

# Municipal Debt Readjustment Present Relief and Future Policy

Harold Gill Reuschlein

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## MUNICIPAL DEBT READJUSTMENT: PRESENT RELIEF AND FUTURE POLICY

HAROLD GILL REUSCHLEIN\*

### I

#### MUNICIPAL DEFAULT: THE ECONOMIC PROBLEM

On January 1, 1933, out of \$14,000,000,000 invested in securities of local state governmental units, \$1,000,000,000 were reported to be in default.<sup>1</sup> The total funded indebtedness was, at that time, about equally divided between cities of over 30,000 population and cities of smaller size, towns, villages, and taxing districts. For the period extending from 1921 to 1932 the average annual rate of issuance of municipal obligations, including state, totalled over \$1,300,000,000 and the rate of retirement was approximately \$500,000,000.<sup>2</sup> The amount of municipal and kindred obligations in default had increased to \$1,200,000,000 by the summer of 1933.<sup>3</sup> In the early part of 1934, the amount of such obligations in default had jumped to well over \$2,000,000,000.<sup>4</sup> The spread of holdings of municipal securities<sup>5</sup> is, perhaps more significant than the extent of the default, for inevitably repercussions of municipal financial collapses are felt throughout the economic structure.

Such was the picture of municipal default when the original Municipal

\*The writer is indebted to Messrs. Louis Cokin and Ralph P. Needle, third year students in the Georgetown Law School, for valuable assistance in the preparation of this article.

<sup>1</sup>(Apr. 1, 1933) *THE BOND BUYER* 5. Cf. Rightor, *The Bonded Debt of 257 Cities* (1932) 21 *NAT. MUN. REV.* 349.

<sup>2</sup>(Apr. 1, 1933) *THE BOND BUYER* 5.

<sup>3</sup>*PUBLIC ADMINISTRATION SERVICE* No. 33, *Municipal Debt Defaults* (1933) 1.

<sup>4</sup>*Hearings Before a Subcommittee of the Judiciary on S. 1868 and H. R. 5950*, 73d Cong., 2d Sess. (1934) 17; see particularly the testimony of Representative Wilcox beginning at page 12.

<sup>5</sup>In December 31, 1932, Mr. Carl Chatters, then editor of *THE BOND BUYER*, estimated that municipal bonds (including state bonds) were distributed as follows:

|  |                    |
|--|--------------------|
| Individuals having annual income exceeding \$5000        | \$4,500,000,000.00 |
| Corporations except banks and insurance companies        | 4,000,000,000.00   |
| Sinking funds of states and their political subdivisions | 3,380,000,000.00   |
| Banks  | 2,800,000,000.00   |
| Life, fire and casualty insurance companies              | 1,000,000,000.00   |
| Fraternal insurance companies                            | 500,000,000.00     |
| Individual investors, income under \$5000                | 900,000,000.00     |
| Other holders  | 1,420,000,000.00   |

Debt Readjustment Act<sup>6</sup> was enacted. The debates in the Senate and the House prior to its passage were long and loud upon the economic need for municipal debt readjustment,<sup>7</sup> and the measure, though enjoying administration support, was essentially non-partisan in that it derived strong support from both sides of the aisle.<sup>8</sup>

Since that time much has happened. The original Act has been invalidated<sup>9</sup> and a new Municipal Debt Readjustment Act has been enacted into law.<sup>10</sup> With the country's enjoyment of improved business conditions during the years 1935-1937 the total amount of municipal obligations in default has been somewhat reduced,<sup>11</sup> and during that period virtually no new municipalities have been added to the list of those in default.<sup>12</sup> Despite all this, history teaches us that depressions are recurrent. It may be that the ways of history have changed and that depressions now recur as "recessions." Be that as it may, there is no assurance that municipal defaults may not soon be on the increase again.

## II

### CONGRESS ATTEMPTS A SOLUTION

To meet the crises occasioned by mounting defaults, and to afford relief, both to the distressed municipality and to its creditors, Congress in 1933 began debate upon a proposal which would permit a readjustment of the debts of municipal and quasi-municipal corporations. Before briefly analyzing the provisions for relief afforded by the first federal statute, it would be well to note the remedies which creditors of municipal corporations have, apart from such legislation.

<sup>6</sup>Sec. 80, amendatory of the National Bankruptcy Act. 48 STAT. 798, 11 U. S. C. A. §§ 301-303 (1934).

<sup>7</sup>The debates may be found in 77 CONG. REC. 5469-5488 (1933) and in CONG. REC., April 30, 1934, at 7849-7871. Comprehensive statistics may be found in the debates.

<sup>8</sup>One of the principal advocates for the passage of Section 80 was Senator Vandenberg, Republican, of Michigan.

<sup>9</sup>*Ashton v. Cameron County Water Improvement District No. 1*, 298 U. S. 513 (1936).

<sup>10</sup>As §§ 81-84, amendatory of the National Bankruptcy Act, 50 STAT. 654, 11 U. S. C. A. § 401 (Supp. 1937).

<sup>11</sup>See letter of Mr. Sanders Shanks, Editor of *THE BOND BUYER*, to Senator McAdoo (February 11, 1938), *Hearings before the Committee on Banking and Currency of the United States Senate on S. 3255 (Regulation of Over-the-Counter Markets)*, 75th Cong., 2d Sess. (1938) at 128.

<sup>12</sup>See letter of Mr. Shanks, note 11. The following summary showing the spread of municipal debt defaults, among various types of local governmental units, revised to March 1, 1938, as reported to *THE BOND BUYER*, is of interest:

|   |      |
|---|------|
| Counties .....  | 185  |
| Cities and Towns .....                                      | 746  |
| School Districts .....                                      | 734  |
| Other Districts .....                                       | 244  |
| Total Number Municipalities .....                           | 1909 |
| Reclamation, Levee, Irrigation and Drainage Districts ..... | 862  |
| Special Assessment .....                                    | 308  |

Grand Total: Municipalities and Special Districts .....3079

There is available to the creditors the prerogative writ of mandamus, a sort of consolation handed to the holders of obligations of municipal corporations.<sup>13</sup> One must remember, however, that judgment creditors may only lay hold upon such properties of the corporation as are not devoted to a "public purpose" and apparently, the courts have had little trouble in finding some degree of public use for virtually all the property upon which the creditors may ordinarily hope to levy.<sup>14</sup> Like limitations seem to apply to garnishment.<sup>15</sup> American courts have been decidedly liberal in granting mandamus, perhaps because it is apparent that the usual remedies at law are worth little enough to the creditors.<sup>16</sup> When default results from dereliction of official duty, or from mere refusal to pay just obligations, mandamus seems to be quite adequate.<sup>17</sup>

Unwillingness to pay is not the cause of widespread default in times of general economic crises. Our problem deals with inability to pay. In such times, funds in the treasury may be totally required for the corporation's current operating expenses. If so, bondholders obtain nothing from the treasury. Constitutional or statutory tax limits may have been reached and a court is then helpless to compel the municipality to secure funds for debt payment.<sup>18</sup> Any man's realistic jurisprudence will tell him that depreciated real estate values and the sympathetic attitude of municipal officials toward over-taxed citizens can make mandamus wholly innocuous. Officials to whom writs have been directed have been known to absent themselves from the jurisdiction; and municipal corporations have been known to delay the appointment or election of tax collectors.<sup>19</sup> Though mandamus proves ineffective, equity has been reluctant to interfere in the administration of a

<sup>13</sup>In theory, *mandamus* is available only when other legal remedies prove inadequate. *Riggs v. Johnson County*, 6 Wall. 166 (U. S. 1867); FERRIS, *EXTRAORDINARY LEGAL REMEDIES* (1926) § 212. For numerous cases, see Fordham, *Methods of Enforcing Satisfaction of Obligations of Public Corporations* (1933) 33 COL. L. REV. 28.

<sup>14</sup>Fordham, *supra* note 13, at 29, 30, n. 7-19.

<sup>15</sup>*Id.*, at 30-32, n. 20-33.

<sup>16</sup>*Sellers v. Frohmiller*, 42 Ariz. 239, 24 P. (2d) 666 (1933) (bondholders may force a city treasurer to fulfill an already issued order of payment and compel such an order to be issued); *Symons v. U. S. ex rel. Masters*, 252 Fed. 109 (C. C. A. 9th 1918) (and this is true even though funds are not available); *State ex rel. Vans Agnew v. Johnson*, 112 Fla. 7, 150 So. 111 (1933) (creditors may require collection of levied taxes); McQUILLAN, *MUNICIPAL CORPORATIONS* (2d ed. 1928) § 2722, n. 50 (creditors may require the levy of new assessments within the municipality's constitutional or statutory taxing powers).

<sup>17</sup>*East St. Louis v. United States ex rel. Zebley*, 110 U. S. 321 (1884). A reduction in operating costs may be ordered where expenses are jumped to defeat a creditor's claim. *Deuel County, Nebraska v. First National Bank of Buchanan County*, 86 Fed. 264 (C. C. A. 8th 1898).

<sup>18</sup>It is generally accepted that mandamus may only compel the exercise of an existing power and that it can create no new power to tax. *United States v. County of Macon*, 99 U. S. 582 (1878).

<sup>19</sup>One Kansas county chose its officials upon condition that they should remain in hiding and appear in the jurisdiction to transact the county's business only by night. PUBLIC ADMINISTRATION SERVICE No. 33, *Municipal Debt Defaults* (1933) 13.

public corporation and so does not come to the aid of the city's bond and warrant holders.<sup>20</sup> Even in the cases of waste and misuse of funds, refusal of officials to collect taxes, or abolition of the taxing district, creditors of such a corporation will not be entitled to a receiver.<sup>21</sup> In Iowa and Maryland, by statute, equity courts were authorized to appoint officers to do such acts as might be necessary to satisfy a writ of mandamus.<sup>22</sup> In a few states, statutes have authorized appointment of a receiver to collect taxes levied for payment of a defaulting drainage or irrigation district's bonds.<sup>23</sup> The virtual impossibility of a creditor of a defaulting municipality to obtain payment of the municipality's obligations is thus spelled out.

If then, the creditor finds that enforcement of the municipality's obligations is denied to him, he must needs resort to some plan for readjustment of the municipality's obligations which will again put him in possession of an enforceable right. Realizing this, some state legislatures have created commissions with power to control refunding or compromise agreements. Pursuant to such authorization, quite a number of cities and their creditors have been able to agree upon much needed readjustments which have called for deferring payment, or for reduction of interest rates, or even for the scaling down of principal.<sup>24</sup> But usually the difficulty in dealing with dissenting bondholders dooms the prospect of employing any such plans on any effectively wide scale.<sup>25</sup> Enforcement of such a state-sanctioned plan against a recalcitrant minority of the creditors runs afoul of the constitutional prohibition against the impairment of the obligations of a contract.

Various methods suggest themselves as possibilities for controlling an obdurate minority among a municipality's bondholders. From time to time, restrictions upon the granting of the discretionary writ of mandamus have been suggested. In earlier times, however, it has been decided that economic emergency and even threatened insolvency cannot be deemed sufficient grounds for denying mandamus to the municipal corporation's creditors.<sup>26</sup> There

<sup>20</sup>Consider the similar situation with regard to a defaulting private corporation, where, upon petition by creditors holding a lien upon such corporation's property, equity will readily appoint a receiver of the debtor's business and assets. STEVENS, CORPORATIONS (1936) 765, 766; 2 CLARK, RECEIVERS (2d ed. 1929) § 700.

<sup>21</sup>Marar v. San Jacinto and P. V. Irrigation District, 131 Fed. 780 (C. C. S. D. Cal. 1904); Thompson v. Allen County, 115 U. S. 550 (1885) (Mr. Justice Harlan's dissent in this case suggested the possibility of appointment of a receiver to conserve the assets of a defaulting public corporation); Merriweather v. Garrett, 102 U. S. 472 (1880). See also Rees v. Watertown, 86 U. S. 107 (1873).

<sup>22</sup>IOWA CODE (1931) § 12453; MD. ANN. CODE (Bagby 1924) Art. 75, § 141.

<sup>23</sup>Statutes of this type are collected in (1933) 46 HARV. L. REV. 1317, 1320, n. 24.

<sup>24</sup>For several typical plans, see PUBLIC ADMINISTRATION SERVICE No. 33, *Municipal Debt Defaults* (1933) Appendix A.

<sup>25</sup>In Alabama it was said that the holders of \$2000 worth of bonds out of \$952,000 outstanding disrupted a settlement agreeable to holders of \$950,000 of bonds. In Coral Gables an agreement was reached by 90 per cent of the creditors, but ten per cent prevented any readjustment. *Hearings before Senate Committee on the Judiciary on S. 1868 and H. R. 5950*, 73rd Cong., 2nd Sess. (1934) 14.

<sup>26</sup>Galena v. Amy, 5 Wall. 705 (U. S. 1866); Little Rock v. United States, 103 Fed.

seems to be little possibility of exercising any effective control over dissenting creditors by restricting the granting of mandamus inasmuch as the courts have stated that legislative restrictions upon the operation of the writ would be inoperative.<sup>27</sup>

Conceivably, condemnation of the dissenters' bonds under eminent domain might be considered as a solvent of the problem. However, the difficulties in the way of such a solution seem insurmountable. In the first place, the municipality is so situated that it would be next to impossible to procure funds for such purpose. Presumably, there would be very little difficulty in complying with the requirement that the taking be for a public use, inasmuch as "public use" seems to mean little other than "public benefit."<sup>28</sup> Supposing that the public use requirement could be spelled out and that funds for condemnation were available, a most serious obstacle would be encountered in the fact that eminent domain proceedings could reach only bonds or warrants, or their holders, within the same jurisdiction. From these considerations, it appears that the states are virtually stalemated in their efforts to effect and enforce a municipal debt readjustment plan.

Because of this situation and because the Bankruptcy Act as then constituted expressly excluded municipal corporations from its purview,<sup>29</sup> the Bankruptcy Act was amended by adding new sections designed to invoke the constitutional power of the Congress to pass uniform laws upon the subject of bankruptcies for the purpose of making possible the readjustment of municipal debts. Representative Sumners of Texas introduced into the House the bill<sup>30</sup> which was enacted into law on May 24, 1934.<sup>31</sup>

The Sumners Act declared the existence of a national emergency and provided that "any municipality or other political subdivision"<sup>32</sup> may file a petition with the local bankruptcy court alleging that the district is unable to meet its debts as they mature "and that the holders of at least thirty per cent of its bonds, notes or certificates of indebtedness consent in writing to the filing of the petition and signify either their willingness that a readjustment plan be drawn up or else their approval of a plan (or major part

418 (C. C. A. 8th 1900); *Hammond v. Place*, 116 Mich. 628, 74 N. W. 1002 (1898).

<sup>27</sup>See *State ex rel. Buckwalter v. City of Lakeland*, 112 Fla. 200, 150 So. 508 (1933); *Dos Amigos, Inc. v. Lehman*, 100 Fla. 1313, 131 So. 533 (1930); *Victor v. Halstead*, 84 Colo. 450, 271 Pac. 185 (1928); *Seibert v. Lewis*, 122 U. S. 284 (1886); *Wolff v. New Orleans*, 103 U. S. 358 (1880).

<sup>28</sup>Cf. *Clark v. Nash*, 198 U. S. 361 (1905); *Strickly v. Highland Boy Gold Mining Co.*, 200 U. S. 527 (1906). For other cases see, 1 LEWIS, EMINENT DOMAIN (3d ed. 1909) § 257, n. 26-30.

<sup>29</sup>Sec. 4 (a) (b), 36 STAT. 839 (1910), 11 U. S. C. A. § 22 (a) (b) (1926).

<sup>30</sup>H. R. 5950, 73rd Cong., 2d Sess. (1934).

<sup>31</sup>48 STAT. 798, 11 U. S. C. A. §§ 301-303 (1934).

<sup>32</sup>"Including (but not hereby limiting the generality of the foregoing), any county, city, borough, village, parish, town or township, unincorporated tax or special assessment district, and any school, drainage, irrigation, levee, sewer, or paving, sanitary, port, improvement or other districts."

thereof) be submitted by the petitioner." On April 11, 1936, "Sec. 80 Municipal Debt Readjustments" of the Bankruptcy Act (the Sumners-Wilcox Act) was amended to provide that

"the petition shall state that a plan of readjustment has been prepared, is filed and submitted with the petition, and that creditors of the taxing district owning not less than 30 per centum in the case of drainage, irrigation, reclamation, and levee districts (except as hereinafter provided) and owning not less than 51 per centum in the case of all other taxing districts in amount of the bonds, notes, and certificates of indebtedness of the taxing districts affected by the plan, excluding bonds, notes, or certificates of indebtedness owned, held, or controlled by the taxing district in a fund or otherwise, have accepted it in writing."<sup>33</sup>

It was further provided under the terms of the original Municipal Debt Readjustment Act that the allegations of the petition might be denied and the district's right to file the petition challenged by holders of five per cent. of the bonds, notes, or certificates of indebtedness, whereupon the judge was authorized to decide, without the aid of a jury, whether or not the allegations were sustained by the proofs and then to either approve or dismiss the petition. Once the petition was approved, the court could enjoin proceedings against the taxing district in other courts.<sup>34</sup> The court could also compel the rejection in whole or in part of executory contracts upon which the district was obligated, saving to the holder of the contract a provable claim for damages from the resulting breach. However, the judge was precluded from interfering with any of the political powers of the taxing district or from interfering with any of its revenues or properties necessary for governmental purposes or with any revenue-producing property of the district "unless the plan of readjustment so provides."

With reference to the plan, the Act provided that it

"(1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; and (2) may contain such other provisions and agreements, not inconsistent with this chapter as the parties may desire."

The judge was required to dismiss the proceedings if no plan was submitted within six months from the date of filing the petition, or if no plan were approved and accepted within a year from that date, but this latter period could be extended for an additional year provided the judge found it necessary so to do. Further, a readjustment plan could be put into effect temporarily by the court's interlocutory decree to remain in effect until such

<sup>33</sup>49 STAT. 1203, 11 U. S. C. A. § 303 (1936).

<sup>34</sup>The bankruptcy judge was authorized to "enjoin or stay, until after final decree, the commencement or continuance of any judicial proceeding to enforce any lien or to enforce any levy of taxes."

time as a plan might be finally confirmed or the proceedings dismissed, provided, however, that in the event a budget had been adopted in reliance upon such temporary plan, a dismissal in such budget year was forbidden.

Before amendment, the Sumners-Wilcox Act provided that final confirmation was permitted only when a readjustment plan was approved "by creditors whose claims have been allowed holding two-thirds in amount of the claims of each class whose claims have been allowed and would be affected by the plan, and by creditors holding  $66\frac{2}{3}$  per centum in the case of drainage, irrigation, reclamation, and levee districts and creditors holding 75 per centum in the case of all other taxing districts in amount of the claims of all classes of the taxing district affected by the plan" and by the district. By amendment in 1936, the requirements of a confirmation were modified as follows:

"The plan of readjustment shall not be confirmed until it has been accepted in writing, filed in the proceedings, by or on behalf of creditors holding at least 51 per centum in amount of the claims of each class in the case of drainage, irrigation, reclamation and levee districts and creditors holding two-thirds in amount of the claims of each class in the case of all other taxing districts whose claims have been allowed and would be affected by the plan, and by creditors holding 51 per centum in the case of all other taxing districts in amount of the claims of all classes of the taxing district affected by the plan . . ."

Before confirming any plan, the judge was required to find that it be "fair, equitable, and for the best interests of the creditors, and does not discriminate unfairly in favor of any class of creditors, and is fairly based upon the reasonable capacity of the taxing district to pay, and is feasible," that all expenses incident to the readjustment have been disclosed, that such expenses be reasonable and that the taxing district be authorized by law to take any and all action requisite to take execution of the plan. The plan having been confirmed, the readjustment was to become binding upon all creditors, irrespective of whether they had filed claims or whether they had accepted the plan, and upon the taxing district. Finally, the Act provided that its passage should in no way impair state administrative supervision or control of political subdivisions; and if supervision of fiscal affairs should be provided, no petition could be filed and no plan put into operation save with the approval of the state supervisory agency.<sup>35</sup>

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<sup>35</sup>Even before its passage the constitutionality of the Sumners Act had been questioned upon several grounds:

- (1) that the bankruptcy power may be exercised only in behalf of persons who are insolvent
- (2) that the subject of bankruptcies extends only to proceedings contemplating surrender of the debtor's assets for distribution to his creditors and discharge of the debtor
- (3) that the Act interfered with the right of the states to control their own political subdivisions.

See James A. McLaughlin, *Hearings before Subcommittee of the Committee on the*

## III

## THE FIRST MUNICIPAL DEBT READJUSTMENT ACT IN THE LOWER COURTS

On July 17, 1934, the Cameron County Water Improvement District, the first political subdivision to avail itself of the terms of the Summers-Wilcox Act, filed its petition seeking readjustment of its outstanding bonds. The petition was dismissed as being insufficient and the court, although discussing the constitutionality of the Act, found it unnecessary to determine its status as a valid Congressional enactment.<sup>36</sup>

Nearly five months later, in the Federal District Court for California, the constitutionality of the Act was brought into issue for the first time.<sup>37</sup> After a thorough discussion of the constitutional points involved, District Judge St. Lure, in an exhaustive opinion found the Act consistent with the powers granted to Congress. He found the Act within the "subject of Bankruptcies," uniform in its scope, not lacking in due process, and although an emergency measure,<sup>38</sup> a valid exercise of legislative powers. Some six weeks after this decision, the District Court for the Southern District of California again upheld the validity of the Act basing its decision on the California permissive statute,<sup>39</sup> holding that there was nothing in the Act that infringed upon unsundered state sovereignty.<sup>40</sup>

Fully two years later, the *Cameron County* case, upon review by the Circuit Court of Appeals for the Fifth Circuit was reversed,<sup>41</sup> the court holding that it was apparent from a reading of the Summers-Wilcox Act that it was not intended to interfere with the sovereign rights of the states.

*Judiciary on S. 1868 and H. R. 5950, 73rd Cong., 2nd Sess. (1934), at 126 et seq.; Morford, Federal Legislation for Corporate Reorganization; A Negative View (1933) 19 A. B. A. J. 702, 703; Briggs, Shall Bankruptcy Jurisdiction be Extended to Include Municipalities and Other Taxable Subdivisions (1933) 19 A. B. A. J. 637; Stebbins, Constitutionality of the Recent Amendments to the Bankruptcy Law (1933) 17 MARQ. L. REV. 161.*

<sup>36</sup>*In re Cameron County Water Improvement District No. 1, 9 Fed. Supp. 103 (S. D. Texas 1934). The Texas enabling statute had not been passed at this time.*

<sup>37</sup>*In re East Contra Costa Irr. Dist., 10 Fed. Supp. 175 (N. D. Cal. 1935).*

<sup>38</sup>For an exhaustive discussion of emergency's part in Constitutional Law, see Maurer, *Emergency Laws (1935) 23 GEO. L. J. 671.*

<sup>39</sup>Chapter 4, Section 7a at 5, Extra Session of 1934. "Whenever any taxing district has heretofore filed or purported or attempted to file a petition under Chap. IX of the Federal Bankruptcy Statute, all acts and proceedings of such taxing district and of the governing board or body and of public officers of such taxing district in connection with such petition or proceedings are hereby legalized, ratified, confirmed and declared valid to all intents and purposes and the power of such taxing district to file such petition and take such other proceedings is hereby ratified, confirmed and declared, but all such proceedings taken after the date this Act takes effect shall be taken in accordance with and pursuant to this Act."

<sup>40</sup>*In re Imperial Irr. District., 10 Fed. Supp. 832 (S. D. Cal. 1935).*

<sup>41</sup>*Cameron County Water Imp. Dist. No. 1 v. Ashton, 81 F. (2d) 905 (C. C. A. 5th 1936).*

## IV

## MUNICIPAL DEBT READJUSTMENT HELD UNCONSTITUTIONAL

On May 25, 1936, the Supreme Court of the United States, speaking through Mr. Justice McReynolds, held the Sumners-Wilcox Act, relating to municipal bankruptcy, unconstitutional.<sup>42</sup> The case involved the petition of a water improvement district in Texas, acting under an enabling statute<sup>43</sup> and claiming to be insolvent and unable to meet its debts as they matured, for confirmation of a plan based on schedules adjusting its obligations in accordance with the provisions of the Act.<sup>44</sup> Owners of more than five per cent of the outstanding bonds of the district appeared and challenged the jurisdiction of the trial court to hear the petition. The petition was accordingly dismissed by the Federal District Court<sup>45</sup> and upon appeal to the Fifth Circuit Court of Appeals was reversed and remanded.<sup>46</sup> A petition for a writ of certiorari was then immediately filed and granted by the Court on April 13, 1936.<sup>47</sup>

The Court's decision, assuming that the Act was adequately related to the subject of bankruptcies and not in contravention of the Fifth Amendment, was based mainly on the invasion of sovereignty of the states and on the impairment of contracts clause of the Constitution. The decisions under the taxing clause were used by way of analogy to sustain its holding on the first ground.

An analysis of these grounds and a consideration of other possible constitutional objections to the validity of the Act will be undertaken to show the inconsistency of the majority with prior decisions and the validity of the Act as a Constitutional measure.

A. *Analogy to the Taxing Power*

First, it is submitted that the tax analogy<sup>48</sup> is wholly inapplicable since the "Power to Tax" has been said to be "the power to destroy",<sup>49</sup> while under this Act the plan is designed to alleviate insolvent municipalities from

<sup>42</sup>Ashton v. Cameron County Water Improvement District No. 1, 298 U. S. 513 (1936). Mr. Justice Cardozo was joined in a vigorous dissent by Chief Justice Hughes, Justice Stone and Justice Brandeis, 298 U. S. 513, 532 (1936). A rehearing was denied, 299 U. S. 619 (1936).

<sup>43</sup>TEX. STAT. (Vernon Supp. 1937) art. 102 §4a.

<sup>44</sup>48 STAT. 798, 11 U. S. C. A. §§ 301-303 (1934).

<sup>45</sup>9 Fed. Supp. 103 (S. D. Tex. 1934).

<sup>46</sup>81 F. (2d) 905 (C. C. A. 5th 1936).

<sup>47</sup>298 U. S. 648 (1936).

<sup>48</sup>"The power to establish 'uniform laws on the subject of Bankruptcies' can have no higher rank or importance in our scheme of government than the power 'to lay and collect taxes.'" Ashton v. Cameron County W. I. Dist. No. 1, 298 U. S. 513, 530 (1936).

<sup>49</sup>M'Culloch v. Maryland, 4 Wheat. 318 (U. S. 1819). But see, Mr. Justice Holmes' dissent in Panhandle Oil Co. v. Mississippi, 277 U. S. 218, 223 (1928), to the effect that "the power to tax is not the power to destroy while this Court sits."

excessive obligations which they are unable at present to meet and in many cases will never be able to meet. Certainly this is no *burden* on the taxing districts as the term is understood in the Reciprocal Immunity tax decisions.<sup>50</sup> The Act, on the contrary, provides for a plan whereby the subdivisions may relieve themselves of that *burden* which Chief Justice Marshall feared Congress might impose.<sup>51</sup> However, let the tax analogy, for all that it is worth, be applied and pursued to the illogical end—the Act would still appear to be constitutional. The majority opinion inexplicably failed to take into consideration the long line of decisions dealing with the “consent” of the sovereign to be taxed. The Court has never hesitated in upholding federal tax assessments on state instrumentalities or state assessments on federal units when the consent of the sovereign was present.<sup>52</sup> To carry the doctrine of consent further, we should consider the incidence of the Eleventh Amendment whereby, despite prohibition against the entertainment by the federal courts of suits by citizens of one state against another state, it is well settled that a state may waive its sovereign immunity by voluntary appearance.<sup>53</sup> It seems clear that either the state or the Federal Government may waive its sovereignty and consent to legislation, which, without such consent, would be unconstitutional.<sup>54</sup>

<sup>50</sup>“ . . . instrumentalities employed for carrying on the operations of their [state] governments . . . should not be liable to be crippled, much less defeated by the taxing power of another government. . . .” *Collector v. Day*, 11 Wall. 113, 125 (U. S. 1870). “A tax is understood to be a charge, a pecuniary burden.” *United States v. Railroad Company*, 17 Wall. 322, 326 (U. S. 1872). Cf. “The right to tax the contract [with a state] to any extent . . . however inconsiderable, is a burden on the operations of government.” *Weston v. Charleston*, 2 Pet. 449, 468 (U. S. 1829).

<sup>51</sup>*McCulloch v. Maryland*, 4 Wheat. 316 (U. S. 1819).

<sup>52</sup>*Baltimore Nat. Bank v. State Tax Commission of Maryland*, 297 U. S. 209 (1936); *Van Allen v. The Assessors*, 3 Wall. 573 (U. S. 1865); *United States v. California*, 297 U. S. 175 (1936); *Owensboro v. Owensboro Nat. Bank*, 173 U. S. 664 (1899).

<sup>53</sup>“The immunity from suit belonging to a State which is respected and protected by the Constitution within the limits of the judicial power of the United States, is a personal privilege which it may waive at pleasure.” *Clark v. Barnard*, 108 U. S. 436, 447 (1883).

“Although a state may not be sued without its consent, such immunity is a privilege which may be waived, and hence where a state voluntarily becomes a party to a cause and submits its rights for judicial determination, it will be bound thereby and cannot escape the result of its own voluntary act by invoking the prohibitions of the Eleventh Amendment.” *Gunter v. Atlantic Coast Line R.R.*, 200 U. S. 273, 284 (1906). “Immunity from suit under the Eleventh Amendment is a personal privilege which may be waived.” *Missouri v. Fiske*, 290 U. S. 18, 24 (1933). See also, DOBIE, *FEDERAL PROCEDURE* (1928) 533, § 132; 5 HUGHES, *FEDERAL PRACTISE JURISDICTION AND PROCEDURE* (1931) 223, § 3043; 1 COOLEY, *CONSTITUTIONAL LIMITATIONS* (8th ed. 1927) 22; 3 WILLOUGHBY, *CONSTITUTION OF THE UNITED STATES* (2d ed. 1925) 1384.

<sup>54</sup>*Pabst Brewing Co. v. Crenshaw*, 198 U. S. 17 (1905) (state regulations concerning intoxicating liquor when imported into a state); *Wilkerson v. Rohrer*, 140 U. S. 545 (1891) (subjecting of intoxicating liquors transported into a state to state laws); *Whitfield v. Ohio*, 297 U. S. 431 (1936) (state control of prison made goods in interstate commerce).

B. *The Preservation of Dual Sovereignty*

The argument of the majority as to the preservation of the dual sovereignty in our federal form of government seems fictional and unreal in that the operation of Section 80 of the Bankruptcy Act is limited to matters over which the "sovereign rights" of states cannot extend, *i.e.*, alteration, compromise, or adjustment of the outstanding obligations of state subdivisions.<sup>55</sup> Where, then, is the much abhorred invasion of states rights? However, if doubt still exists as to the impairment of state sovereignty, then the doctrine of consent renders the dual sovereignty argument unconvincing.<sup>56</sup>

Article I, Section 10 of the Federal Constitution providing that "no State shall pass any law impairing the obligations of Contracts" is wholly inapplicable to Section 80 of the Bankruptcy Act. It is argued that a state has no power to impair existing obligations of its subdivisions<sup>57</sup> and, therefore, by its enabling statutes,<sup>58</sup> it is doing indirectly what it is prohibited from doing directly.<sup>59</sup> This line of reasoning is questionable in that Section 80 does not authorize the states through their own legislatures to impair existing obligations. If contracts are impaired, the impairment is occasioned by the federal courts acting under an act of the Congress: the state merely authorizes its subdivisions to file a petition.<sup>60</sup> Impairment is not forbidden unless effected by the states themselves and the granting of the petition by the courts of the United States is the efficient cause of the release. There being no restraint on the Congress in this respect,<sup>61</sup> the argument of impairment must fall.

C. *The Doctrine of Uniformity*

The Act is not lacking in uniformity as provided for in Article I, Section

<sup>55</sup>U. S. Const. Art. I, § 10, cl. 1. "A state has authority to pass a bankrupt [insolvency] law provided such law does not impair the obligations of contracts." *Sturges v. Crowninshield*, 4 Wheat, 122, 207 (U. S. 1819). "So long as there is no national bankrupt act, each State has full authority to pass insolvent laws . . . provided it does not impair the obligation of existing contracts; . . ." *Brown v. Smart*, 145 U. S. 454, 457 (1892).

<sup>56</sup>It is of passing interest to note that briefs *amici curiae* were filed on behalf of ten states in support of the constitutionality of the Sumners-Wilcox Act. Are we to force immunity upon states against their own will?

<sup>57</sup>*Sturges v. Crowninshield*, 4 Wheat. 122 (U. S. 1819).

<sup>58</sup>Five states have enacted this type of statute: Arizona, California, Florida, Ohio, and Texas.

<sup>59</sup>*Ashton v. Cameron County W. I. Dist. No. 1*, 298 U. S. 513, 532 (1936).

<sup>60</sup>Apparently there is no authority for either view on this topic. See Brief for Respondent, p. 16.

<sup>61</sup>"Contracts, however express, cannot fetter the authority of the Congress." *Norman v. Baltimore and Ohio R.R.*, 294 U. S. 240, 307 (1935). *New York v. United States*, 257 U. S. 591 (1922) (existing rate contracts are subject to subsequent schedules by I.C.C.); *Addyston Pipe and Steel Co. v. United States*, 175 U. S. 211 (1899) (previous contracts subject to anti-trust legislation of Congress); *Philadelphia B. & W. R. R. v. Schubert*, 224 U. S. 603 (1912) (Employers' Liability Act held applicable to contracts made before its passage).

8 of the Constitution.<sup>62</sup> The uniformity required is geographical and not personal.<sup>63</sup> The mere fact that the Act is applicable only to such public corporations as have the capacity under the laws of their mother state does not make it one lacking in uniformity; for if capacity exists, the rule is uniform for all.<sup>64</sup>

#### D. *The Incidence of the Fifth Amendment*

There is no violation of the Fifth Amendment<sup>65</sup> involved in applying the Municipal Debt Readjustment Act. It is questionable whether there is a deprivation of property in any real sense when secured creditors are compelled by a law, such as Section 80, to accept something which the court finds is equivalent to their contract rights.<sup>66</sup> Unlike the *Frazier-Lemke* case,<sup>67</sup> wherein Section 75 of the Bankruptcy Act was declared unconstitutional as repugnant to the due process clause of the Fifth Amendment,<sup>68</sup> this situation does not present itself in proceedings under the Municipal Debt Readjustment Act. In the former case, property of the mortgagee was taken and given back to the mortgagor without even the right of the mortgagee to bid the property in at an open sale—clearly a taking without due process. However, inasmuch as municipal property, governmental in nature, cannot be levied upon or sold for municipal debts,<sup>69</sup> the reorganization under Section 80 does not involve the insurmountable obstacle of Section 75. Therefore, any attempt to apply the decision in the *Louisville Joint Stock Land Bank* case<sup>70</sup> to the Municipal Debt Readjustment Act for the purpose of questioning its constitutionality seems unwarranted. There is a substantial difference between bankruptcy provisions, legitimately exercised, effect-

<sup>62</sup>"Congress shall have power to establish uniform Laws on the subject of Bankruptcies throughout the United States."

<sup>63</sup>*Hanover Nat. Bank v. Moyses*, 186 U. S. 181 (1902); *Lehigh Carriage Co. v. Stengel*, 95 Fed. 637 (C. C. A. 6th 1899).

<sup>64</sup>"Notwithstanding the requirement as to uniformity the bankruptcy acts of Congress may recognize the laws of the state, although such recognition may lead to different results in different states." *Stellwagen v. Clum*, 245 U. S. 605, 613 (1918).

<sup>65</sup>"No person shall be . . . deprived of life, liberty, or property, without due process of law, . . ." U. S. CONST. Amend. V.

<sup>66</sup>" . . . in bankruptcy when a 'corporation' agreement with the bankrupt debtor, if assented to by the required majority of creditors, is made binding on the non-assenting minority, in no just sense do such governmental regulations deprive a person of his property without due process of law." *Canada Southern Ry. v. Gebhard*, 109 U. S. 527, 536 (1883).

<sup>67</sup>*Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555 (1935).

<sup>68</sup>"The bankruptcy power . . . is subject to the Fifth Amendment" *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, 589 (1935). See the earlier suggestion to the contrary: "Limitations contained in the Fifth Amendment to the Constitution are not restrictive upon the bankruptcy power." Gerdes, *Constitutionality of Sec. 77B of the Bankruptcy Act* (1934) 12 N. Y. U. L. Q. REV. 196, 207.

<sup>69</sup>*Townsend v. Greeley*, 5 Wall. 326 (U. S. 1866); *City of Flora v. Naney*, 136 Ill. 45, 26 N. E. 645 (1891); COOLEY, MUNICIPAL CORPORATIONS (1914) 468; ELLIOT, MUNICIPAL CORPORATIONS (3rd ed. 1925) 407, § 392.

<sup>70</sup>295 U. S. 555 (1935) (the *Frazier-Lemke* Act declared unconstitutional as a violation of the Fifth Amendment).

ing consequential injury or abrogating existing contracts and a direct appropriation of property belonging to an individual,<sup>71</sup> as was attempted by Section 75 of the Bankruptcy Act.<sup>72</sup> Section 80, in its attempt to ease the burden of over-bonded state subdivisions, does merely what is within the very essence of a bankruptcy law, namely, equalize distribution of a debtor's assets among his creditors.<sup>73</sup> Therefore, it is difficult to see how any objection to the Act's validity on the ground of lack of due process can be sustained in view of the *Railroad Reorganization* case<sup>74</sup> upholding Section 77 of the Bankruptcy Act.<sup>75</sup>

### E. The Fear of the Future

The fear of the majority in the *Ashton* case<sup>76</sup> as to the possible future expansion of the Bankruptcy Clause to embrace the states themselves and thus destroy their sovereignty and make them submissive to the will of Congress is entirely without basis.<sup>77</sup> The Court was not called upon to decide there, nor will it be under the Second Municipal Bankruptcy Act, the possibility of state bankruptcy. However, when that occasion arises, there is room for argument that the bankruptcy concept does not include the states themselves. Surely, the states could not be subject to involuntary proceedings, since a suit against a state without its consent is prohibited

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<sup>71</sup>"Closely allied to the objection we have just been considering is the argument—that the legal tender acts were prohibited by the spirit of the Fifth Amendment, that provision has always been understood as referring only to a direct appropriation and not to consequential injuries resulting from the exercise of lawful power." *Legal Tender Cases*, 79 U. S. 457, 551 (1870).

<sup>72</sup>47 STAT. 1470, 11 U. S. C. A. § 203 (1933).

<sup>73</sup>"The very essence of a national bankrupt system is the doing away with preexisting contracts, the prevention of preferences among creditors allowed by the common law, the distribution of the assets of a debtor, upon the principle that equality is equity among creditors. . . . Upon this subject there is no constitutional inhibition imposed upon Congress and it can exercise the full powers of sovereignty. . . ." *In re Vogler*, Fed. Cas. No. 16,986 at 1250 (W. D. N. C. 1873).

<sup>74</sup>"The Constitution, as it many times has been pointed out, does not in terms prohibit Congress from impairing the obligation of contracts as it does the states. . . . Speaking generally, it may be said that Congress, while without power to impair the obligation of contracts by laws acting directly and independently to that end, undeniably, has authority to pass legislation pertinent to any of the powers conferred by the Constitution, however it may operate collaterally or incidentally to impair or destroy the obligation of private contracts. . . . And under the express power to pass uniform laws on the subject of bankruptcies, the legislation is valid though drawn with the direct aim and effect of relieving insolvent persons in whole or in part from the payment of their debts." *Continental Illinois Nat. Bank v. Chicago, R. I. & P. Ry.*, 294 U. S. 648, 680 (1935).

<sup>75</sup>47 STAT. 1474 (1933) 11 U. S. C. A. § 205 (1934).

<sup>76</sup>298 U. S. 513 (1936).

<sup>77</sup>The Congress clearly negatives the intention of invasion of state sovereignty by providing that "nothing contained in this chapter shall be construed to limit or impair the power of any state to control by legislation or otherwise any municipality or any political subdivision of or in such state in the exercise of its political or governmental powers including expenditures therefor. Section 83(i) of the Bankruptcy Act, 50 STAT. 659, 11 U. S. C. A. § 403(i) (Supp. 1937). A similar provision can be found in the earlier Act. Section 80 (k), 48 STAT. 802 (1934).

under the Federal Constitution.<sup>78</sup> In public law, the state is a quasi-sovereign; not so its local governmental units. This is borne out by decisions under the Eleventh Amendment allowing suits against such governmental units to be maintained contrary to their will, whereas the same suits brought against the state would have been dismissed.<sup>79</sup> Thus, Justice McReynolds' fear of vanishing state lines seems rather unwarranted.

#### F. *Bankruptcy—An Expanding Concept*

The foregoing arguments are all based upon the assumption that the Municipal Debt Readjustment Act was one properly within "the subject of bankruptcies." Doubt may be expressed as to the validity of such an assumption. But bankruptcy is an expanding concept and this is best demonstrated by a brief survey of this process of expansion.

To that elusive individual, "the average man", bankruptcy conveys one absorbing idea—that some poor fellow staggering under the burden of crushing debt is to be released from his bondage. If one surveys but cursorily the evolution of the idea of bankruptcy, he cannot help but learn that the idea of the debtor's release from bondage is but one phase of bankruptcy's all embracing purpose. Indeed, the idea of release may in many instances be but incidental to the principal purpose of particular bankruptcy legislation.<sup>80</sup>

<sup>78</sup>U. S. CONST. Amend. XI. "A state cannot be sued by a citizen of another state, or of a foreign state." *Hans v. Louisiana*, 134 U. S. 1 (1890). Accord: *In re Quarles*, 158 U. S. 532 (1894); *In re Ayers*, 123 U. S. 443 (1887); *Hagood v. Southern*, 117 U. S. 52 (1886). 5 HUGHES, FEDERAL PRACTISE, JURISDICTION AND PROCEDURE (1931) 223, § 3043.

<sup>79</sup>"Neither public corporations nor political subdivisions are clothed with that immunity from suit which belongs to the state alone by virtue of its sovereignty." *Hopkins v. Clemson Agricultural College*, 221 U. S. 636, 645 (1911); *Norris v. Montezuma Valley Irrig. Dist.*, 248 Fed. 369 (C. C. A. 8th 1918) (political subdivision subject to mandamus); *Tyler County v. Town*, 23 F. (2d) 371 (C. C. A. 5th 1928) (local governmental units subject to equity proceedings). See DOBIE, FEDERAL PROCEDURE (1928) 532, § 132.

<sup>80</sup>This is true, of course, of municipal bankruptcy legislation.

Ancient peoples apparently had a crude conception of the debtor release phase of the bankruptcy idea. The Israelites had fixed upon every seven years as a sabbatical year of release. "At the end of every seven years thou shalt make a release. And this is the manner of release: Every creditor that lendeth aught unto his neighbor shall release it. He shall not exact it of his neighbor or his brother; because it is called the Lord's release. Of a foreigner thou mayest exact it again; but that which is thine with thy brotherly hand shall release; save when there shall be no more poor among you." DEUT. 15. The Roman law had, in the time of Julius Caesar, repudiated the idea that laws pertaining to insolvent debtors should be regarded as criminal statutes when *Cessio Bonorum* provided that when an insolvent debtor had turned over his property for the benefit of his creditors in all good faith, he should not be liable either to capital punishment, imprisonment nor slavery, as had theretofore been his fate. See the CODE OF JUSTINIAN, *Dig.* 2, 4, 25, 48, 19, *Nov.* 4, 3. Of course, *Cessio Bonorum* was not a bankruptcy law inasmuch as its operation could not be invoked by creditors in the first instance. It more closely resembled a voluntary assignment for the benefit of creditors for it was purely a voluntary proceeding on the debtor's part. The first English Bankruptcy Act, 1542, 34 Hy. VIII was a criminal statute in effect, going

As the result of the recommendations of Charles Pinckney and John Rutledge the power "to establish uniform laws on the subject of bankruptcies" was incorporated into Article I as Clause 4 of Section 8 of the Federal Constitution.<sup>81</sup> Congress first legislated on the subject of bankruptcy in 1800<sup>82</sup> The Act, in its terms, was limited to five years and embraced bankers, brokers, underwriters, and factors, in addition to traders. It is interesting to note that no provision was made for voluntary proceedings or discharge of the debtor.<sup>83</sup> This Act was short-lived, and due to considerable dissatisfaction with its operation, was repealed in 1803.<sup>84</sup> Congress reentered the field in 1841. This statute, for the first time, allowed voluntary proceedings and its benefits were extended to all individuals,<sup>85</sup> it was repealed in 1843 after the statute fell upon evil days—the period of the most heated debate centering around the states rights controversy.<sup>86</sup> In 1867, Congress made a third attempt.<sup>87</sup> Under the terms of this Act, it was far too easy to be adjudged a bankrupt, but the multiplication of qualifications made it almost impossible to obtain a discharge. Attached to its administration was a decidedly vicious fee system which, in many instances, consumed the corpus of the fund.<sup>88</sup> More interesting than the Act itself is the Amendment of 1874,<sup>89</sup> wherein for the first time Congress, under its

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upon the premise that all bankruptcies are fraudulent. The next acts, 13 Eliz. 1570 and of 1 and 23 James I, in general simply amplified and made more definite the first statute. By Elizabeth's law bankruptcy was confined to merchants, brokers and traders, a limitation which, in its main features, was to continue in England and America until well into the nineteenth century. Until the reign of Anne there was no provision for discharging the bankrupt from his remaining debts. Even the right to new property acquired by the bankrupt was, under Elizabeth's statute, immediately vested in his creditors, old and new. In the English law of 1705, 4 Anne c. 17, the prominence of the criminal idea was abandoned and a discharge was granted to the bankrupt for the first time.

<sup>81</sup>WARREN, BANKRUPTCY IN UNITED STATES HISTORY (1935) 5. In the debates and writings contemporary with the Constitutional Convention only James Madison seems to have set down his ideas on the scope and meaning of the Bankruptcy Clause where he stressed the idea that the clause was to be regarded as intimately connected with the regulation of commerce, as designed to prevent frauds and to benefit the commercial class of creditors and debtors. See THE FEDERALIST (Lodge ed.) No. 42.

<sup>82</sup>2 STAT. 19.

<sup>83</sup>Apparently in this respect the colonial statutes had not adopted the rudimentary ideas on discharge found in 4 Anne c. 17 (1705).

<sup>84</sup>The reasons for repeal of the Act of 1800 usually assigned are: a) difficulty of travel to the distant and unpopular Federal Courts; b) small dividends paid to creditors, most of debtors being already in jail; c) Rich debtors used act to obtain discharge from debts. WARREN, BANKRUPTCY IN UNITED STATES HISTORY (1935) 19: "the fear of the people at the time that the Federal Government was drawing around their necks the cords of a strongly centralized and domineering government coupled with the uprisings at the time of the Alien Sedition laws brought about the repeal of the Bankruptcy Act of 1800 before its destined objectives were perceived." See 1 REMINGTON, BANKRUPTCY (4th ed. 1934) 5.

<sup>85</sup>5 STAT. 440.

<sup>86</sup>See WARREN, BANKRUPTCY IN UNITED STATES HISTORY (1935) 68-69.

<sup>87</sup>14 STAT. 517.

<sup>88</sup>See *In re Wells*, 114 Fed. 222 (D. C. Mo. 1902).

<sup>89</sup>18 STAT. 178.

power "to establish uniform laws on the subject of bankruptcies," introduced into our bankruptcy law a provision for composition agreements between debtor and creditor. Congress repealed the third Act in 1878.

In 1898 the present Bankruptcy Law<sup>90</sup> was enacted including within the scope of its operation as voluntary bankrupts "any person who owes debts except a corporation" and as "involuntary bankrupts" any natural person except a wage-earner or a person engaged chiefly in farming or in tillage of the soil, any unincorporated company, and any corporation engaged principally in manufacturing, trading, printing, publishing, mining or mercantile pursuits, owing debts to the amount of \$1000 or over. "Private bankers but not national banks or banks incorporated under state or territorial laws" could be adjudged involuntary bankrupts. By section A "a partnership during the continuation of the partnership business or after its dissolution and before the final settlement thereof may be adjudged a bankrupt."

In 1910, Congress excluded from the benefits of the Act of 1898 as amended (whether as voluntary or involuntary bankrupts) municipal, railroad, insurance, and banking corporations.<sup>91</sup> In 1932, building and loan associations were also denied the benefits of the Bankruptcy Act.<sup>92</sup> Apparently, railroad, insurance, and banking corporations had sought the benefits of the Act, but no case seems to have arisen in which a municipal corporation sought to avail itself of the privilege.

On an eventful day, March 3, 1933, Congress enacted Section 74 providing that "any person excepting a corporation may file a petition stating that he is insolvent or unable to meet his debts as they mature and that he desires to effect a composition or an extension of time to pay his debts."<sup>93</sup> The groundwork was thereby laid for Sections 75, 77, enacted contemporaneously with Section 74, and for Section 77B, soon to follow. Section 75, the Frazier-Lemke Act,<sup>94</sup> designed to offer agrarian relief with its ingenious scheme of taking the property of the debtor from the secured creditor and handing it back to the debtor instead of distributing it to the creditors as a class, was foreign to all hitherto conceived ideas of bankruptcy and composition. It died in the Supreme Court as violative of the Fifth Amendment.<sup>95</sup> The amended Act of 1934<sup>96</sup> cured the defect of the first Act in that, "while it

<sup>90</sup>30 STAT. 544 (1898), 11 U. S. C. A. § 1.

<sup>91</sup>36 STAT. 839 (1910).

<sup>92</sup>47 STAT. 47 (1932), 11 U. S. C. A. § 22 (1934).

<sup>93</sup>47 STAT. 1467 (1933), 11 U. S. C. A. § 202 (a) (1934).

<sup>94</sup>47 STAT. 1470 (1933), 11 U. S. C. A. § 203 (1934). For an historical survey of early composition laws indicating that there was English legislation as early as 1769 modeled after even earlier French legislation see Glenn, *Essentials of Bankruptcy: Prevention of Fraud, and Control of Debtor* (1937) 23 VA. L. REV. 373, 378-9.

<sup>95</sup>Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555 (1935).

<sup>96</sup>48 STAT. 1289, 11 U. S. C. A. § 203 (1934).

did affect the interest of the lienholders in many ways" it did not hand Blackacre back to the debtor.<sup>97</sup>

Came then Section 77 with its plan for "Reorganization of Railroads Engaged in Inter-State Commerce."<sup>98</sup> The historical jurist would tell us that the remedies which the section affords to railroads and the procedure regulating the same are frankly foreign to "bankruptcy," for nowhere can be found the slightest suggestion that under any circumstances, the railroad may be adjudicated a bankrupt. There were those who thought the Act could not withstand the test of constitutionality.<sup>99</sup> They had to learn that it could happen here.<sup>100</sup> Congress enacted Section 77B on June 7, 1934.<sup>101</sup> More novel devices were introduced with Section 77B to take care of all distressed corporations with the exception of municipal, insurance, and banking corporations, building and loan associations, and such railroads as came under Section 77. In Section 77B the Congress went a long step further by permitting the courts to take jurisdiction over corporations which are not insolvent in the present bankruptcy sense, and it authorized the adjustment of the rights of stockholders of such corporations.<sup>102</sup> Section 77B has been sustained innumerable times in the lower federal courts despite numerous assaults upon the section on various constitutional grounds.<sup>103</sup>

Thus it is seen that "bankruptcy" has been an ever-expanding concept, both as to the *form* of relief offered and as to the *classes of persons* (*natural and artificial*) relieved. In light of such a history, municipal debt readjustment would hardly be either an alarming or an unreasonable further expansion of the bankruptcy concept.

<sup>97</sup>Wright v. Vinton Branch of Mountain Trust Bank of Roanoke, 300 U. S. 440 (1937).

<sup>98</sup>47 STAT. 1474, 11 U. S. C. A. § 205 (1933).

<sup>99</sup>See Stebbins, *Constitutionality of the Recent Amendment to the Bankruptcy Law* (1933) 17 MARQ. L. REV. 161. Rodgers and Groom, *Reorganization of Railroad Corporations under Sec. 77* (1933) 33 COL. L. REV. 571; Lowenthal, *The Railroad Reorganization Act* (1933) 47 HARV. L. REV. 18.

<sup>100</sup>Continental Illinois National Bank and Trust Co. v. Chicago R. I. and P. Ry., 294 U. S. 648 (1935).

<sup>101</sup>48 STAT. 912, 11 U. S. C. A. § 207 (Supp. 1934).

<sup>102</sup>Weiner, *Corporate Reorganizations Section 77B* (1934) 34 COL. L. REV. 1173; Gerdes, *Constitutionality of Section 77B* (1935) 12 N. Y. U. L. Q. REV. 96; Garrison, *Power of Congress Over Corporate Reorganization* (1933) 19 VA. L. REV. 343; Swaine, *Federal Legislation for Corporate Reorganization* (1933) 19 A. B. A. J. 698. See *In re* 33 North Michigan Ave. Building Corp., 84 F. (2d) 936 (C. C. A. 7th 1936), *cert. denied*, *Rotfeld v. 333 North Michigan Ave. Bldg. Corp.* 57 Sup. Ct. 194 (1936); *Campbell v. Allegheny Corp.*, 75 F. (2d) 947 (C. C. A. 4th 1935), *cert. denied* 296 U. S. 581 (1935); *Grand Blvd. Investment Co. v. Straus*, 78 F. (2d) 180 (C. C. A. 8th 1935); *In re Pierce-Arrow Sales Corp.*, 10 Fed. Supp. 776 (W. D. N. Y. 1935).

<sup>103</sup>Continental Ins. Co. v. Louisiana Oil Refining Corp., 89 F. (2d) 333 (C. C. A. 5th 1937); *In re Prima Co.*, 88 F. (2d) 785 (C. C. A. 7th 1937); *Grand Boulevard Inv. Co. v. Strauss*, 78 F. (2d) 180 (C. C. A. 8th 1935); *Campbell v. Allegheny Corp.*, 75 F. (2d) 947 (C. C. A. 4th 1935). *cert. denied*, 296 U. S. 581 (1935).

## V

## CONGRESS TRIES AGAIN

Soon after the *Ashton decision*, the Subcommittee on Bankruptcy and Reorganization of the House Judiciary Committee undertook the admittedly difficult task of drafting a bill which would accomplish the twofold purpose of retaining the desired results of the recently declared unconstitutional Sumners-Wilcox Municipal Debt Readjustment Act and, at the same time, one "that would pass muster over there in the big white building."<sup>104</sup> What are the carefully worded legislative differences between the new Act and the statute involved in the *Ashton* case and what are the possible effects of these differences in determining the constitutionality of a Municipal Debt Readjustment Plan?

In the first place, Section 80 was limited in its scope to "political subdivisions" and hence any district that does not fall into this class was without the statute, and if it does fall within this class it must be denied relief under the decision in the *Ashton* case.<sup>105</sup> The new Act does not mention "political subdivisions" but classifies the various types of districts into six classes.<sup>106</sup> It will now be possible for the courts to pass upon them as distinct groups. Subsection 6 seems to be the only group that would necessarily fall within the definition of "political subdivision," the other groups in many states not being considered as such.<sup>107</sup> *A fortiori*, the "saving clause" in the second Act will play an important role in contrast to its part in the first Act where its

<sup>104</sup>Hearings before Subcommittee on Bankruptcy of the House Committee on the Judiciary on H. R. 5403, 75th Cong., 1st Sess. (1937) 101.

<sup>105</sup>*In re Imperial Irrigation District*, 37 F. (2d) 355 (C. C. A. 9th 1936).

<sup>106</sup>"(1) Drainage, drainage and levee, levee, levee and drainage, reclamation, water irrigation, or other similar districts, commonly designated as agricultural improvement districts or local improvement districts, organized or created for the purpose of constructing, improving, maintaining, and operating certain improvements or projects devoted chiefly to the improvement of lands therein for agricultural purposes; or (2) local improvement districts such as sewer, paving, sanitary, or other similar districts, organized or created for the purposes designated by their respective names; or (3) local improvement districts such as road, highway, or other similar districts, organized or created for the purpose of grading, paving or otherwise improving public streets, roads, or highways; or (4) public-school districts or public-school authorities organized or created for the purpose of constructing, maintaining, and operating public schools or public-school facilities; or (5) local improvement districts such as port navigation, or other similar districts, organized or created for the purpose of constructing, improving, maintaining and operating ports and port facilities; or (6) any city, town, village, borough, township, or other municipality." 50 STAT. 654, 11 U. S. C. A. § 401 (1937).

<sup>107</sup>*Holbrook Irr. Dist. v. First State Bank of Cheraw*, 84 Colo. 157, 268 Pac. 523 (1928) (irrigation district); *Colorado Investment and Realty Co. v. Riverview Drainage Dist.*, 83 Colo. 468, 266 Pac. 501 (1928) (drainage district); *Davis v. Commissioners of Sewage of Louisville*, 13 F. Supp. 672 (N. D. Ky. 1936) (sewers and drains). *Contra*: *Mokovitch v. Independent School District*, 177 Minn. 446, 225 N. W. 292 (1929) (school district); *Martin v. Dade Much Land Co.*, 95 Fla. 530, 116 So. 449 (1928) (drainage district); *Northrup v. Jackson*, 273 Mich. 20, 262 N. W. 641 (1935) (sewerage district).

insertion was mere surplusage, as the Sumners-Wilcox Act applied to only one group, "political subdivisions."<sup>108</sup> A further attempt to get away from the deadliness of the term "political subdivision" is evidenced by the omission of the term "county" from the supposedly curative second Act; the drafters were aware of the necessity of this unit as an arm of the sovereign state.<sup>109</sup> Secondly, the new Act takes pains to make it clear that effect is to be given only to a voluntary composition agreement between majority creditors and the debtor district. This, it was believed, would dispel the fear of "interference".<sup>110</sup> It is distinctly stated that only by consent of the insolvent may any proceedings be instituted, and in no case can the defaulting district be brought into court against its will or have any plan but its own confirmed.<sup>111</sup> Thirdly, the procedure under the second Act is virtually the same as that of the first. The only procedural change that might have any bearing in determining the validity of Section 81 is the requirement that owners "of not less than fifty percent in amount of the securities affected by the plan have accepted it in writing" prior to the petition, as against the provision in the now invalidated Sumners-Wilcox Act that "not less than thirty percent in amount of securities affected by the plan in the case of drainage, irrigation and reclamation districts" shall have agreed in writing.<sup>112</sup> The new Act nowhere in its provisions has circumvented the holding in the *Ashton* case that the state enabling statutes are, in effect, impairments of existing contracts and, therefore, the exercise of a power forbidden to the states.<sup>113</sup>

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<sup>108</sup>"A county is a political subdivision par excellence. State governments would continue to function if there were no municipalities or taxing districts, the former are mere creations of the State, and the latter are generally representative of the land owners, but a county undoubtedly is a part of the sovereign government of the State. No State, as we know it, could function without a county (or parish). The State looks to the county to provide it with a jury, with a Sheriff, with a court house, with a clerk of the courts, with a tax collector. These county officers are also state officers and they perform governmental functions having to do with the State." Black, *Has Congress Circumvented the Ashton Decision?* (1937) 23 A. B. A. J. 683, 684.

<sup>109</sup>"If obligations of states or other political subdivisions may be subjected to the interference here attempted, they are no longer free to manage their own affairs, the will of Congress prevails over them." *Ashton v. Cameron County Water Imp. District No. 1*, 298 U. S. 513, 531 (1936) (italics supplied).

<sup>110</sup>50 STAT. 655, 11 U. S. C. A. § 403 (1937).

<sup>111</sup>It is interesting to note the comment of Representative Wilcox of Florida, the staunchest advocate of municipal reorganization. "I am confident that if this act is presented to the Supreme Court in a case in which the vast majority of creditors have agreed to a simple plan of adjustment, so that they can understand that it is not designed to interfere with any governmental function, that they will qualify and distinguish that first decision [*Ashton* case] and uphold this act, even as to a subdivision of a State government." *Hearings before Subcommittee on Bankruptcy of the House Committee on the Judiciary on H. R. 5403*, 75th Cong., 1st Sess. (1937) 145.

<sup>112</sup>50 STAT. 654, 11 U. S. C. A. §§ 401-404 (Supp. 1937).

<sup>113</sup>U. S. CONST. Art. I, § 10.

## VI

## THE NEW ACT MEETS ITS FIRST TEST.

In the first decision involving the new Municipal Bankruptcy Act<sup>114</sup> it was, like its predecessor, declared unconstitutional.<sup>115</sup> The court ruled that an irrigation district was a political subdivision and, inasmuch as the Supreme Court had outlawed all units falling within this category from participating under the Debt Readjustment Plan,<sup>116</sup> found itself bound to follow this precedent set by the *Ashton* case. Two appeals, one by the United States in support of the constitutionality of the act, and one by the Irrigation District on behalf of its right to petition in accordance with the provisions of the Act, were immediately filed with the Supreme Court.<sup>117</sup> The Court granted the appeals on February 28, 1938; the cases will be argued together sometime in April, 1938.

## VII

## HOW DIFFERENT IS THE NEW ACT FROM THE OLD?

Assuming that the *Ashton* case will not be reversed, what is the practical effect of the new Act? The federal courts in applying Section 81 will have to determine the status of each agency which seeks relief. Is it governmental or proprietary in nature? The answer will depend upon the state statute as construed by the courts of that state,<sup>118</sup> and will determine the particular petitioning agency's right to rely on the Act. The opinions in the state courts are in irresolvable conflict as to whether their agencies exercise purely governmental powers, solely proprietary functions, or a combination of the two.<sup>119</sup>

This difficulty in applying the new Act may well be insurmountable. In the case of an agency exercising both governmental and proprietary functions,

<sup>114</sup>*In re Lindsay-Strathmore Irrig. Dist.*, 21 Fed. Supp. 129 (S. D. Cal. 1937).

<sup>115</sup>*Ashton v. Cameron County Water Impr. Dist. No. 1*, 298 U. S. 513 (1936) (holding the First Municipal Debt Reorganization Act unconstitutional by a 5-4 decision).

<sup>116</sup>It is interesting to note the concluding paragraph of District Judge Yankwich's decision. "As a student, exercising private judgment, I agree with the conclusion of the dissenters [in the *Ashton* Case] that immunity from interference through federal bankruptcy laws, even if applicable to states, should not be extended to state instrumentalities, whether they be municipal, quasi-municipal or public corporations. However, as a judge of a lower court, I cannot exercise private judgment, but must follow the opinion of the majority, which, as I read it, extends the immunity to all governmental agencies created by a state for the performance of public functions." 21 Fed. Supp. 129, 135 (S. D. Calif. 1937).

<sup>117</sup>*United States v. Bekins*; *Lindsay-Strathmore Irrigation District v. Bekins*, 5 U. S. L. W. 748 (1938).

<sup>118</sup>The settled decisions of a state's highest court as to the extent and character of the powers which its political and municipal organizations possess are binding upon the federal courts. *Hicklin v. Coney*, 290 U. S. 169 (1933); *Morehead v. New York*, 298 U. S. 587 (1936).

<sup>119</sup>See, *Legislation* (1937) 25 GEO. L. J. 98, 102-105.

obligations incurred in the exercise of governmental functions must be segregated from obligations incurred in the exercise of proprietary functions. Even though various units may perform some proprietary acts, they will necessarily be denied relief altogether since they were dubbed "political subdivisions" by their respective state courts. Even a proprietary agency may, as an incident to its proprietary functions, perform some governmental duties. It will be almost impossible to readjust the interrelated financial transactions of these dual capacity agencies with any apparent success without encroaching upon the sovereignty of the state. The "saving clause"<sup>120</sup> of the new Act may fall short of its avowed purpose if the Court should find that one section of the Act cannot stand without the other.<sup>121</sup> The new legislation will thus fall heir to the same infirmity which paralyzed its predecessor in the courts.

The fundamental weaknesses of the Sumners-Wilcox Act as depicted in the *Ashton* case, impairment of contracts by the states, and invasion of state sovereignty, have not been cured in the new Municipal Debt Readjustment Act insofar as it is applied to political subdivisions of a state. However, it is submitted that (A) upon a re-examination of the constitutional points involved, (B) the fact that the court is interpreting a new act and, (C) the possibility of a "liberal" interpretation by a court numbering only three of the members who constituted the majority when the *Ashton* case was handed down, the sweeping decision of the *Ashton* case will be either narrowed in scope or reversed altogether.

## VIII

### AFTER READJUSTMENT — WHAT?

Admitting the economic need for municipal debt readjustment and admitting the possibility of a reversal of the *Ashton* decision, it must be apparent that readjustment with nothing more is inadequate as a legal method of accomplishing the desired objectives of economic and social engineering in the field of credit as it pertains to municipalities and other units of local government. Indeed, unless the period of debt readjustment is followed by workable state plans for control of local credit, we may find ourselves in more serious predicaments than if we keep our hands off the problem and forget about legislation authorizing municipal debt readjustments.

<sup>120</sup> . . . If any provision of this chapter, or the application thereof to any such taxing agency or district or class thereof or to any circumstance, is held invalid, the remainder of the chapter, or the application of such provision to any other or different circumstances, shall not be affected by such holding." 50 STAT. 654, 11 U. S. C. A. § 401 (Supp. 1937).

<sup>121</sup> [the saving clause] provides a rule of construction which may sometimes aid in determining that [legislative] intent. But it is an aid merely; not an inexorable command." *Dorchy v. Kansas*, 264 U. S. 286, 290 (1924); *Domling, Dissection of Statutes* (1932) 18 A. B. A. J. 298.

It must be apparent that confirmation of a plan of readjustment by a court of bankruptcy can offer no assurance that the indebted taxing district would not, upon the termination of the plan's operation, repeat the practices that brought it to the brink of financial ruin. True, a readjustment plan may provide for strict supervision of municipal finances for some period following discharge, but it cannot set up permanent machinery designed to insure the continued availability of low-cost borrowing or avoidance of future defaults. Existing statutory provisions for the administrative supervision of local credit, whether in the guise of administrative supervision of local indebtedness or administrative supervision of local tax bases and of expenditures or administrative supervision of general fiscal management, are woefully inadequate.<sup>122</sup>

The diversity of conditions, economic, social, and political, renders it impossible to suggest any single workable system of administrative supervision of local credit suitable for all states. But, this difficulty does not in any way diminish the need for each state to determine what it can do to insure that the defaulting municipality shall not return to improper and unsound financial practices and that steps should be taken to place the municipality's credit structure upon a sound basis. With respect to local governmental units other than true municipal corporations (cities), the objections, particularly the legal objections, would seem to be less appalling, at least with regard to such units of local government as can be labeled "mere agents of the state" or "political subdivisions". With respect to "true municipal corporations", the problem presents a challenge to legislative and judicial ingenuity, but it is, none the less, a challenge which should be met.

There are, of course, certain "practical" objections to state administrative supervision of local credit—such as the argument that for local political influence and incompetence would be substituted state political influence and incompetence. Of course, public office, whether appointive or elective, can never be wholly free from politics and incompetence, yet it would seem that state appointment would afford adequate opportunity to obtain the services of financial administrators quite capable and, very likely, less partisan.<sup>123</sup> It may be urged that state administrative bodies lack contact with purely local conditions. To this it can be answered that these allegedly "purely local" conditions are scarcely "purely local" since the credit standing of one local unit invariably profoundly affects the credit standing of all local

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<sup>122</sup>See Comment, *Administration of Municipal Credit* (1934) 43 YALE L. J. 924, 982-995; Sauer, *An Experiment in Municipal Financing: Factual Background of Cameron County Improvement District No. One* (1936) 5 GEO. WASH. L. REV. 1.

<sup>123</sup>See Leslie, *State Control of Local Expenditure—the Indiana Plan* (1932) 49 STONE AND WEBSTER J. 28, wherein it is suggested that in Indiana the members of the administrative bodies enjoy a reputation for strict non-partisanship and of freedom from political interference.

communities within the state and even the credit standing of the state itself.<sup>124</sup> But even if unfamiliarity with local conditions be a meritorious argument, a scheme of departmental organization with head and subordinate agencies could keep in close touch with local conditions.

With regard to legal objections, it is unlikely that the validity of delegating the necessary legislative functions to administrative agencies and conferring upon them such executive and judicial powers as may be necessary can be seriously challenged. The courts seem to have brought the doctrine of non-delegability of powers to the basic requirement that the powers delegated be such as the legislature could itself exercise or confer and that adequate standards be set up to guide administrative officials in the application of general policies to particular facts.<sup>125</sup> When all is said and done, it would seem that legislative declarations of policies as limiting its agencies' discretion may be very broad<sup>126</sup> and often the test of valid delegation comes down to the need for effective regulation.<sup>127</sup> All in all, the courts have had little difficulty in upholding administrative supervision of local credit.<sup>128</sup>

Admittedly, the home rule guaranties found in the constitutions of many states<sup>129</sup> may interpose barriers to the enactment of legislation setting up centralized state administrative control over local finances. It must be remembered, however, that these state guaranties of non-intervention are either expressly or impliedly restricted to purely "municipal affairs",<sup>130</sup> and

<sup>124</sup>See (Jan. 2, 1935) THE BOND BUYER 5.

<sup>125</sup>See BURDICK, LAW OF THE AMERICAN CONSTITUTION (1923) 60; FREUND, AMERICAN ADMINISTRATIVE LAW (1923) 118-24; Duff and Whiteside, *Delegata Potestas Non Potest Delegari: A Maxim of American Constitutional Law* (1928) 14 CORNELL L. Q. 168; Cheadle, *The Delegation of Legislative Functions* (1918) 27 YALE L. J. 892; Berle, *The Expansion of American Administrative Law* (1917) 30 HARV. L. REV. 430.

<sup>126</sup>See BURDICK, *op. cit. supra*, note 125, at 153. See also the directions with regard to the powers granted to the Interstate Commerce Commission discussed in the Inter-mountain Rate Cases, 234 U. S. 476 (1914).

<sup>127</sup>Duff and Whiteside, cited *supra* note 125, at 196; note (1929) 27 MICH. L. REV. 558-559.

<sup>128</sup>*Sparkman v. County Budget Commission*, 103 Fla. 242, 137 So. 809 (1931) (delegation to county Budget Commission of power to approve local budgets and make revision on basis of wisdom and expediency upheld); *Zoercher v. Agler*, 202 Ind. 214, 172 N. E. 186 (1930) (delegation to State Tax Commission of power to review legality of local tax levies upheld); *Van Hess v. Board of Commissioners of St. Joseph County*, 190 Ind. 347, 129 N. E. 305 (1921) (delegation to State Board of Tax Commissioners of power to review local debt incurrence, as to legality and policy sustained.) Accord: *State ex rel. Freeland v. Evans*, 197 Ind. 656, 150 N. E. 788 (1926); *State ex rel. Board of Commissioners of Kosciusko and Fulton Counties v. Leonard*, 198 Ind. 356, 153 N. E. 777 (1926).

<sup>129</sup>ARIZ. CONST. Art. XIII; CAL. CONST. Art. XI, §§ 8, 8½; COLO. CONST. Art. XX, § 6; MD. CONST. Art. XI-A; MICH. CONST. Art. VIII, §§ 20, 21; MINN. CONST. Art. IV, § 36; MO. CONST. Art. IX, § 16; NEB. CONST. Art. XI; N. Y. CONST. Art. XII, §§ 2, 3; OHIO. CONST. Art. XVIII, §§ 2, 3, 7, 13; OKLA. CONST. Art. XVIII, § 3; ORE. CONST. Art. XI, § 2; PA. CONST. Art. XV, § 1; TEX. CONST. Art. XI, § 5; UTAH CONST. Art. XI, § 5; WASH. CONST. Art. XI, § 10; WIS. CONST. Art. XI, § 3.

<sup>130</sup>MCGOLDRICK, THE LAW AND PRACTICE OF MUNICIPAL HOME RULE, 1916-1930 (1933); MCBAIN, THE LAW AND PRACTICE OF MUNICIPAL HOME RULE, 673-84 (1916).

in matters of state-wide interest, state regulation is paramount. It is demonstrable that local financial standing, affecting as it does the credit of both other municipalities and the state, as well as the welfare of investors, some of whom may be quasi-public institutions, is of general state concern and so appropriately within the purview of state regulation.<sup>131</sup>

But state constitutions differ in the nature and extent of the home rule which they grant to municipalities. Some constitutions reserve to the legislatures the power to restrict municipal indebtedness and to limit taxation and assessment.<sup>132</sup> At least one state constitution provides that the legislature shall supervise municipal deposits.<sup>133</sup> In these states the difficulties incident to establishment of state administrative control over local finance are minimized.

In other home rule states, the constitutional provisions constitute formidable hurdles. In Colorado, home-rule municipalities are given exclusive control over issuance, refunding, and liquidation of municipal obligations, the assessment of local property, as well as the levy and collection of taxes for municipal purposes and over the creation, duties and qualifications of municipal offices.<sup>134</sup> In some other states, there are constitutional guaranties to preclude the performance of local functions by any others than local officers.<sup>135</sup> Perhaps such guaranties would preclude the establishment of effective devices for administrative financial control. Some success in circumventing constitutional guaranties of this latter type has been achieved. The New York<sup>136</sup> and Wisconsin constitutions<sup>137</sup> provide for election or appointment by the authorities of counties, towns, and villages of officers performing duties exercised by such political unit at the time of the adoption of the state constitution. Despite provisions of this kind, the courts have found a way to permit some degree of centralized financial control on the theory that, when the state constitution was adopted, the local governments failed to vest any official with a veto power over financial plans.<sup>138</sup> In the case of offices temporary in character, an exceptive doctrine has grown up

<sup>131</sup>See Legislation (1933) 46 HARV. L. REV. 1317, 1322, 1323; Tooke, *Construction of Municipal Powers* (1933) 7 TEMP. L. Q. 267, 274. For cases recognizing state-wide interest in local credit in case of indebtedness regulation, see *Tulsa v. Dabney*, 133 Okla. 54, 270 Pac. 1112 (1928); *Van Hess v. Board of Commissioners of St. Joseph County*, 190 Ind. 347, 129 N. E. 305 (1921).

<sup>132</sup>ARIZ. CONST. Art. IX, § 8; MICH. CONST. Art. VIII, § 20; MO. CONST. Art. X, § 1, 2; NEB. CONST. Art. XI, § 4; N. Y. CONST. Art. XII, § 1; OHIO CONST. Art. XVIII, § 13; OKLA. CONST. Art. X, § 20; ORE. CONST. Art. XI, § 5; TEX. CONST. Art. III, § 52.

<sup>133</sup>CAL. CONST. Art. XI, § 16½.

<sup>134</sup>COLO. CONST. Art. XX, § 6 (a), (e), (g).

<sup>135</sup>LEGIS. (1933) 46 HARV. L. REV. 1917, 1323 *et. seq.*

<sup>136</sup>N. Y. CONST. Art. X, § 2.

<sup>137</sup>WIS. CONST. Art. XIII, § 9.

<sup>138</sup>*Cf. People v. Tax Commissioners*, 174 N. Y. 417, 67 N. E. 69 (1903); *People v. Bradley*, 207 N. Y. 592, 101 N. E. 766 (1913); *Matter of Morgan v. Furey*, 186 N. Y. 202, 78 N. E. 869 (1906); *State v. Frear*, 148 Wis. 456, 134 N. W. 673 (1913).

based upon the argument that the state-appointed officer is non-local and so falls without the scope of the constitutional restriction.<sup>139</sup> Under this doctrine, it is possible to sustain the validity of municipal receiverships instituted because of default and at least temporary administrative supervision. So, too, statutes permitting the local taxing process to be carried on by other than the usual officers in their absence or their non-action come within this exceptive doctrine.<sup>140</sup> Should the legislature get serious about the whole thing, it is within the realm of possibility that new units together with new officials may be substituted in individual instances.<sup>141</sup>

A number of state constitutions provide that the necessary officers of specified classes of municipalities shall be elected by the voters of those municipalities.<sup>142</sup> Under these constitutions, the temporary character of the public interest in state administrative supervision will very likely render such supervision valid. At least seven constitutions forbid the state legislature to delegate to any special commission the power to supervise municipal property or funds or to levy taxes or perform any municipal function whatever.<sup>143</sup> Taken literally, one might suppose these provisions would prevent any and all commission control of local finance. It is said that these provisions were originally adopted to prevent special discriminatory treatment of particular municipalities.<sup>144</sup> Accordingly, it has been argued that such provisions were not meant to apply to state commissions created for the avowed purpose of permanently supervising the financial affairs of all municipalities.<sup>145</sup> It should be noted that often the constitutionally prohibited class is "special commissions." In at least one state, the courts have interpreted the prohibited class of "special commissions" as excluding permanent commissions with regularly defined duties.<sup>146</sup> Of course, if one person is exercising the

<sup>139</sup>People v. Board of Supervisors, 170 N. Y. 105, 62 N. E. 1092 (1902); People v. McDonald, 69 N. Y. 362 (1877); Strange v. Oconto Land Co., 136 Wis. 516, 117 N. W. 1023 (1908); MCBAIN, THE LAW AND PRACTICE OF MUNICIPAL HOME RULE (1916) 36.

<sup>140</sup>Strange v. Oconto Land Co., 136 Wis. 516, 117 N. W. 1023 (1908). Cf. 1 McQUILLIN, MUNICIPAL CORPORATIONS (1931) 510, § 187.

<sup>141</sup>MCBAIN, *op. cit. supra* note 139, 46, 47.

<sup>142</sup>CAL. CONST. ART. II, § 234; KY. CONST. § 160; LA. CONST. ART. XIV, § 22; NEB. CONST. ART. IX, § 4; OHIO CONST. ART. X, § 1, ART. II, § 27; PA. CONST. ART. XIV, §§ 1, 2; VA. CONST. § 120; WASH. CONST. AMEND. 12.

<sup>143</sup>CAL. CONST. ART. XI, § 13; COLO. CONST. ART. V, § 35; MONT. CONST. ART. V, § 36; PA. CONST. ART. III, § 20; S. D. CONST. ART. III, § 26; UTAH CONST. ART. VI, § 29; WYO. CONST. ART. III, § 37.

<sup>144</sup>MCBAIN, THE LAW AND PRACTICE OF MUNICIPAL HOME RULE (1916) 46, 47.

<sup>145</sup>Public Service Commission v. City of Helena, 52 Mont. 527, 539, 159 Pac. 24, 27 (1916). But see Logan City v. Public Utilities Commission, 72 Utah 536, 271 Pac. 961 (1928); People v. Loveland, 76 Colo. 188, 230 Pac. 399 (1924).

<sup>146</sup>City of Denver v. Iliff, 38 Col. 357, 89 Pac. 823 (1906); City of Denver v. Landover, 33 Colo. 104, 80 Pac. 117 (1905); *In re* Fine and Excise Commission, 19 Colo. 482, 36 Pac. 234 (1894); *In re* Senate Bill, 12 Colo. 188, 21 Pac. 481 (1889).

administrative supervision he hardly falls under the prohibition directed against commissions.<sup>147</sup>

Finally, several states have constitutional provisions forbidding the state legislature to impose taxes for municipal purposes.<sup>148</sup> This provision has been held to preclude administrative control over local budgets and tax levies beyond the determination of their legality.<sup>149</sup> Just how far this latter type of provision prevents centralized administrative control is difficult to determine. On the theory that the state has a general interest in the financial stability of its subdivisions inasmuch as their condition vitally affects the state revenue system, the Washington court held that this type of constitutional provision would prevent a State Tax Commission from reassessing property for local taxation purposes, but not from reviewing local tax assessments<sup>150</sup> even though review, like reassessment, in the opinions of some is tantamount to the imposition of local taxes.

Admittedly, these several types of home rule provisions are no small obstacles in the path of the establishment of effective administrative supervision of local credit. But it should be remembered that in virtually every instance the home rule guaranties resulted from "spoils legislation" by means of which the state political machines mulcted the local units.<sup>151</sup> The proposed administrative supervision of local finance has as its avowed purpose the conservation and not the spoliation of the resources of the state's units of local government. And so it may be supposed that a court, cognizant of the change in legislative motive, might be influenced strongly in its final conclusion.<sup>152</sup> Perhaps, in the interest of the establishment of a central administrative supervision, having for its purpose the correction of local fiscal mismanagement and the better maintenance of municipal credit, the courts might be willing to minimize the application of some of the constitutional restrictions to a central administrative supervision. They might be, at times, quick to take advantage of a legal circumvention of a given home rule restriction where the legislature calls attention to pressing economic, social, and political needs for centralized control. Perhaps the courts might even evade certain prescribed restrictions against the interference of state officials or commissions in local affairs and against imposition of local taxes by the state on the ground that such intervention is directed toward objects not purely municipal but state-wide in their import. All these are possibilities. Perhaps

<sup>147</sup>Kraus v. Philadelphia, 265 Pa. 425, 109 Atl. 226 (1919).

<sup>148</sup>CAL. CONST. Art. XI, § 12; COLO. CONST. Art. X, § 70; OKLA. CONST. Art. X, § 20; WASH. CONST. Art. XI, § 12.

<sup>149</sup>City of Ardmore v. Excise Board, 155 Okla. 126, 8 P. (2d.) 2 (1932).

<sup>150</sup>State *ex rel.* King County v. Tax Commission, 174 Wash. 668, 26 P. (2d) 80 (1933).

<sup>151</sup>MCBAIN, THE LAW AND PRACTICE OF MUNICIPAL HOME RULE (1916) 5-12; LANCASTER, STATE SUPERVISION OF MUNICIPAL INDEBTEDNESS (1923) 103-104.

<sup>152</sup>But see, Perkins v. Philadelphia, 156 Pa. 539, 27 Atl. 356 ((1893).

they are little more. Perhaps the courts ought to feel constrained to give "literal" effect to specific constitutional provisions. Too often we lose sight of the fact that the twilight zone between "literal" and "substantial" is often an area, the soil content of which is "opinion."

One must remember that, whatever the difficulties in the way, preservation of municipal credit is of great social and economic importance. Granting the importance of the problem, state constitutions may and ought to be amended to permit of administrative supervision of local credit and fiscal affairs. After all, no such difficulties as attach to the amendment of the Federal Constitution will have to be hurdled in amending state constitutions.