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CONSTITUTIONAL LIMITATION ON INDEBTEDNESS

Two recent decisions of the Indiana Supreme Court have pointed to the need of a solution to the recurring problem of municipal indebtedness. The difficulty has roots in the internal improvement boom of the middle 19th century.¹ After every hamlet, township, and county had over-burdened itself with debt,² an overdue accounting was begun in the 1870's³ culminating

decided the question in a similar case which had proceeded through the state courts. Suit was brought in the state court, following the *Thompson* decision, in June, 1940, and while pending a compromise settlement was reached. Best estimates are that it would have taken approximately two years to complete litigation in the Illinois courts.

The following are cases where the federal court proceeded to judgment on all issues, state and federal. No subsequent decisions, construing the unsettled state question, have been rendered by the state courts since the federal court's decision in *Estate of Spiegel v. Comm'r of Internal Revenue*, 335 U. S. 701 (1948); *Meredith v. Winter-Haven*, 320 U. S. 228 (1943); and *Mac Gregor v. State Mutual Life Assur. Co.*, 315 U. S. 280 (1941). Nor has there been a subsequent decision by the Illinois courts inconsistent with the conclusion reached by the Supreme Court in *Helvering v. Stuart*, 317 U. S. 154 (1942).

This information was received through the courtesy of Mr. Ireland Graves of Austin, Texas, counsel for the Pullman Co.; Mr. Cecil A. Morgan of Fort Worth, Texas, counsel for the pullman conductors; Mr. Albert E. Hallett of Chicago, Ill., *amicus curiae* in the *Fieldcrest* case; Mr. Herbert S. Thatcher of Washington, D. C., counsel for the A. F. of L.; Mr. Cyril Coleman of Hartford, Conn., counsel for the Spector Motor Co.; Mr. Craig Van Meter of Mattoon, Ill., counsel for the Magnolia Petroleum Co.; Mr. Thos. T. Railey of St. Louis, Mo., counsel for Thompson, trustee of the Missouri Pac. R. R.; Mr. Herbert A. Friedlich of Chicago, Ill., counsel for the Spiegel estate; Mr. D. C. Hull of De Land, Fla., counsel for Meredith; Mr. William B. Giles of Detroit, Mich., counsel for Mac Gregor; and Mr. Herbert Pope of Chicago, Ill., counsel for Stuart.

1. The War of 1812 had made it clear that both military and economic considerations demanded the development of transportation facilities. See PAXSON, *HISTORY OF THE AMERICAN FRONTIER* c. 29 (1924). There was also arising at this time in settlements, once only temporary in nature but rapidly taking on marks of permanence, a longing for the modern conveniences of the day. See BOND, *THE CIVILIZATION OF THE OLD NORTHWEST* c. 11, 13 (1934). "The completion of the Erie Canal in 1825 and the first steam locomotive in the early 1830's had a great influence in transferring dormant desires into fervent action." WAY, *THE MISSISSIPPI VALLEY AND INTERNAL IMPROVEMENTS* 111 (1910). "Indiana, for example, began work on the Wabash Canal in 1832 and at the same time chartered several railroads. Four years later, the Legislature authorized the sale of municipal bonds to the extent of \$10,000,000 to aid internal improvements, an average of over twenty dollars for every inhabitant of the state." CLARK, *THE WEST IN AMERICAN HISTORY* 333 (1937).

2. The total national figure of municipal indebtedness in 1880 was placed at \$728,000,000. The sum is impressive when considered with the fact that in 1840 local debt had amounted to scarcely \$20,000,000. In general, see DEWEY, *FINANCIAL HISTORY OF THE UNITED STATES* c. 7 (1924). Indiana's share of the 1880 burden has been estimated at \$20,000,000. See Zwerner, *Indiana Municipal Revenue Bond Financing*, 12 *IND. L. J.* 266, 268 (1936). Of course the defaults, bankruptcies, and staggering tax burdens which resulted were unexpected; there seems to have existed an overall confidence when the indebtedness was being incurred that "tolls and tariffs would soon produce an income sufficient to relieve the people from taxation for the support of the government." CLARK, *op. cit. supra* n. 1, at 333.

3. State governments also caught the "craze to go in debt," in most instances at an even earlier date than their subordinate units. It was from the states themselves that the first aid for railroad and canal building was sought. Fortunately, however, extension of state credit was effectively checked by 1860, in Indiana in 1851. *IND. CONST. Art. 10, § 5.*

in nationwide checks upon such nearsighted financial maneuvering.⁴ Indiana responded in 1881 with a constitutional amendment which restricted the indebtedness of a local unit to 2% of the value of its taxable property.⁵

It was soon apparent that a strict interpretation of the debt provision would impose undesirable hardships on municipalities.⁶ Whether units were in debt over the limit or not,⁷ there were certain services which they had to

For some unexplained reason the local units, both in Indiana and elsewhere, were left free to go their own blundering way for a considerable number of years. See DEWEY, *op. cit. supra* n. 2, at 243; Williams and Nehemkis, *Municipal Improvements As Affected By Constitutional Debt Limitations*, 37 COL. L. REV. 177, 178 (1937).

4. For the geographic extent of local credit restriction, see Legis., 47 HARV. L. REV. 688, n. 6, 689, n. 7 (1934). Few, if any local units escaped the period unscathed.

5. IND. CONST. Art. 13, § 1:

No political or municipal corporation in this state shall ever become indebted in any manner or for any purpose to an amount in the aggregate exceeding two per centum on the value of the taxable property within such corporation, to be ascertained by the last assessment for state and county taxes, previous to the incurring of such indebtedness; and all bonds or obligations in excess of such amount, given by such corporation shall be void: . . .

The term "political or municipal corporation" includes any governmental unit whatsoever which possesses the power to tax. *Indiana Ry. Co. v. Calvert*, 168 Ind. 321, 329, 80 N. E. 961, 964 (1906).

The restrictions imposed throughout the country vary to a considerable extent, but may be classified into four general categories: (1) a constitutional limitation, based on percentage of assessed valuation or amount of current revenue; limit is absolute for all types of debts. In force in Alabama, Arizona, Arkansas, Illinois, Indiana, Iowa, Maine, Missouri, Oklahoma, So. Carolina, Texas, West Virginia, and Wisconsin. (2) A constitutional limitation as in No. 1, above, but with one or more types of debts excepted, such as water debts, sewer debts, etc. In force in Georgia, New Mexico, New York, Montana, Virginia and Wyoming. (3) A constitutional limitation, based on amount of current revenue, but limit can be raised any amount by the voters of the unit. In force in California, Idaho, Kentucky, Louisiana, and North Carolina. (4) A statutory limitation, similar to one of the constitutional provisions. In force in the remaining states.

It seems clear that the statutory limitation does not present the same problems as the constitutional; since the amendment or repeal of a statute is a relatively simple matter when compared with similar action on the constitutional level. By the same token, the constitutional limitation which can be raised any amount by the voters of a unit presents more of an inconvenience than a real obstacle. The absolute constitutional limitation, however, even when providing for some exceptions, cannot be dealt with so easily; and it is in this area that the serious problems have arisen. See Legis., 18 IOWA L. REV. 269 (1933).

6. It was one thing to have placed in the constitution a prohibition against municipal borrowing; it was another thing for municipalities, in the face of such restriction, to meet the compelling demands of government. The maturing of the national economy had been accompanied by an increase in the scope of activity of local government. Concentration of population, industrial and commercial growth, and the tendency toward urbanization required sewerage, street improvements, water systems, and electric light and power utilities. An absolute debt limitation was certain to be an obstacle to the acquisition of improvements requiring large outlays of capital. See Foley, *Revenue Financing of Public Enterprises*, 35 MICH. L. REV. 1, 4 (1936).

7. Certainly with a total local indebtedness in the state of \$20,000,000, more than just a few municipalities were starting the "pay as you go" era with both hands tied. Indeed, some units were so far above the 2% limit in 1881 that even with the most frugal management several years would necessarily elapse before their existing indebtedness could be reduced sufficiently to allow any substantial movement. For illustrations, see

perform in order to justify their existence.⁸ This, coupled with the fact that a 2% obligation was nowhere near the danger mark of bankruptcy,⁹ soon created pressures seeking a release from the arbitrary bar of the constitution.¹⁰

The half century following the passage of the Indiana debt limit amendment saw the development of various methods of avoiding the strict letter of the constitution, most of which centered around the court's definition of a debt: "any *existing* obligation enforceable against the *general* fund of the unit."¹¹ Since revenue producing projects had a fund of their own, a pledging of this was not considered to be a municipal debt.¹² Included in this category

Sackett v. City of New Albany, 88 Ind. 473 (1883) (a 6% indebtedness); Powell v. City of Madison, 107 Ind. 106, 8 N. E. 31 (1886) (a 7% indebtedness); City of Logansport v. Dykeman, 116 Ind. 15, 17 N. E. 587 (1888) (a 5% indebtedness).

8. "The American way is for a better, more convenient, healthful and sanitary living." Zwerner, *Indiana Municipal Revenue Bond Financing*, 12 IND. L. J. 266, 280 (1936). "Certainly the community which is denied the opportunity to offer a minimum of modern conveniences is in danger of losing its inhabitants to a more advanced locality." Elliot, C. J. in *City of Valparaiso v. Gardner*, 97 Ind. 1, 5 (1884).

9. The limitations of other states range from 3% to as high as 18%. See Legis., 47 HARV. L. REV. 688 (1934).

10. A municipality without adequate firefighting equipment, Sackett v. New Albany, 88 Ind. 473 (1883); without a permanent water supply, *City of Valparaiso v. Gardner*, 97 Ind. 1 (1884); without adequate roads and streets, *Strieb v. Cox*, 111 Ind. 229, 12 N. E. 481 (1887); without a school, *Town of Winamac v. Huddleston*, 132 Ind. 217, 31 N. E. 561 (1892); or without a drainage system, *City of Logansport v. Jordan*, 171 Ind. 121, 85 N. E. 959 (1908) could hardly be expected to respect a provision which denied these necessities without regard to the unit's real ability to pay for them. See Comment, 42 YALE L. J. 762 (1933).

11. Sackett v. City of New Albany, 88 Ind. 473, 476 (1883). Nothing in the case required the court to talk in terms of "existing" indebtedness or "general" fund; yet the definition was repeated in subsequent cases and never examined as to the accuracy or necessity of the words used. The constitution, of course, makes no attempt to define indebtedness other than ". . . in any manner or for any purpose . . .". See note 5 *supra*.

12. Before the amendment in question, there existed no reason to distinguish between revenue received from the taxpayer, and that received from the consumer. However, the debt provision seemed directed primarily toward protection of the taxpayer, since the limit was measured by a percentage of the assessed value of taxable property. There was no intimation that the consumer was to be equally affected; and indeed, there was no particular reason that he should be, because theoretically, at least, his paying of rates for services was wholly voluntary. Thus, if a debt of a local unit was to consist of a pledge of its "general" fund, did not that mean the revenue derived from taxation as distinguished from consumer's rates and assessments? If this were true, then it would seem that a unit could pledge the latter fund without violating the constitution, even though in debt the full 2%. See, in general, Foley, *Revenue Financing of Public Enterprises*, 35 MICH. L. REV. 1 (1936). Some states, however, refuse to distinguish between the taxpayer and the ratepayer. See Durisch, *Publicly Owned Utilities and the Problem of Municipal Debt Limits*, 31 MICH. L. REV. 503, 511 (1933). It is true that in many instances the two are one and the same person; yet even this double identity does not seem to remove the significance of the voluntary nature of the payment of rates as contrasted with the payment of taxes. See Note, 44 HARV. L. REV. 610 (1931).

were improvements for which property could be assessed,¹³ and projects which had an income from consumer's rates.¹⁴

Because non-revenue producing projects could only be financed from a unit's general fund,¹⁵ a different "no debt" argument had to be found. From the proposition that a municipal debt was an "existing" obligation,¹⁶ it was reasoned that "an installment contract, entered into by a unit, will not create an indebtedness for the aggregate sum of all the installments because the obligation to pay each one does not come into existence until it has been earned."¹⁷ If the unit had enough unpledged revenue to meet the payments as they became due, then no debt would be contracted.¹⁸

13. Bonds issued by a county for construction of roads were held not to be a debt of the county, since not payable out of the general funds of the county treasury, but debts of the particular fund to be raised by the collection of assessments made on benefited land. *Strieb v. Cox*, 111 Ind. 299, 12 N. E. 481 (1887). *Accord*, *Quill v. City of Indianapolis*, 124 Ind. 292, 23 N. E. 788 (1890).

14. In *Fox v. City of Bicknell*, 193 Ind. 537, 141 N. E. 222 (1923), bonds payable solely and exclusively from the income and revenue of water plant were held not to constitute a municipal indebtedness. *Accord*: *Bollenbacher v. Hariss*, Mayor of Bloomington, 196 Ind. 657, 148 N. E. 417 (1925); *Underwood v. Fairbanks Morse and Co.*, 205 Ind. 316, 185 N. E. 118 (1933); *Indiana Service Corp. v. Town of Warren*, 206 Ind. 385, 189 N. E. 523 (1934); *Letz Mfg. Co., v. Public Service Corp. of Indiana*, 210 Ind. 467, 4 N. E.2d 194 (1936); *Edwards v. Housing Authority of City of Muncie*, 215 Ind. 330, 19 N. E.2d 741 (1938). The Indiana Court was considerably more hesitant in allowing a pledge of the public utility fund than the special assessment fund. In *Voss v. Waterloo Water Co.*, 163 Ind. 69, 71 N. E. 208 (1904) an over-indebted unit was flatly denied use of the method, the court refusing to apply the special assessment analogy, which had been in use some 15 years. The ruling was not tested until 1923 with *Fox v. City of Bicknell*, *supra*. See Note, 14 COL. L. REV. 70 (1914).

15. It might seem that practically every local activity could have been financed through special assessments, thus nullifying the debt limit amendment completely. However, the Indiana Legislature early provided that property must be benefited in a "special and peculiar" manner before it could be assessed by a local unit. IND. STAT. ANN. (Burns, 1933) § 48-2701; *Ross v. Stackhouse*, 114 Ind. 200, 16 N. E. 501 (1887). Special and peculiar benefits have existed in the past only in the case of streets, gutters, sidewalks, streetlights, and sewers; i.e., it must be clear that the value of the property will be enhanced. See *Adams v. City of Shelbyville*, 154 Ind. 467, 471, 57 N. E. 114, 117 (1889).

16. See note 11 *supra*.

17. *City of Valparaiso v. Gardner*, 97 Ind. 1 (1884).

18. *Id.* at 8. The installment contract, in one form or another, has been used by over-indebted units for various purposes: to procure a supply of water for a city for a twenty-year period, to be paid for annually as furnished, *City of Valparaiso v. Gardner*, 97 Ind. 1 (1884); to procure a supply of electricity for a town for a twenty-year period, to be paid for annually as furnished, *Crowder v. Town of Sullivan*, 128 Ind. 486, 28 N. E. 94 (1891); *Foland v. Frankton*, 142 Ind. 546, 41 N. E. 1031 (1895) (a five-year period); to lease a building to be used as a city hall for twelve years, at an annual rental, *City of South Bend v. Reynolds*, 155 Ind. 70, 57 N. E. 706 (1900); to purchase a school building by leasing it and exercising an option to purchase after rent payments had equaled the purchase price, *Jefferson School Township v. Jefferson Township School Building Co.*, 212 Ind. 542, 10 N. E.2d 608 (1937).

Certainly an installment contract which was not binding upon a unit except in regard to the first installment (one with an option to cancel after each installment) would not create a debt as to the sum of all the installments. However, all of the cases cited above involved contracts which were binding as to all of the installments; the unit was bound to receive the complete performance of the supplier. This being the case in *Valparaiso v.*

Though providing some relief, the installment contracts had one serious deficiency. Theoretically, Indiana units could have no unpledged revenue because of their budget system.¹⁹ Thus, for practical reasons, the financing of a project of any size in this manner was highly unlikely. To meet this shortcoming, advantage was taken of the legislature's power to create taxing districts. A new and separate unit, imposed upon the same territory as that of the over-indebted municipality, was given authority to carry out the proposed project. Approval of this was based upon the rationale that any debts incurred were those of the new unit and not the old, even though the taxpayers were the same and were subject to an extra 2% debt.²⁰

Gardner, *supra*, the court was asked how that unit could not be indebted when it only had enough cash to meet the first installment. The court's answer was that it was uncertain that any future installments would become due, because either the unit or the supplier might refuse to perform the remainder of the contract; and this, in spite of the fact that it was well settled that the possibility of a breach was not the equivalent of an option to cancel in so far as the binding quality of a contract was concerned. Perhaps the court felt this liberal interpretation of the constitution to be justified by the fact that in Valparaiso v. Gardner the legislature had provided for review by the Public Service Commission of the rates to be charged for the water supplied. See, *e.g.*, IND. STAT. ANN. (Burns, 1933) §§ 48-5301-5368. At least there was no danger there of the unit paying for more than it received. However, in all of the other cases cited above the same "possibility of breach" argument was repeated by the court, even though continued administrative review of the reasonableness of the contract price was never made available except in case of contracts for public utility services, such as water, gas, and electricity.

One type of installment contract, the conditional sales contract, has never been before the Indiana Court, although it has been accepted in several other states. Jones v. City of Corbin, 227 Ky. 674, 13 S. W.2d 1013 (1919); Johnston v. City of Stuart, 226 N. W. 164 (Iowa 1929); Barnes v. Lehi City, 74 Utah 321, 279 Pac. 878 (1929). This type of contract differs from the supply or lease type of installment contract in that performance of the seller, except for passage of legal title, is completed in a single act. Thus, one can only speculate as to whether or not the "non-existing" debt argument would be applied by the Indiana Court to such a contract. The application of the argument has been made in those states approving the conditional sales contract on the ground that the performance of the supplier is not completed until he has passed title. The Indiana Court will possibly have an opportunity to pass upon the question in the near future, since the legislature in 1947 authorized townships in the state to purchase fire-fighting equipment in this manner. IND. ACTS 1947, c. 95. In theory, there would seem to be no difference between the conditional sales contract and the other installment contracts; for, in absence of an option to cancel, a unit is equally bound by each.

19. See IND. STAT. ANN. (Burns 1943 Repl.) 64-1332, and rulings of State Board of Tax Commissioners and State Board of Accounts of Indiana.

20. Board of Commissioners of Monroe County v. Harrell, 147 Ind. 500, 46 N. E. 124 (1897); Board of Commissioners of Switzerland County v. Reeves, 148 Ind. 467, 46 N. E. 995 (1897); Johnson v. Board of Park Commissioners, 202 Ind. 282, 174 N. E. 91 (1930).

Prior to 1881 there was undoubtedly an unlimited power in the Legislature to create as many separate taxing districts in a given area as it saw fit, so long as two bodies were not given identical power. Taylor v. City of Fort Wayne, 47 Ind. 274 (1874); Strosser v. City of Fort Wayne, 100 Ind. 443 (1884). See also the discussion in Campbell v. City of Indianapolis, 155 Ind. 186, 206, 57 N. E. 920, 929 (1900). The instances in which it had done so were numerous; many localities were loaded with school, street, park sewer, and other kinds of taxing districts. The result was several corporate entities covering the same geographical area. See, *e.g.*, Gilson v. Board of County Commissioners of Rush County,

By 1923 the municipalities in Indiana had found adequate, if not full relief from the hardships imposed by the letter of the debt limit amendment.²¹ Yet, even though no repetition of the 19th century financial bubble had resulted from a lessening of the restriction, from the standpoint of the taxpayer, potential abuses were possible.²² When at first the court had passed upon the means of circumvention, the motivating factor was the actual need of the local unit for the proposed project.²³ However, the frequency with which the instances arose, coupled with the fact that municipal financing was growing more complex²⁴ forced the court to abandon an inquiry into the necessity of the project, and to substitute a more expeditious test: whether the accepted formalities of evasion had been followed.²⁵ Consequently, local units were able to violate the intent as well as the letter of the constitution by using an accepted vehicle to finance projects of questionable merit.²⁶

128 Ind. 65, 27 N. E. 235 (1890); *Heinl v. City of Terre Haute*, 161 Ind. 44, 66 N. E. 450 (1903); *Brown v. Miller*, 162 Ind. 684, 71 N. E. 122 (1904). The question was, to what extent had this power been altered by the debt limit amendment? After some forty years without a single taxing district having been declared invalid under this provision, the answer seemed to be that the power remained unaffected. This seemed especially so after the cases of *School City of Marion v. Forest*, 168 Ind. 94, 78 N. E. 187 (1906) and *Greathouse v. Indianapolis*, 148 Ind. 95, 151 N. E. 411 (1926). Each of these cases had involved the creation of separate taxing districts, in the former a library district and in the latter a school district. In neither was the question of violation of the debt limit amendment raised, the validity of the districts being challenged on the sole ground of unconstitutional delegation of the legislative power to tax. Both cases seemed to be in harmony with the dictum of *Gause, J. in Follett v. Sheldon*, 195 Ind. 510, 529, 144 N. E. 867, 873 (1924):

The legislative power to create different tax districts or quasi corporations for various purposes, including the same territory, may thus be used to avoid debt limits. The rule stated is doubtless the correct rule in principle. The courts could not change it without wholly denying the legislative power in the creation of subordinate governmental agencies. Under it, however, it is possible for great abuses to be perpetrated and it would be well if these abuses should be everywhere guarded against by *express constitutional limitations*. . . . However wise some such a limitation might be, the courts cannot supply the same.

21. In summation: revenue producing projects had been set completely free from the limitation. Small projects, without revenue, could be financed by an over-indebted unit if it had sufficient cash on hand to enter into one of the installment contracts. For projects too large for an installment contract to accommodate, the separate taxing district seemed more than adequate. For appraisals of the various methods of evasion in Indiana, see 5 IND. L. J. 191 (1930); 6 IND. L. J. 522 (1931); 13 IND. L. J. 511 (1938).

22. See *Stason, State Administrative Supervision of Municipal Indebtedness*, 30 MICH. L. REV. 833, 840 (1932).

23. *Elliot, J. in Crowder v. Sullivan*, 128 Ind. 486, 487, 28 N. E. 94, 95 (1891):

If municipal corporations cannot contract for a long period of time for such things . . . the result would be disastrous . . .

24. See *Comment*, 43 YALE L. J. 924 (1934).

25. *Howard, C. J. in Brashear v. City of Madison*, 142 Ind. 685, 688, 36 N. E. 252, 254 (1895):

The constitutional debt limit is not violated by a city in purchasing (through an installment contract) even though it may not be wise for the common council to extend credit in this way.

26. The intent of the debt limit provision seems to have been expressed by *Elliot*,

Possibly feeling that specialized treatment was necessary for each individual case of indebtedness, and that the court was not equipped to offer such,²⁷ the Indiana Legislature in 1919 provided for administrative supervision over local financial activity.²⁸ Henceforth, a unit could incur indebtedness up to \$5,000 without state approval; but for all obligations in excess of that amount, ten taxpayers could require the State Board of Tax Commissioners to rule upon whether or not the proposed indebtedness was "unnecessary, unwise, or excessive."²⁹ The Board was given plenary power, in that it could allow, decrease, or refuse the contemplated municipal obligation.³⁰ For the next two and half decades the State of Indiana was considered as having achieved a more than satisfactory solution to the problem of when a unit should be allowed to evade the prescribed debt limit.³¹

The year 1947 brought a complete reversal in the Indiana Supreme Court's treatment of municipal indebtedness. In *Cerajewski v. McVey*,³² an act of the Legislature creating a new and separate taxing district for the purpose of building and maintaining a vocational high school in the same area as the city of Hammond was declared invalid. Already existing, at that time, besides the civil city, was the School City of Hammond, which had full authority to provide for all necessary schools, but was too far in debt to undertake such a project. Money borrowed by the new taxing unit was to be charged against its own debt limitation without regard to the indebtedness of the old school city. The court admitted that the debt limit amendment did not forbid the existence of more than one taxing unit encompassing

C. J. in *City of Valparaiso v. Gardner*, 97 Ind. 1, 5 (1884) :

We are not to presume that the electors were ignorant of the existence, condition, and necessities of our great towns and cities.

See *Voss v. Waterloo Water Co.*, 163 Ind. 69, 90, 71 N. E. 208, 215 (1904) for both an expression and an application of the letter of the constitutional provision. As written, the amendment countenances none of the accepted methods of evasion, with the possible exception of the separate taxing district.

27. Vitaly needed were: (1) means of preventing wasteful extension of credit, (2) means of forcing units to retire debts promptly, (3) means of recognizing the real needs of local units, and (4) means of determining the burden that taxpayers were able as well as willing to bear. See Comment, 43 *YALE L. J.* 924, 983 (1934).

28. *IND. STAT. ANN.* (Burns 1943 Repl.) § 64-1332.

29. *Ibid.*

30. The tax commission is also given unusual powers over local budgets. *IND. STAT. ANN.* (Burns 1943 Repl.) § 64-1331. The act provides that local budgets shall be established only after publication and public hearing, and that any ten or more taxpayers may file a petition setting forth their objections to any tax levy or item thereof, and the commission shall have the powers to affirm or decrease said total tax levy . . . and the action of the . . . board . . . shall be final and conclusive." The constitutionality of the act was upheld in *Forrey v. Board of Commissioners*, 189 Ind., 257, 126 N. E. 673 (1920).

31. See Stason, *State Administrative Supervision of Municipal Indebtedness*, 30 *MICH. L. REV.* 833, 845, 855 (1932).

32. 225 Ind. 67, 72 N. E.2d 650 (1947).

identical territory;³³ and yet, ignoring prior authority to the contrary,³⁴ it declared that the legislature was powerless to create more when the effect was to evade the constitutional limitation.³⁵ No mention was made of the fact that the method had been approved in the past because of necessity, and therefore considered consistent with the underlying intent of the provision. Thus, the only conclusion to be drawn from the opinion was that the earlier, more realistic conception had been abandoned by the court, and that the strict letter of the amendment was to be controlling. Clearly all relief to over-indebted units in the form of taxing districts had been removed by the decision.³⁶ However, the consequences did not necessarily stop there; for the effect of the installment contract and special fund methods of evasion, like the taxing district,³⁷ was to expose property to a tax burden in excess of that provided for by a strict interpretation of the constitution.³⁸ At best the status of the several means of municipal financing was in doubt.

Opportunity for clarification came in 1949, with *Rappaport v. Dept. of Public Health and Hospitals*,³⁹ where the validity of a legislative act creating in Indianapolis a Public Health and Hospitals District for the purpose of carrying out all health measures was questioned. Prior to the enactment, the power given to the new unit to tax and expend had rested with the city of Indianapolis. Under the statute, a bond issue had been authorized and contract negotiations begun for the purpose of improving and enlarging a charitable hospital. In reversing the trial court's denial of an injunction, the Indiana Supreme Court applied the rule laid down in the *Cerajewski* case. The majority felt that any financial activity on the part of or in behalf of a unit should be examined in light of the debt limit amendment; and if the *effect*

33. Citing *Campbell v. City of Indianapolis*, 155 Ind. 186, 57 N. E. 920 (1900) and *Caldwell v. Bauer*, 179 Ind. 146, 99 N. E. 117 (1912). Both cases involved taxing districts which were created before 1881.

34. See cases cited in note 20 *supra*.

35. *Cf. Greathouse v. Board of School Commissioners of Indianapolis*, 198 Ind. 95, 151 N. E. 411 (1926).

36. The unfairness of the *Cerajewski* decision to some localities in the state is apparent. At the time of the adoption of the debt limit amendment not all areas had been equally subjected to the "maze of taxing districts." Some had several such units for various purposes, allowing a combined indebtedness of anywhere from 12 to 20%; while other areas, with only town, township, school and county units, were restricted to a mere 8%. For example, compare *Town of Winamac v. Huddleston*, 132 Ind. 217, 31 N. E. 561 (1892) with *Campbell v. City of Indianapolis*, 155 Ind. 186, 57 N. E. 920 (1900). With the doctrine of *Board of County Commissioners v. Harrell*, 147 Ind. 500, 46 N. E. 124 (1897), allowing the creation of an additional taxing district in an area, the way was left open for the legislature to equalize the areas in this respect whenever necessary. Now the position of all localities seemed to be frozen as per 1947, in spite of the fact that they had by no means been equalized in regard to the number of taxing districts present in each.

37. See *Board of Commissioners of Switzerland County v. Reeves*, 148 Ind. 467, 474, 46 N. E. 995, 999 (1897).

38. See 13 IND. L. J. 511 (1938).

39. 87 N. E.2d 77 (Ind. 1949); Emmert, J. dissenting at 88 N. E.2d 150 (Ind. 1949).

of a proposed scheme would be to violate that provision, then it could not be countenanced. Since the taxing district created in Indianapolis would in effect increase the debt limit of that area, the court declared it to be invalid. Again the assumption seemed to be that the letter of the amendment was controlling.⁴⁰ Inconsistently, however, the court attempted to soften the rigor of the rule applied in this and the *Cerajewski* decisions by providing for an exception in the case of a taxing district for local improvement purposes.⁴¹ This exception was extracted from the case of *Board of County Commissioners of Monroe County v. Harrell*,⁴² decided in 1897: the first case involving the creation of a taxing unit after the passage of the debt limit amendment. In the *Harrell* decision, the court had held that "the Legislature, in the exercise of its power over taxation, in making local improvements, can still create a separate taxing district without regard to the boundaries of existing units."⁴³ If the term "local improvements" had been used by the 1897 court in any restrictive sense, it would seem to be as to the units need for the project, and not as a designation of any certain type of improvement.⁴⁴ The court in the *Rappaport* decision, however, declared a hospital not to be a local improvement because it had not been thought of as such in the past.⁴⁵

40. Young, J. in *Rappaport v. Dept. of Health*; 87 N. E.2d 77, 80 (1949):

If on the whole, the real effect seems to be to increase borrowing power . . . Art. 13 has been violated. . . . Whether incurred in one name or another, ultimately it would have to be paid by the same taxpayers of the same areas.

See note 38 *supra*.

41. Of course any taxing district, no matter what the purpose, will have the "effect" of increasing an area's debt limit.

42. 147 Ind. 500, 46 N. E. 124 (1897).

43. *Id.* at 504, 46 N. E. at 125.

44. If a designation of certain types of improvements had been intended by the 1897 court, the only logical ones would be those for which special assessments could be levied by a local unit; i.e., those improvements which increased the value of the assessed property. See note 15 *supra*. But the statement of the court in the *Harrell* decision, "a tax . . . for local improvements is based upon the theory that it is a return for the benefit received by the *person* who pays the tax *or* by the property assessed . . .," *id.* at 505, 46 N. E. at 126, shows that the court was thinking in broader terms; for a unit could not, under the municipal bond statutes, assess property for a benefit bestowed only upon an individual. Besides this, a new taxing district was not needed in order to levy an ordinary assessment; pre-existing units could already do that without incurring a debt. Thus, to say that the result of the *Harrell* case was that a taxing district could be created only for improvements for which local units could assess, is to say that the legislature had performed a useless and ineffective act which the court went to pains to approve and hold constitutional.

45. "Nor is there any reasonable ground for denying that a hospital may be a local public improvement . . . Art. 13 does not . . . purport to say that only public improvements existing at the time of its adoption could be considered public improvements for all time, 'for, while the meaning of constitutional guaranties never varies, the scope of their application must expand or contract to meet the new and different conditions which are constantly coming within the field of their operation. In a changing world it is impossible that it should be otherwise' . . ." Emmert, J. dissenting in *Rappaport v. Dept. of Health*, 88 N. E.2d 150, 156 (Ind. 1949).

The *Harrell* case had involved only gravel roads.⁴⁶ Subsequent cases approving the creation of a taxing district for a library,⁴⁷ a school,⁴⁸ and a park⁴⁹ had mentioned neither the term "local improvement" nor the *Harrell* case.⁵⁰ Thus, it is impossible to determine what, besides gravel roads, is within that category, for future taxing district purposes.⁵¹

Of course the *Cerajewski* and *Rappaport* cases, when restricted to their facts, may have reached a proper result; it is possible that Hammond did not need a school nor Indianapolis a modernized hospital. If these were denials of indebtedness for wasteful purposes, they could hardly be criticized.⁵² But this was not the rationale of the court; instead it was said that in determining the application of the debt limit amendment, form would be disregarded in search of substance and anything with the effect of nullifying the constitution would not be countenanced.⁵³

As pointed out, this test, when applied to determine whether the letter of the constitution has been violated, could spell doom to most, if not all of the previously accepted methods of evasion.⁵⁴ The difference between the installment contract and a bond issue is slight. Installments are, in reality, as certain to become payable as bonded obligations. There has never been any question that a bond issue creates an indebtedness;⁵⁵ thus, the effect of both

The majority's words were: "Roads and streets have through the years been thought of and considered as local improvements . . . Hospitals, on the other hand, have through the years been thought of as (one) of the general functions of local government . . ." *Rappaport v. Dept. of Health*, 87 N. E.2d 77, 82 (Ind. 1949).

46. *Board of County Commissioners of Monroe County v. Harrell*, 147 Ind. 500, 501, 46 N. E. 124 (1897).

47. *School City of Marion v. Forest*, 168 Ind. 94, 78 N. E. 187 (1906).

48. *Greathouse v. Indianapolis*, 148 Ind. 95, 151 N. E. 411 (1926).

49. *Johnson v. Board of Park Commissioners*, 202 Ind. 282, 174 N. E. 91 (1930).

50. In his dissenting opinion to the *Rappaport* case, Emmert, J. refers to the *Johnson* case as having held a park to be a "local improvement." 88 N. E.2d 150, 156 (Ind. 1949). However, a reading of the *Johnson* opinion does not reveal the source of his information.

51. See note 44 *supra*.

52. For the overall need of additional schools and hospitals, see Cottrell, *Problems of Local Governmental Reorganization*, 2 WESTERN POLITICAL QUARTERLY 599 604 (Dec. 1949).

53. Young, J. in *Rappaport v. Dept. of Health*, 87 N. E.2d 77, 80 (Ind. 1949):

. . . when 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 (letter?) of the Constitution, we must condemn it, no matter what form it takes.
See note 40 *supra*.

54. See 6 IND. L. J. 191 (1930); 6 IND. L. J. 522 (1931); 13 IND. L. J. 511 (1938) for discussions to the effect that each of the various methods of evasion violate the "letter" of the debt limit amendment. See also *Board of Commissioners of Switzerland County v. Reeves*, 148 Ind. 467, 474, 46 N. E. 995, 999 (1897).

55. *Winamac v. Huddleston*, 132 Ind. 217, 31 N. E. 561 (1892); *Wilcoxon v. Bluffton*, 153 Ind. 267, 54 N. E. 110 (1899).

would seem to be the same.⁵⁶ Also, the court in the *Cerajewski* case, in setting up the "effect" test, cited and discussed the disapproved case of *Voss v. Waterloo Water Co.*,⁵⁷ which had proclaimed the separate fund method to be an improper subterfuge.⁵⁸ Thus the constitutionality of special assessments and revenue bonds may be in question.⁵⁹ Finally, of course, the taxing district for non-local improvement purposes is directly forbidden by the *Cerajewski* and *Rappaport* cases. As shown, the extent of such prohibition is unknown; but the holding of the *Rappaport* case lends color to the supposition that the term "local improvement" is to receive a strict construction.⁶⁰

It should be apparent from the history of municipal indebtedness that a limitation is inadequate which does not consider both the need of a local unit to become indebted and its ability to finance projects.⁶¹ An arbitrary restriction on the extension of credit, such as the Indiana amendment, fails to meet this requirement; for little relationship exists between a percentage of the assessed value of a unit's property, its needs, and its ability to pay.⁶² As a result, the need of the municipalities to occasionally exceed the designated limit early forced the Indiana Supreme Court to liberally construe the debt limit amendment. However, the court soon lost sight of this consideration; and, when abuse resulted, it was necessary for the legislature to provide for administrative supervision over local indebtedness with an eye toward the prevention of waste and extravagance. The *Cerajewski* and *Rappaport* cases now show that possibly once again over-indebted units are to be denied necessities.⁶³

The constant failure of the Indiana Supreme Court, for the past seventy

56. A bond issue for \$100,000, to be retired in 20 years, and an installment contract for the same amount to run for a like period will each increase taxes to the same extent, excluding interest payments on the bonds. See *Caldwell v. Bauer*, 179 Ind. 146, 159, 99 N. E. 117, 126 (1912).

57. 163 Ind. 69, 71 N. E. 208 (1904), disapproved in *Fox v. City of Bicknell*, 193 Ind. 537, 14 N. E. 222 (1923).

58. See note 14 *supra*. The majority in the *Rappaport* case also voiced approval of the opinion of Board of Commissioners of Switzerland County v. Reeves, 148 Ind. 467, 46 N. E. 995 (1897) in which criticism was leveled at the special assessment method of evasion.

59. All would seem to depend upon whether or not the majority of the present court feels that the distinction drawn between taxpayers and ratepayers is a valid one. See note 12 *supra*.

60. "We do not know the extent to which the rule laid down in the *Harrell* case has been acted upon and we do not overrule it although we think it badly decided." *Rappaport v. Dept. of Health*, 87 N. E.2d 77, 83 (Ind. 1949).

61. See Comment, 43 *YALE L. J.* 924, 953 (1934).

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

63. The effect of this upon the centralization v. decentralization battle should be obvious. If local units are to be arbitrarily denied the opportunity to provide those things deemed essential by both the state and federal government, interference with local autonomy will come as a matter of course.

years; to solve adequately the problems raised by the municipal debt provision is not surprising.⁶⁴ Obviously, the needs of each individual unit vary according to its location, area, population, function, and degree of modernization and industrialization. Experience in other fields has shown that a court cannot competently deal with such complex matters by pronouncing rules of law drawn from isolated instances. Indebtedness, if it is to be properly controlled, requires quick and comprehensive supervision by those skilled and experienced in the field. This is an administrative and not a judicial function.⁶⁵

Of course complete administrative control over municipal indebtedness necessitates an amendment to the constitution. But because constitutions are difficult to amend,⁶⁷ an immediate workable solution requires operation within the existing framework of the law. It would seem that in search of an answer the situation existing prior to 1947 could serve as a working basis; for, as previously pointed out, most authorities were agreed that the action of the Indiana Court in allowing needed relief, and of the Legislature and its administrative agency in preventing abuse by over-indebted units, had come close to a satisfactory formula.⁶⁸ The only criticism of this was found in possible administrative laxness in requiring a showing of necessity without a corresponding check by the court. The defect could have been easily cured by a continuing awareness on the part of the court that local necessity was both the basis for permitting escape from the letter of the constitution and intervening legislative restriction.

The Tax Commission's sanction of a municipal obligation is presumably made with the complete picture of local need in mind.⁶⁹ Thus a return to a modified pre-1947 situation of municipal indebtedness could be accomplished if the court would accept the fact that an administrative finding as to the need of an over-indebted unit to incur additional indebtedness is *prima facie* correct. This would by no means abolish judicial review, but would direct it to where it is most needed: to that instance where the Tax Commission fails to make a correct finding.⁷⁰

64. See note 27 *supra*.

65. See, in general, Comment, 43 YALE L. J. 924, 953 (1934).

66. Stason, *State Administrative Supervision of Municipal Indebtedness*, 30 MICH. L. REV. 833, 854 (1932).

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

68. See Stason, *State Administrative Supervision of Municipal Indebtedness*, 30 MICH. L. REV. 833, 845, 855 (1932).

69. See Comment, 43 YALE L. J. 924, 982 (1933).

70. This would seem to go far in answering the fears of the majority in the *Rappaport* case, "If a separate government unit with a separate and independent debt limit for health and hospitals may be created, then a separate unit to exercise the functions of the fire and police departments can be carved out. If a city hospital can be so financed, why not a city hall or any other essentially city function or building? If these things can be done, then

Of course the argument could be advanced that such treatment of the municipal debt problem by the court would be an open flaunting of the constitutional prohibition.⁷¹ However, such a contention disregards the fact that from the beginning the amendment as it read was unworkable,⁷² and that the court has indirectly recognized that relief is sometimes necessary.⁷³ The present confusion in the field is a result of the court's failure to bring such recognition out into the open.⁷⁴ A frank statement to that effect would have prevented subsequent courts, as in the *Cerajewski* and *Rappaport* cases, from ignoring the basic issue involved.

The problem of municipal indebtedness today is neither academic nor remote. There is little doubt that there will be a continuing need on the part of local units to evade the 2% limitation.⁷⁵ It is suggested that the proposed approach, based upon the real considerations present in a debt limitation, will provide both just and certain relief.

SECURITIES

CERTIFICATE OF TITLE AS NOTICE OF LIENS UPON MOTOR VEHICLES

Crissinger, the owner of a motor vehicle, gave to the Community State Bank a chattel mortgage which was duly filed in the chattel mortgage records. At the same time the bank took possession of the certificate of title, but subsequently returned it to Crissinger for the alleged purpose¹ of permitting the

the debt limitation of the constitution for all practical purposes is nullified." *Rappaport v. Dept. of Health*, 87 N. E.2d 77, 82 (Ind. 1949). See also *Cerajewski v. McVey*, 225 Ind. 67, 73, 72 N. E.2d 650, 652 (1947).

71. "If within our constitution, as it is, we cannot finance necessary hospital additions and improvements then we should amend the constitution, not flout it." Young, J. in *Rappaport v. Dept. of Health*, 87 N. E.2d 77, 82 (Ind. 1949).

72. See Williams and Nehemkis, *Municipal Improvements as Affected by Constitutional Debt Limitations*, 37 COL. L. REV. 177, 184 (1937).

73. Otherwise why was the "local improvement" district saved by the majority in the *Rappaport* decision?

74. In nearly all of the cases in which evasion was allowed, the court went out of its way to show that evasion was not taking place.

75. Cottrell, *Problem of Local Government Reorganization*, 2 WESTERN POLITICAL QUARTERLY 599 (Dec. 1949):

Population in most metropolitan areas is now pressing beyond the safety margin of the resources available for its support. . . . Finances and facilities of all governments are strained by the problems presented. The situation is one in which governments are trying to meet demands for more schools, playgrounds, streets, recreational areas, utilities, and numerous other services through a two inch pipe when a ten inch main is required.

1. The Indiana statutes seemingly require an applicant for registration plates to "present satisfactory evidence" that the applicant has been issued a certificate of title. IND. STAT. ANN. (Burns Supp. 1949) § 47-2501. As a matter of practice, however, an applicant for registration plates is not required to produce the certificate of title because, through its records, the department determines whether or not a certificate has been issued to him.