impose an independent limitation on debts of this nature.[15] Another modification is one which provides that debts of any amount may be contracted with voter approval.[16] The additional amount of indebtedness which may be incurred in this manner may be limited to a specified extent.[17]

Sometimes a peculiar variation may be found in addition to the forms already described. Thus, Indiana has reserved the right for its citizens to petition for an increase of the limit in time of "war, foreign invasion, or other great public calamity."[18] New York has provided a decreasing percentage rate as its limit, which has been lessened automatically by the passage of time.[19] The Pennsylvania limitation applicable to Philadelphia is higher than that binding all other cities of the state.[20] A few states using the debt-to-property ratio specify taxable real property as the basis for computing the amount of allowable debt.[21] These features, however, are not in general usage.

Many states leave debt limitation to the legislature by terms of their constitutions.[22] This function may then be performed by means of a general statute[23] or by provision within the individual charter.[24]

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14. *E.g.*, COLO. CONST. Art. XI, § 8 (water supply); MONT. CONST. Art. XIII, § 6 (legislature may extend limit for provision of sewerage system or water supply); N.M. CONST. Art. 9, § 13 (water supply or sewers); N.D. CONST. Art. XII, § 183 (revenue-producing utility); OKLA. CONST. Art. X, § 27 (public utilities); PA. CONST. Art. IX, § 15 (waterworks, subways, underground railways, or street railways); WIS. CONST. Art. XI, § 3 (public utilities); WYO. CONST. Art. XVI, § 5 (water supply). See 15 MCQUILLIN, MUNICIPAL CORPORATIONS, § 41.07 (3d ed., Smith, 1950) for cases construing this type provision.

15. *E.g.*, ALA. CONST. Art. XII, § 225 (additional 3% for waterworks, gas light plants, sewerage, or street improvements); ARIZ. CONST. Art. 9, § 8 (additional 15% for supplying water, lights, or sewers); N.D. CONST. Art. XII, § 183 (additional 4% for waterworks and sewers); S.D. CONST. Art. XIII, § 4 (additional, not exceeding 10%, for providing water and sewerage, irrigation, domestic uses, and other purposes) (up to 8% for constructing street railways, lights, or light plants in cities of more than 8,000 population); WASH. CONST. Art. VIII, § 6 (up to 5% additional for water, lights or sewers); WYO. CONST. Art. XVI, § 5 (additional, not exceeding 4%, for sewers or schools). See 15 MCQUILLIN, MUNICIPAL CORPORATIONS, § 41.07 (3d ed., Smith, 1950) for cases construing this type provision.

16. *E.g.*, ARIZ. CONST. Art. 9, § 8; IDAHO CONST. Art. XIII, § 8.

17. *E.g.*, ME. CONST. Art. XXXIV (additional 2½ in cities of 40,000 or more population); N.D. CONST. Art. XII, § 183 (additional 3%); OKLA. CONST. Art. X, § 26 (up to 5%); PA. CONST. Art. IX, § 8 (voter approval required for all over 2%), § 15 (additional 3%); WASH. CONST. Art. VIII, § 6 (additional 3½%).

18. IND. CONST. Art. 13, § 1.

19. N.Y. CONST. Art. VIII, § 4.

20. PA. CONST. Art. IX, § 8 (10% for Philadelphia; 7% for others).

21. *E.g.*, N.Y. CONST. Art. VIII, § 4.

22. *E.g.*, Harsha v. City of Detroit, 261 Mich. 586, 246 N.W. 849 (1933); Allen v. City of Raleigh, 181 N.C. 453, 107 S.E. 463 (1921); Phillips v. Hume, 122 Ohio St. 11, 170 N.E. 438 (1930). See also 1 JONES, BOND AND BOND SECURITIES § 137 (4th ed., Bowers, 1935).

23. See Legis., 47 HARV. L. REV. 688, 689 n.7 (1934).

24. The Tennessee legislature sets debt limits by means of city charters; the Nashville limit has been increased by about 50% in the past eleven years. See Nashville Banner, July 31, 1951, p. 2, col. 5.

Historically,[25] the debt limitations have been referred to as a product of the growing pains of the country, which reached a peak about the middle of the nineteenth century.[26] The inflationary period following the Civil War seems to have fostered the conditions which led to the necessity for restriction of some sort.[27] It was during this period that even the villages and hamlets envisoned themselves as the great metropolitan centers of the future; as a result of this delusion, excessive debts were incurred in an effort to achieve that desired status. Often the tax monies were spent by officials possessing only a limited knowledge of finances and lacking in the experience[28] conducive to a sound fiscal policy. Indeed, it was the economic depression of 1873-1874 following in the wake of these conditions that gave the greatest impetus to the adoption of some mode of debt limitation.[29] The mushroom growth and expansion of railroads in an attempt to span the continent were also factors pointing to the desirability of limiting the power of a city to invest its funds and extend its credit without restriction.[30]

The increasing importance which the subject of municipal debt limitation achieved in the years following the extensive adoption of some form of restriction is common knowledge. The trend to urbanization, with its accompanying increased need for services, brought problems to the forefront.[31] As the effect of the limitations was beginning to be felt by cities once again desirous of expansion and as the refinements of their operation were being evolved by the courts,[32] the topic assumed a new prominence to the student of local finance law. Perhaps this phenomonen is illustrated as well by the space which the authors of standard works on municipal corporations began to devote to the subject as by any other evidence. For instance, it was not until the fifth edition of Dillon's *Municipal Corporations* appeared in 1911 that an independent chapter was assigned to debt limitations.[33] A glance at the dozens of pages and extensive case citations to be found in even an elementary

25. See SHATTUCK, MUNICIPAL INDEBTEDNESS—A STUDY OF THE DEBT-TO-PROPERTY RATIO (58 Johns Hopkins Univ. Stud. in Hist. & Pol. Sci. 1940), for an excellent and exhaustive historical study of municipal debt limitations in general.

26. See Note, 6 OHIO ST. L.J. 297, 298 (1940).

27. See Stason, *State Administrative Supervision of Municipal Indebtedness*, 30 MICH. L. REV. 833, 837 (1932).

28. See note 26, *supra.*

29. See note 27, *supra.*

30. See Williams aud Nehemkis, *Municipal Improvements as Affected by Constitutional Debt Limitations*, 37 COL. L. REV. 177 (1937).

31. *Id.* at 184.

32. See Foley, *Revenue Financing of Public Enterprises*, 35 MICH. L. REV. 1, 4 (1936); Notes, 25 IND. L.J. 325, 327 (1950), 42 YALE L.J. 762 (1933).

33. "The subject is so important, and the decision construing and applying the constitutional provisions and showing their practical workings are so numerous, that in this edition of the present work we have felt that it was necessary to prepare a new chapter entirely devoted to its consideration." 1 DILLON, MUNICIPAL CORPORATIONS § 190 (5th ed. 1911).

text on municipal government today serves to demonstrate the prominence which the subject now enjoys.

Many of the qualifications referred to earlier[34] are outgrowths of the difficulties experienced as a result of the inflexible, fixed forms which the earliest restrictions took.[35] Both the legislatures and the courts have attempted to ease the harsh effects of the limitations;[36] and the people themselves have, by way of more liberal constitutional provision, often softened the vigorous impact of the earlier statements of limitations.

The courts and the commentators are in virtual agreement as to the basic purpose of the limitations and as to the result sought to be achieved, although there is some variance in the language used by the courts. The reasoning behind the restrictions is variously denominated as a desire to promote the common good and welfare;[37] to provide the minority with a means of checking an improvident majority;[38] to install the city on a pay-as-you-go basis;[39] to prevent the present administration from imposing too great a burden on its successors and on the taxpayers at large;[40] to prevent the pledging of more than a certain part of the taxpayers' property for debts;[41] to check the proneness of a municipality to incur indebtedness, especially where the burden can be cast on posterity;[42] to serve as a limit to taxation and for protection of the taxpayers;[43] to maintain municipal solvency;[44] and to protect persons and their property from an abuse of corporate credit and its consequent burdensome, perhaps ruinous, taxation.[45] Certainly the prime motivation running through all these statements appears to be a desire to

34. See notes 13-17, *supra*.

35. These qualifications have been traced directly to the difficulty experienced in the earlier fixed forms of limitation. See 1 DILLON, MUNICIPAL CORPORATIONS § 190 (5th ed. 1911).

36. See DOUGLAS, DEMOCRACY AND FINANCE 221 (1940) for a discussion of federal aid to debtors during municipal default, a subject without the scope of this discussion. See also Patterson, *Municipal Debt Adjustments under the Bankruptcy Act*, 90 U. OF PA. L. REV. 520 (1942).

37. Hoyt v. Broome County, 175 Misc. 896, 25 N.Y.S.2d 527, 531 (Sup. Ct. 1941).

38. C. B. Nash Co. v. City of Council Bluffs, 174 Fed. 182, 184-85 (C.C.S.D. Iowa 1909) (construing Iowa provision).

39. *E.g.*, Prince v. City of Quincy, 128 Ill. 443, 21 N.E. 768, 770 (1889); Voss v. Waterloo Water Co., 163 Ind. 69, 71 N.E. 208, 215 (1904); Butler v. Andrus, 35 Mont. 575, 90 Pac. 785, 786 (1907); Earles v. Wells, 94 Wis. 285, 68 N.W. 964 968 (1896).

40. See 29 GEO. L.J. 519 (1941).

41. McBean v. City of Fresno, 112 Cal. 159, 44 Pac. 358, 359 (1896).

42. Bank v. Grace, 102 N.Y. 313, 17 N.E. 162, 163 (1886). See also 1 DILLON, MUNICIPAL CORPORATIONS § 190 (5th ed. 1911).

43. State *ex rel.* School Dist. of Kansas City v. Thompson, 327 Mo. 144, 36 S.W.2d 109, 111-12 (1931); Bank v. Grace, *supra* note 42; Lang v. City of Cavalier, 59 N.D. 75, 228 N.W. 819, 825 (1930); Barnes v. Lehi City, 74 Utah 321, 279 Pac. 878, 884 (1929).

44. Public Service Electric & Gas Co. v. City of Camden, 118 N.J.L. 245, 192 Atl. 222, 228 (1937).

45. Law v. People *ex rel.* Huck, 87 Ill. 385, 396 (1877); Butler v. Andrus, 35 Mont. 575, 90 Pac. 785, 786 (1907); Appeal of the City of Erie, 91 Pa. 398, 402 (1879).

provide a sound fiscal policy by preventing in advance the imposition of an excessive tax burden.

Perhaps as accurate and fair statement of the purpose of debt limitations as can be found is one which attempts to arrive at the primary purpose behind them. To this extent there is virtual unanimity that the

> "primary purpose of the limitations . . . is to forestall and prevent the yielding by municipal officers to temptations of extravagance and improvidence . . . and to check in advance any tendency to bring wreck and ruin down upon them, in times of popular excitement or overzeal for the creation or erection of internal or public improvements, by forwarding the mistaken notion that an artificial impctus to go on through the incurring of indebtedness is municipal progress."[46]

The spirit of the limitations, then, appears to be quite clear. As will be developed later,[47] that is the primary factor with which the courts must deal in evaluating a particular financing scheme.

II. COMPUTATION OF EXISTING INDEBTEDNESS

While there is virtual uniformity in the statement of the purpose of the limitations, there is not even proximity to a uniform definition of "indebtedness" in computing the amount of debt existent at any given time.[48] Here, there is a widespread refusal to apply any standard set of principles; thus, the interested person must consult the decisions of his own state in order to be sure of the interpretation which the word has received in that jurisdiction.

However, there have developed a group of principles which most courts apply in making the computation. Thus, a study of several of those widely accepted is deemed to be profitable, with the word of caution that any one or more of the factors may be rejected within a given jurisdiction.

Several cases, most of them early decisions, construing the term "indebtedness" held that virtually every form of indebtedness was to be included in arriving at the total,[49] without deduction as to existing assets or for other reasons. Recalling, however, that the purpose of the limitation is to prevent excessive taxation, it is only natural that courts in subsequent cases have allowed certain deductions to be made, where the item deducted would

46. 1 JONES, BONDS AND BOND SECURITIES § 76 (4th ed., Bowers, 1935).

47. See pp. 44-53 *infra*.

48. See, *e.g.*, Cochran v. Mayor and Council of Middletown, 14 Del. Ch. 295, 125 Atl. 459, 460 (Ch. 1924) (imports an obligation to pay); City Council of Dawson v. Dawson Waterworks Co., 106 Ga. 696, 32 S.E. 907, 913 (1899) (not to be construed in its broad and unrestricted sense); Scheiber v. City of Mohall, 66 N.D. 593, 268 N.W. 445, 449 (1936) (amount for which the public would be presently liable if called upon to discharge the obligation to pay in the future).

49. *E.g.*, Chicago v. McDonald, 176 Ill. 404, 52 N.E. 982 (1898) (no deduction for cash or uncollected taxes); McPherson v. Foster Bros., 43 Iowa 48 (1876); Jordan v. Andrus, 27 Mont. 22, 69 Pac. 118 (1902) (no deduction for demands the city held against others).

prevent the imposition of a tax burden by being applied to payment of the existing debt in the ordinary course of business. The term, then, is quite uniformly held to mean "net indebtedness" today.[50]

Perhaps the most widely recognized deduction is that for cash on hand in the treasury at the time the computation is made.[51] Current expenses are generally deducted if they are covered by anticipated current revenues applicable within the year or by money on hand.[52] Nor is a given debt to be included in the computation if an irrevocable sinking fund is existent to cover it.[53] Unearned interest is not included in the computation;[54] until earned and due, it is not a debt. But, of course, it is included as a debt if it is due and payable.[55] Finally, debts owed to the city and uncollected current taxes are generally deducted in computing the existing net indebtedness.[56] As for taxes, some require that a levy must actually have been made;[57] others require the tax roll to be in the hands of the collector;[58] some states allow also the deduction of delinquent taxes as a debt owed to the city.[59]

Of course, the limitation itself often expressly excludes certain items from the calculation. Thus, a debt incurred in anticipation of current revenue is often not included;[60] nor are current expenses to be included according to some limitations.[61]

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50. *E.g.,* Schuldice v. Pittsburgh, 251 Pa. 28, 95 Atl. 938 (1915).

51. *E.g.,* People *ex rel.* Lindheimer v. Hamilton, 373 Ill. 124, 25 N.E.2d 517, 524 (1940); Levy v. McClellan, 196 N.Y. 178, 89 N.E. 569, 573 (1909); State *ex rel.* Barton v. Hopkins, 14 Wash. 59, 44 Pac. 134, 135 (1896); Crogster v. Bayfield County, 99 Wis. 1, 74 N.W. 635, 638 (1898). See Raynor v. King County 2 Wash.2d 199, 97 P.2d 696 (1940) for a discussion of items properly considered as cash assets.

52. Chestnut v. Yates, 177 Ark. 894, 9 S.W.2d 37, 38 (1928); People *ex rel.* Toman v. Mercil & Sons Plating Co., 378 Ill. 142, 37 N.E.2d 839 (1941). See Notes, 92 A.L.R. 1299 (1934), 134 A.L.R. 1399 (1941).

53. City of Jackson v. First Nat. Bank of Jackson, 289 Ky. 1, 157 S.W.2d 321, 324 (1941); Kansas City v. Reed, 358 Mo. 532, 216 S.W.2d 514 (1948); Levy v. McClellan, 196 N.Y. 178, 89 N.E. 569, 573 (1909); Briggs v. Greenville County, 137 S.C. 288, 135 S.E. 153, 161-62 (1926). *Contra:* City of Waxahachie v. Brown, 67 Tex. 519, 4 S.W. 207, 211 (1887). See, generally note, 125 A.L.R. 1394 (1940).

54. Thom. v. Mayor and City Council of Baltimore, 154 Md. 273, 141 Atl. 125, 129-30 (1928); Carlson v. City of Helena, 39 Mont. 82, 102 Pac. 39, 44 (1909); Scheiber v. City of Mohall, 66 N.D. 593, 268 N.W. 445, 450 (1936); Kurn v. Helm, 182 Okla. 260, 77 P.2d 552, 554 (1938). See note, 100 A.L.R. 610 (1936).

55. Kurn v. Helm, *supra* note 54; Williams v. City of Rock Hill, 177 S.C. 82, 180 S.E. 799, 802 (1935).

56. Bird v. Franklin, 151 Ga. 4, 105 S.E. 834 (1921); Payne v. City of Covington, 285 Ky. 14, 146 S.W.2d 54 (1940); Coos County v. Oddy, 156 Ore. 546, 68 P.2d 1064, 1066 (1937); Raynor v. King County, 2 Wash.2d 199, 97 P.2d 696, 703-04 (1940). *Contra:* Wade v. East Side Levee & Sanitary Dist., 320 Ill. 396, 151 N.E. 260, 268 (1926).

57. *E.g.,* Shannon v. City of Huron, 9 S.D. 356, 69 N.W. 598, 600 (1896).

58. *E.g.,* Balch v. Beach, 119 Wis. 77, 95 N.W. 132, 134 (1903).

59. See, *e.g.,* State *ex rel.* Rothrum v. Darby, 345 Mo. 1002, 137 S.W.2d 532, 541 (1940); *accord,* George Township v. Union Trust Co. of Uniontown, 293 Pa. 364, 143 Atl. 10, 15 (1928). *Contra:* School Dist. v. Williamson, 174 Okla. 18, 49 P.2d 749, 752 (1935).

60. City of Georgetown v. Elliott, 95 F.2d 774, 775 (4th Cir. 1938); Blood v. Beal, 100 Me. 30, 60 Atl. 427, 431 (1905).

61. See 15 McQUILLIN, MUNICIPAL CORPORATIONS § 41.24 (3d ed., Smith, 1950) for citations.

It is perhaps apparent that the term "indebtedness" may offer trouble also in deciding whether a given proposed expenditure is within the coverage of the limitation, so that it would be excessive if carried out by the city.[62] For instance, an unpaid tort judgment is figured in computing existing indebtedness,[63] although it would not be considered a debt if the question was whether or not it could be incurred.[64]

III. DEVICES FOR AVOIDANCE OF THE RESTRICTIONS

A. *Introductory*

Not long after the adoption of the limitations the courts were besieged with various plans which had been formulated in an effort to avoid the restrictions. It became apparent that hardships would be imposed by a strict observance of the letter of the limits.[65] In fact, some cities were indebted beyond the limit at the time the provision was adopted; years of virtual inactivity would have resulted unless an escape had been provided.[66] The constant pressure for some relief from the binding restrictions was strong in view of the desire for expanded municipal services[67]—planning and zoning, sewage disposal systems, garbage collection, recreational programs, parking lots, utilities, and an unending list of services have been demanded of the progressive city.[68] When the desired service could be classed as a necessity, the pressure was usually overwhelming. It is not surprising, then, that the courts very early adopted an interpretation of debt restrictions which greatly eased their effect. Prosperity in general and the new concept of installment-buying contributed to the desire to circumvent the limitations.[69]

Some of the escape devices which have been sanctioned by the courts are explainable only in historical terms; some get their licenses by reason of liberal interpretation of the limitations; most may be rationalized only as an observance of the spirit of the limitations in spite of a sacrifice of their letter.

B. *Separate Taxing Entities*

Apparently the first means of evasion to receive the blessing of the courts was the creation of a new public corporation whose territorial limits

62. See FORDHAM, LOCAL GOVERNMENT LAW 575 (1949).
63. *E.g.*, Chicago v. McDonald, 176 Ill. 404, 52 N.E. 982, 986 (1898).
64. See note 89 *infra*.
65. See Note, 25 IND. L.J. 325, 326 (1950).
66. See Logansport v. Dykeman, 116 Ind. 15, 17 N.E. 587, 591 (1888).
67. See Note, 42 YALE L.J. 762 (1933).
68. See 23 ROCKY MT. L. REV. 360 (1951).
69. "The recent extensive development of payment on the installment plan has taxed the ingenuity of man to invent a shift whereby municipalities may circumvent this constitutional requirement in public financing." Williams v. City of Emmett, 51 Idaho 500, 6 P.2d 475, 476 (1931).

overlapped, in whole or in part, those of the city.[70] Thus, reasoned the courts, this new local unit then had a limitation of its own, wholly apart from that of the city in which it was formed.[71] It could then incur debts up to the limit, regardless of the financial status of the parent city.

The scheme has, in general, proved an effective means of getting around the limit.[72] Its only warrant is in historical terms; the use of overlying districts is older than the debt limitations, being in common existence prior to adoption of the restrictions.[73] Certainly, the spirit of the restriction is disregarded by the device; the taxpayer of the city and the taxpayer of the special district are, of course, often the one and same person. It matters little from a practical standpoint whether an individual's property is jeopardized by a single debt or by two separate debts. In truth, the former is more desirable, since the latter may result in a total debt twice as large as the former, as where each unit becomes indebted up to the limit; if more than one new unit is formed, the debt may grow by multiples.

In spite of its general acceptance, the device has been limited in some respects. The new district must actually be an independent and separate entity;[74] if the city obligates itself to the new corporation, the device may be stricken down as a mere subterfuge.[75] Too, the device may not be upheld if the new unit is not of a type recognized as separate and distinct at the time the limit was adopted.[76] Again, a court will refuse to allow circumvention in this manner if the new unit has been created solely in an effort to escape the limit.[77] Finally, the state legislature must, of course, authorize establishment of the new district.[78]

The separate-entity device has been upheld in cases of improvement districts,[79] water districts,[80] township including a city indebted to the limit,[81]

70. See Kuhn *ex rel.* McRae v. Thompson, 168 Mich. 511, 134 N.W. 722, 725-28 (1912). See also SHATTUCK, MUNICIPAL INDEBTEDNESS—A STUDY OF THE DEBT-TO-PROPERTY RATIO 67-75 (1940), for a treatment of this device.

71. People *ex rel.* Wysong v. Honeywell, 258 Ill. 319, 101 N.E. 571, 572 (1913); Cerajewski v. McVey, 225 Ind. 67, 72 N.E.2d 650, 651-52 (1947); Kelley v. School Dist., 134 Me. 414, 187 Atl. 703, 707-08 (1936); State *ex rel.* Sewer Dist. v. Smith, 337 Mo. 855, 87 S.W.2d 147, 154 (1935).

72. See FORDHAM, LOCAL GOVERNMENT LAW 548 (1949). See also Note, 94 A.L.R. 818 (1935). For the effect of merger or consolidation of units, see Note, 103 A.L.R. 154 (1936).

73. See 48 MICH. L. REV. 1016 (1950).

74. Jones v. Board of Education of Bowling Green, 191 Ky. 198, 229 S.W. 1032, 1033 (1921); Kelley v. School Dist., 134 Me. 414, 187 Atl. 703, 707 (1936). See also McCabe v. Gross, 274 N.Y. 39, 8 N.E.2d 269, 273 (1937).

75. *In re* Opinion to the Governor, 54 R.I. 45, 169 Atl. 748, 749-50 (1933).

76. McCabe v. Gross, 274 N.Y. 39, 8 N.E.2d 269 (1937).

77. *E.g.,* Cerajewski v. McVey, 225 Ind. 67, 72 N.E.2d 650, 652-53 (1947).

78. See Durisch, *Publicly Owned Utilities and the Problem of Municipal Debt Limits,* 31 MICH. L. REV. 503, 504 (1933).

79. See, *e.g.,* Lumbermen's Trust Co. v. Town of Ryegate, 50 F.2d 219, 224-25 (D. Mont. 1931) (failed for another reason).

80. *E.g.,* Kennebeck Water Dist. v. Waterville, 96 Me. 234, 52 Atl. 774, 782-83 (1902).

81. *E.g.,* Irwin v. Lowe, 89 Ind. 540, 552-53 (1883).

boards of education,[82] and independent school districts.[83] School and improvement districts have been its chief use.

The device is subject to great abuse;[84] indeed, the maze of overlapping taxing districts in metropolitan areas, such as Chicago, has been attributed directly to efforts to evade the limitations.[85] Nonetheless, apparently only South Carolina has a constitutional provision which expressly prohibits the abuse of this device: ". . . wherever there shall be several political divisions or municipal corporations covering or extending over the territory, or portions thereof, possessing a power to levy a tax or contract a debt, then each of such . . . shall so exercise its power . . . that the aggregate debt over and upon any territory of this State shall never exceed fifteen per centum. . . ."[86] Even then, a greater total debt than the 8% allowed for a single city[87] is permisible. Too, numerous amendatory exclusions are provided; and the judiciary has further weakened the limitation.[88]

C. *Applicable Only to* Ex Contractu *Obligation*

By a process of liberal interpretation, the courts have allowed another mode of escape. It is generally held that the debt limitation applies only to *ex contractu* obligations, not to those sounding in tort.[89] However, many courts hold that once an *ex delicto* claim is reduced to judgment, it then merges with the judgment and becomes a debt.[90] Sometimes it is held that the limit is not applicable to a debt not voluntarily incurred, as where it is imposed by law.[91] But even if the court applies the limit only to voluntary debts, it may go far to find that a given debt is voluntary, thus subject to the limitation.[92]

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82. *E.g.*, Rowan Co. Bd. of Educ. v. Citizens Bank, 279 Ky. 413, 130 S.W.2d 832, 833 (1939).

83. *E.g.*, Heinl v. Terre Haute, 161 Ind. 44, 66 N.E. 450, 452 (1903); Rash v. Madisonville, 148 Ky. 154, 146 S.W. 386, 388-89 (1912).

84. See Foley, *Revenue Financing of Public Enterprises*, 35 MICH. L. REV. 1, 2 n.5 (1936) for the results of a 1934 study showing that 392 units of government in Cook County, Illinois, had power to levy a general property tax. The article is especially good in tracing the growth of public corporations.

85. See note 84 *supra*. See also Durisch, *Publicly Owned Utilities and the Problem of Municipal Debt Limits*, 31 MICH. L. REV. 503, 505 (1933).

86. S.C. CONST. Art. X, § 5.

87. See note 86 *supra*.

88. See Elliott v. Heyward 127 S.C. 468, 121 S.E. 257 (1924) (county could incur indebtedness up to 8% regardless of debt status of city within it).

89. Indiana R.R. v. Calumet City, 391 Ill. 280, 63 N.E.2d 369, 375-76 (1945); Ft. Dodge Elec. L. & P. Co. v. Ft. Dodge, 115 Iowa 568, 89 N.W. 7, 11 (1902); State *ex rel.* Pyle v. University City, 320 Mo. 451, 8 S.W.2d 73, 75-76 (1928); Raynor v. King County, 2 Wash.2d 199, 97 P.2d 696, 708 (1940).

90. *E.g.*, State *ex rel.* Emerson v. City of Mound City, 335 Mo. 702, 73 S.W.2d 1017 (1934). See Note, 94 A.L.R. 937, 940 (1935). Thus, it is possible under this view for an injured person to recover a judgment on which execution would be denied because it exceeded the debt limit.

91. Los Angeles Gas & Elec. Corp. v. City Council of City of Seal Beach, 18 Cal. App.2d 97, 61 P.2d 1179, *rehearing*, 63 P.2d 326, 328-29 (1936); Knepfle v. City of Moorehead, 301 Ky. 417, 192 S.W.2d 189, 193 (1946); County Comm'rs of Tulsa

The extent of usage of this mode of evasion is not great. Probably its justification lies in the desire to allow a recovery to injured persons where a city is the tortfeasor, a result which would often be denied if the claim should be called a debt.[93] It is doubtful that the device offers a wide path of avoidance of debt limits, since it is not susceptible of varied use, especially insofar as planned circumvention is concerned.

D. *Special Assessments*

One of the earliest devices used to circumvent the debt limitation was the incurring of obligations to be met by special assessment. Thus, obligations would be issued by the city to cover the cost of a local improvement and would be made payable solely from the revenue derived from assessment against the property thereby benefited.[94] The courts were generally sympathetic to the argument that, as this procedure imposed no general tax burden on the populace as a whole, it was consistent with the theory of the debt limit.[95] This plan has been generally upheld so long as the city does not make itself liable on the bonds or other obligations;[96] it has been invalidated where the general credit of the city was pledged.[97] The entire bond issue has also been invalidated where the special assessment was not sufficient to meet the entire cost of the project,[98] on the theory that the general credit of the city is thereby pledged.[99] Finally, due process probably requires that special assessments be levied only in instances where the property is peculiarly and specially benefited by the improvement.[100] Thus, the scope of the device is effectively limited to improvements of a fairly localized and restricted nature.

County v. Mullins, 202 Okla. 628, 217 P.2d 835 (1950). *Contra:* Lake County v. Rollins, 130 U.S. 662, 9 Sup. Ct. 651, 32 L. Ed. 1060 (1889).

92. See Hancock v. Village of Hazel Crest, 318 Ill app. 170, 47 N.E.2d 557 (1943), discussed in 42 MICH L. REV. 721 (1944), for an interesting example of this procedure.

93. In cases where it would exceed the limit.

94. Davis v. Des Moines, 71 Iowa 500, 32 N.W. 470 (1887) (sewer); Wickliffe v. Greenville, 170 Ky. 528, 186 S.W. 476, 478 (1916) (street improvement); Little v. Portland, 26 Ore. 235, 37 Pac. 911, 913-14 (1894) (street improvement); *accord,* Comm'rs of Hwys. of Town of Goshen v. Jackson, 165 Ill. 17, 45 N.E. 1000 (1897).

95. See German Nat. Bank of Covington v. Covington, 164 Ky. 292, 175 S.W. 330, 331 (1915) (held invalid here for other reason). See also note 94 *supra.* For a discussion of the possibility of a creditor's judgment against the city where it is derelict in collecting and paying off the special assessment obligations, see Note, 44 HARV. L. REV. 610 (1931). Of course, it then becomes a question of whether such would be an *ex contractu* judgment or not, as to whether it would be subject to the debt limitation.

96. *E.g.,* City of Bainbridge v. Jester, 157 Ga. 505, 121 S.E. 798, 801 (1924); Henning v. City of Casper, 50 Wyo. 1, 57 P.2d 1264 (1936).

97. Canawha Mfg. Co. v. Charleston, 105 W. Va. 98, 141 S.E. 520 (1928).

98. McAnulty v. Pittsburgh, 284 Pa. 304, 131 Atl. 263 (1925).

99. *Id.,* 131 Atl. at 264.

100. See Note, 1 VAND. L. REV. 425 (1948).

E. *Self-Liquidating Projects*

With the precedent of the special assessment idea before them,[101] the courts were not long in upholding an analagous device, also based upon its compatibility with the purpose of the debt restrictions. This was the "special fund" idea, by which an income-producing improvement is made with borrowed funds or by one who contracts with the city, the lender or contractor taking in exchange therefor municipal obligations payable solely from the proceeds produced by the project. Again, no increase in tax levies is necessary; no additional burden falls on the taxpayer as such.

The Supreme Court of Washington was apparently the first court to recognize and apply the special assessments analogy to this kind of situation, in the case of *Winston v. City of Spokane*[102] in 1895. There, the city adopted an ordinance authorizing the borrowing of money to complete a system of waterworks, the obligations of the city to be issued to the creditors. The obligations were payable solely from a fund made up of part of the receipts to be realized from the waterworks. The ordinance was attacked on the grounds that it authorized excessive debt, since the city was already indebted beyond the constitutional limit. In upholding the ordinance, the court decided that no debt within the constitutional sense was created. After explaining that no obligation except to pay out of the special fund was created, with the result that the city's general credit was not pledged, the court continued: "The transaction, therefore, is no more the incurring of an indebtedness on the part of the city than is the issue of warrants payable out of a special fund created by an assessment upon property to be benefited by a local improvement."[103]

In this, as in other fields of evasion of the limitations, qualifications have been announced which restrict the utility of the device. The most frequent condition laid down is that no part of the general funds of a city may be pledged in connection with such a plan.[104] Too, if the purchase price is secured by a mortgage of property other than that acquired by the transaction, it is generally held that a debt is created;[105] there is a division of authority where only the acquired property is embraced by the mortgage, with probably

101. See Williams and Nehemkis, *Municipal Improvements as Affected by Constitutional Debt Limitations,* 37 COL. L. REV. 177, 187 (1937).

102. 12 Wash. 524, 41 Pac. 888 (1895).

103. 41 Pac. at 889. See Randall v. State *ex. rel.* Tuskegee. 233 Ala. 446, 172 So. 277 (1937); De Leuw, Cather & Co. v. Joliet, 327 Ill. App. 453, 64 N.E.2d 779, 785 (1945); Waco v. McCraw, 127 Tex. 268, 93 S.W.2d 717 (1936). See also Hoyt and Fordham, *Constitutional Restrictions upon Public Debt in North Carolina,* 16 N.C.L. REV. 329 (1938) for rationale of the fund doctrine.

104. Joliet v. Alexander, 194 Ill. 457, 62 N.E. 861 (1902); Adams v. Durham, 189 N.C. 232, 126 S.E. 611 (1925).

105. *E.g.,* Joliet v. Alexander, *supra* note 104.

a majority saying that no debt arises.[106] The name given to the bonds issued is not controlling, of course; even though they are called "revenue" bonds, they may be treated as mortgage bonds and stricken down if they contain an improper mortgage provision.[107] Some courts have held that if the arrangement includes an agreement to pay a specified sum out of the utility fund, a present debt for the whole is created.[108] A few courts have flatly refused to recognize the device at all,[109] stating that the taxpayers and ratepayers are substantially the same group, both within the protection of debt limitations.[110] This latter view has been sharply criticized on the ground that rates are distinguishable from taxes in that rates are voluntary, in spite of the fact that often the same individual is involved.[111]

The self-liquidating project has apparently been employed more extensively than any other escape route.[112] Its use is adaptable to the acquisition of extensive improvements of a major character. Perhaps its importance is on the decline insofar as public utilities are involved, due to the frequent express exemption of this type of expenditure from debt limits;[113] but it offers possibility of renewed use for such properties as parking lots, recreational facilities, and other nontraditional types of municipal services. Aside from its conformity to the principle of the limitations, the device is advantageous in that it does not require the taxpayer to finance services to the consumer; it facilitates special attention to the financing of particular projects; and it enables a city to adjust the amount payable to the creditor.[114] As may

106. *E.g.,* Simpson v. City of Highwood, 372 Ill. 212, 23 N.E.2d 62 (1939); Meier v. City of Madison, 257 Wis. 174, 42 N.W.2d 914 (1950) (by express constitutional provision). *Contra:* Lesser v. Warren Borough, 237 Pa. 501, 85 Atl. 839 (1912).

107. McNichols v. City and County of Denver, 230 P.2d 591 (Colo. 1950), discussed in 23 ROCKY MT. L. REV. 360 (1951).

108. Williams v. City of Emmett, 51 Idaho 500, 6 P.2d 475 (1931); Evans v. Holman, 244 Ill. 596, 91 N.E. 723 (1910).

109. Zachary v. City of Wagoner, 146 Okla. 268, 292 Pac. 345, 348 (1930). Illinois apparently has distinguished between special assessments and the special fund idea at one time. People *ex rel.* Scoon v. Chicago & A.R.R., 253 Ill. 191, 97 N.E. 310 (1912). Later cases have recognized the device, however. See, *e.g.,* De Leuw, Cather & Co. v. Joliet, 327 Ill. App. 453, 64 N.E.2d 779 (1945).

110. See Durisch, *Publicly Owned Utilities and the Problem of Municipal Debt Limits,* 31 MICH. L. REV. 503, 507 (1933).

111. See 44 HARV. L. REV. 610 (1931).

112. *E.g.,* Chamberlain v. Board of Comm'rs of Mobile, 243 Ala. 662, 11 So.2d 724 (1943) (tunnel); Crawford v. City of Prescott, 52 Ariz. 471, 83 P.2d 789 (1938) (civic recreational area); Hogue v. Housing Authority of North Little Rock, 201 Ark. 263, 144 S.W.2d 49 (1940) (housing project); McCutchen v. City of Siloam, 185 Ark. 846, 49 S.W.2d 1037 (1932) (light plant); State v. Miami, 146 Fla. 266, 200 So. 535 (1941) (water distribution system); Miller v. Head, 186 Ga. 694, 198 S.E. 680 (1938) (waterworks); Young v. Ann Arbor, 267 Mich. 241, 255 N.W. 579 (1934) (sewage disposal plant); Mettet v. City of Yankton, 71 S.D. 435, 25 N.W.2d 460 (1946) (toll bridge). See Note, 6 OHIO ST. L.J. 297, 300 (1940). For cases holding that the device is subject to debt limitations, while recognizing that the weight of authority is otherwise, see Town of Galax v. Appalachian Elec. Power Co., 177 Va. 29, 12 S.E.2d 778 (1941); and Town of South Hill v. Allen, 177 Va. 154, 12 S.E.2d 770 (1941).

113. See notes 14 and 15 *supra.*

114. See Williams and Nehemkis, *Municipal Improvements as Affected by Constitutional Debt Limitations,* 37 COL. L. REV. 177, 191 (1937).

be expected, however, the special fund device has been the subject of strong criticism.[115]

F. *Long-Term Contracts for Services*

Still another device is frequently used to enable cities to provide recurring needs and services by long-term contracts calling for annual payments, each of which is within the allowable debt, although the entire contract price would exceed the limit.[116] The courts have realized that changing conditions make it desirable that a city be allowed to increase its contractual capacity in order to render it able to provide even minimum services.[117] By construing "indebtedness" to include only *existing* obligations, it was reasoned that the annual sum payable is only a current expense, there existing no obligation to pay the entire contract price.[118]

Thus, in *Valparaiso v. Gardner*,[119] the Indiana court upheld a contract for furnishing water to the city for a period of twenty years at a yearly expense of $6,000. This was done although the city was presently indebted beyond the limit, since the annual sum was to be derived from current revenues. The court used the following language in upholding the device:

> "The effect of the proposed contract is that the city shall be liable for water as it is furnished and not before. It is not until after the water has been furnished that there can be justly said to be a debt. . . . If it can pay this indebtedness when it comes into existence, without exceeding the constitutional limitation, then there is no violation of the letter, and surely none of the spirit of the Constitution."[120]

Even if the contract be considered as creating a debt at all prior to receipt of any of the consideration, it is a debt only for the annual sum, not for the aggregate.[121]

A modification of the continuing contract device is also used occasionally. A purchase by a city under a conditional sales contract may be upheld,[122] on the theory that the seller's performance is not complete until he transfers title to the city after payments are completed.

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115. See Durisch, *Publicly Owned Utilities and the Problem of Municipal Debt Limits*, 31 MICH L. REV. 503, 511 (1933).

116. *E.g.*, Walla Walla City v. Walla Walla Water Co., 172 U.S. 1, 19 Sup. Ct. 77, 43 L. Ed. 341 (1898). For a case holding that a debt for the aggregate amount is created, see Evans v. Holman, 244 Ill. 596, 91 N.E. 723 (1910). See generally, Note, 103 A.L.R. 1160 (1936).

117. See Durisch, *supra* note 115, at 504.

118. *E.g.*, Wade v. Borough of Oakmont, 165 Pa. 479, 30 Atl. 959 (1895).

119. 97 Ind. 1 (1884).

120. *Id.* at 8.

121. *E.g.*, Denver v. Hubbard, 17 Colo. App. 346, 68 Pac. 993 (1902) (citing extensively).

122. See Johnston v. City of Stuart, 226 N.W. 164 (Iowa 1929); Barnes v. Lehi City, 74 Utah 321, 279 Pac. 878 (1929). See, however, note 131 *infra*.

G. *Tax Anticipation*

It has been noted earlier that many courts offset the amount of applicable current revenue in computing present indebtedness of a city.[123] Even if this is not done, however, the same result may be reached by deciding that issuance of obligations to be met by current revenues does not create a debt in the sense of the limitation.[124] The justification for this device is that once taxes have been assessed, their payment is legally certain, so that no outstanding debt will remain.[125] Of course, a given jurisdiction should not take both steps—hold that the amount of current revenue should be deducted in computing existing indebtedness and also hold that obligations issued in anticipation thereof are not new debts. To do so would be to allow a double deduction for current revenues.

It has been held that a note issued as evidence of a temporary loan to the city in anticipation of current revenue is not a debt and that it does not become such even if not paid off with the anticipated revenue.[126] If it is valid in its inception, it remains so although it becomes an obligation payable from the general fund.

The use of this device is limited to cases where the temporary obligation is issued to meet ordinary and current expenses;[127] it does not extend to situations involving extraordinary expense.

H. *Long-Term Leases*

One of the most widely used devices to circumvent the debt limitation is the leasing of facilities by a city, to be financed by the payment of an annual rental which is within the allowable amount.[128] The courts had only to extend the reasoning in the continuing-services contract cases one step to include the acquisition of capital facilities.[129] If a city could purchase a water supply under a long-term contract, no valid reason was seen to prevent the city's leasing the waterworks and operating it itself to furnish the water.[130]

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123. See note 52 *supra*.

124. *E.g.*, Butts County v. Jackson Banking Co., 129 Ga. 853, 60 S.E. 149 (1908). See Note, 92 A.L.R. 1299 (1934).

125. See State *ex rel.* Umatilla County v. Davis, 161 Ore. 127, 85 P.2d 379, 380 (1938).

126. Wakem v. Town of Van Buren, 137 Me. 127, 15 A.2d 873 (1940), 29 GEO. L.J. 519 (1941).

127. Windsor v. Des Moines, 110 Iowa 175, 81 N.W. 476 (1900); Brown v. City of Corry, 175 Pa. 528, 34 Atl. 854 (1896).

128. *E.g.*, Los Angeles v. Offner, 19 Cal.2d 483, 122 P.2d 14 (1942) (rubbish incinerator); Jefferson Sch. Tp. v. Jefferson Tp. Sch. Bldg. Co., 212 Ind. 542, 10 N.E.2d 608, 145 A.L.R. 1362 (1937) (school bldg.); Bacon v. Detroit, 282 Mich. 150, 275 N.W. 800 (1937) (incinerators); Ambrozich v. City of Eveleth, 200 Minn. 473, 274 N.W. 635 (1937) (real property).

129. See Los Angeles v. Offner, *supra* note 128.

130. See note 128 *supra*.

The courts have insisted that such leases be true rental arrangements, not disguised purchases.[131] Thus, if it is really a contract for an improvement, with only payment being postponed, it is invalid.[132] Too, if the lease calls for conveyance of the property to the city upon termination of the lease, with little or no additional payment, it is generally considered a purchase and not merely a lease, so that a debt for the whole sum arises.[133] A mere option to purchase does not create a debt, however.[134]

J. *Funding and Refunding Issues*

A final type of plan which has been upheld is the issuance of funding or refunding bonds by a city.[135] Funding bonds are those issued to replace outstanding evidences of indebtedness other than bonds, such as warrants; refunding bonds are new ones issued as a replacement for existent outstanding bonds. The rationale of the cases is that this simply changes the form of the indebtedness and does not create a new debt.[136]

There has been an attempt to draw a distinction between an exchange of new bonds for the old and a sale of the new with application of the proceeds to retirement of the old. Thus, the United States Supreme Court has stated:

> "There is a wide difference in the two alternatives. . . . Exchanging bonds . . . for outstanding bonds [is an arrangement] by which the new bonds . . . would be a substitute for and an extinguishment of them. . . . But under the first alternative . . . to sell the new bonds and to apply the proceeds of the sale to the payment of the outstanding ones, it is evident that . . . the aggregate debt . . . is at once and necessarily increased. . . ."[137]

The distinction, however, has not been recognized generally. Instead, the position of the dissenting opinion that this is "too technical an interpretation of the constitutional provision"[138] has been adopted in a majority of jurisdic-

131. Chester v. Carmichael, 187 Cal. 287, 201 Pac. 925, 926-27 (1921); Hall v. Cedar Rapids, 115 Iowa 199, 88 N.W. 448, 450 (1901); Reynolds v. Waterville, 92 Me. 292, 42 Atl. 553 (1898); Spilman v. Parkersburg, 35 W. Va. 605, 14 S.E. 279 (1891).

132. See Windsor v. Des Moines, 110 Iowa 175, 81 N.W. 476, 482 (1900).

133. Reynolds v. Waterville, 92 Me. 292, 42 Atl. 553 (1898); Kelley v. Earle, 320 Pa. 449, 182 Atl. 501 (1936); Spilman v. Parkersburg, 35 W. Va. 605, 14 S.E. 279 (1891) ($1).

134. Town of Klamath Falls v. Sachs, 35 Ore. 325, 57 Pac. 329 (1899). See notes, 71 A.L.R. 1318 (1931), 145 A.L.R. 1362 (1943).

135. *E.g.*, Johnson v. Middleton, 243 Ky. 251, 47 S.W.2d 1030 (1932); Alexander v. Board of Education of Carmen, 161 Okla. 287, 18 P.2d 863 (1933). See Note, 97 A.L.R. 442 (1935).

136. "The indebtedness was not incurred by the issuance of the funding bonds. The issuance of the funding bonds changed the form of the evidence of the indebtedness." Alexander v. Board of Education of Carmen, *supra* note 135 at 864.

137. Doon Tp. v. Cummins, 142 U.S. 366, 371-72, 12 Sup. Ct. 220, 35 L. Ed. 1044 (1892).

138. 142 U.S. at 379-80.

tions.[139] Certainly if the sale and application are handled in a single closing transaction, there would seem to be no grounds for the distinction.[140]

IV. Conclusions

A. *Present Limitations Undesirable*

One cannot study the present debt limitations and their operation without extracting the conclusion that they are undesirable in their present form.[141] Either a court reads them strictly as they appear and thereby effectively stifles the growth and expansion of an increasingly complex unit of local government;[142] or it interprets away the restraining influence almost completely[143] by upholding devices whose form alone is consistent with the purpose of the limits, leaving the substance to thwart the restriction. Neither the student of local finance nor the advocate of an orderly system of laws can agree with either course. Legal word-play and judicial juggling do little to clarify thought on any problem.

History demonstrates clearly that there must be some check to prevent the abuses of the past; it shows equally well that neither the courts nor the people are very sympathetic with a rule which prevents desirable expansion. Perhaps a statutory limitation is preferable to the prevalent constitutional limitation; thereby can be achieved a degree of deliberation without being confronted by the resistance to constitutional amendment which is often virtually impossible to overcome. Perhaps administrative supervision of debts within the statutory limits would also be advantageous. Indeed, there has been some strong agitation for administrative action to supplant entirely any fixed limit, rather than merely supplement it.[144] But to those who look with disfavor upon extension of the administrative process, a statutory limit offers a superior solution by providing flexibility which may be utilized with relative promptness.[145]

Whatever conclusion one reaches as to the form the limitations of the future should take, there is little dissent from the proposition that the success

139. *E.g.*, Taxpayers and Citizens of Shelby County v. Shelby County, 246 Ala. 192, 20 So.2d 36 (1944); Kocsis v. Chicago Park Dist., 362 Ill. 24, 198 N.E. 847 (1935).

140. See Fordham, Local Government Law 568 (1949).

141. See McGoldrick, Law and Practice of Municipal Home Rule 1916-1930 c. 14 (1933).

142. "[T]he debt limits now serve, where they serve at all, to cramp expanding needs of government and to place inflexible and arbitrary bounds on long term financing." Legis., 47 Harv. L. Rev. 688, 692 (1934).

143. See Legis., 18 Iowa L. Rev. 269, 278 (1933).

144. See Bromage, Introduction to Municipal Government and Administration 490 (1950); Stason, *State Administrative Supervision of Municipal Indebtedness*, 30 Mich. L. Rev. 833 (1932). See Fordham, Local Government Law 579 (1949) for the extent of the adoption of administrative control.

145. See Wallerstein, *What Cities Need in the Constitution*, 19 Tenn. L. Rev. 759 (1947) for an attack on constitutional limitations.

or failure of a particular financing plan should not be made dependent upon how well local ingenuity succeeds in fitting it into the framework of established evasions. Indeed, one is shocked to find that the courts have been so ready to look merely to the form of the proposed plan, leaving its substance and effect to evade the debt restriction. The judicial process is not often seen in so complacent a position in other fields, even where the reasons for liberality are more impressive.

B. *Probability of Success of A Particular Plan for Circumvention*

Notwithstanding the dissatisfaction with debt limitations, there is no indication that any general changes will be forthcoming within the immediate future. Since we must deal with the limitations in the existing attitude surrounding them, it is desirable that we be able to forecast with whatever certainty is possible as to the probable treatment which a proposed plan will receive at the hands of the courts. It behooves the finance officers of a city, interested potential contracting parties, and the lawyer whose client seeks an opinion as the validity of a proposed bond issue or of a contemplated contract with a city to be familiar with the principles which the courts have evolved in regard to debt limitations.

Perhaps all that can be done is to generalize, in light of past decisions. Even then, however, there are two conflicting judicial approaches which must be taken into account. These two competing attitudes are typified by the courts of Indiana and those of Michigan.[146] In striking down a statute which authorized withdrawal of health and hospital service from Indianapolis and establishment of a new and separate governmental unit to administer such service, the Supreme Court of Indiana, in the case of *Rappaport v. Department of Public Health and Hospitals of City of Indianapolis*,[147] stated the strict view:

> "[W]hen we meet such a situation we must examine it carefully and look through form to substance and where we find something, the effect of which is in substance to evade the intent of the Constitution, we must condemn it, no matter what form it takes."[148]

The court went on to say:

> "In each case, we must look to the true inwardness of the situation. . . . If, on the whole, the real effect seems to be to increase borrowing power in the exercise of substantially the same governmental function, in substantially the same area, rather than better to accomplish a public service, then there has been an evasion and Article 13 has been violated."[149]

146. See 48 MICH. L. REV. 1016 (1950) for a comparison and evaluation of the two views.
147. 227 Ind. 508, 87 N.E.2d 77, 88 N.E.2d 150 (1949).
148. 87 N.E.2d at 80.
149. *Id.* at 80-81.

Thus, the Indiana court invalidated one of the oldest recognized devices—that of a separate entity, at least insofar as the new unit is set up to administer an established service ordinarily performed by the city itself.[150] The substance and the effect, not the mere form, of the plan is to be the test of validity.[151]

The import of the decision has since been restricted somewhat by the case of *Department of Public Sanitation of City of Hammond v. Solan.*[152] In upholding a bond issue of a special taxing district, the court said in referring to the *Rappaport* decision: "To say the least this is a border line case that might well have been decided either way. We are inclined to limit it to its own facts, and not to extend its reasoning or principle in any way."[153] It remains vital to indicate the thesis of this argument, however—that so long as the success of a plan depends upon judicial interpretation, the plan may be held invalid in spite of its conformity to previously recognized devices if the court chooses to revert to a strict interpretation.

The other judicial attitude is exemplified in the case of *Walinske v. Detroit-Wayne Joint Bldg. Authority,*[154] decided by the Supreme Court of Michigan. There, an authority was established to construct a joint city-county building, with power to issue bonds to be retired from a special fund made up of rentals paid to the authority under a long-term lease with the City of Detroit and the County of Wayne. The court upheld this device although the arrangement called for conveyance of the building to the city and county upon retirement of the bonds. The court had little difficulty in finding that the arrangement was only a lease, not a sale by installment contract, although in so doing, it relied on a prior case in which the plan did not call for conveyance to the governmental unit upon retirement of the bonds.[155] The tenor of the opinion is that the court will disregard the substance and effect of a proposal if its form is similar to that of the recognized modes of circumvention.

The *Walinske* case has thus far been relied upon in only one other case,[156] and in it the Wyoming court indicates a misconception of what was decided by the Michigan court. It is cited as authority for the special fund idea,[157] but it should be recalled that the units whose debt limits were under concern in the Michigan case were not the ones which were to make payments from a special fund.

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150. But see notes 152 and 153 *infra.*
151. *Ibid.*
152. 97 N.E.2d 495 (Ind. 1951).
153. *Id.* at 501.
154. 325 Mich. 562, 39 N.W.2d 73 (1949), 34 MINN. L. REV. 360 (1950).
155. The court relied on Kelley v. Earle, 325 Pa. 337, 190 Atl. 140 (1937). The case had been decided the other way a year earlier when the provision called for conveyance upon termination of the lease. See 320 Pa. 449, 182 Atl. 501 (1936). See 34 MINN. L. REV. 360 (1950). See also note 133 *supra.*
156. Laverents v. City of Cheyenne, 217 P.2d 877 (Wyo. 1950).
157. *Id.* at 880.

Thus, the success of a given scheme must depend upon the particular court's attitude toward debt limitations. It is perhaps safe to say that necessity and desirability of the proposal[158] will continue to be important factors in the court's determination. Ability to fix the plan into the pattern of a recognized device will, no doubt, enhance the probability of its being upheld. Mere subterfuge to evade the limitation will perhaps continue to be frowned upon by the courts.[159] Until the form of debt limitations is changed, these will probably prove to be the safest conclusions on which to rely, with a recognition of the caution essential because of the occasional strict interpretation.

158. It will be recalled that this was a prime consideration in the cases which early allowed circumvention. See Crowder v. Town of Sullivan, 128 Ind. 486, 28 N.E. 94 (1891).

159. See De Jarnette v. Hospital Authority of Albany, 195 Ga. 189, 23 S.E.2d 716 (1942); Cerajewski v. McVey, 225 Ind. 67, 72 N.E.2d 650 (1947).