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REVENUE BOND REMEDIES

JOHN PERSHING

I.

In private corporate financing, a corporate bond is ordinarily the corporation's unconditional written promise, over its authorized signature and under its seal, to pay a stated sum of money at maturity, and pending maturity, to pay interest thereon periodically. But a private corporation may issue its income bonds, differing from its ordinary debenture (unsecured) bonds in that the promise to pay is not absolute, but contingent upon the corporation's earning a net income sufficient for payment. There is no standard form of income bond. Like other contracts, it may express whatever agreement the parties wish, subject to statutory requirements.

So in public corporate financing, a municipal bond is ordinarily the unconditional promise of the municipal corporation to pay a stated sum of money with interest, usually accompanied by a pledge of the full faith and taxing power of the municipality. But a municipal corporation may issue income bonds and fund income anticipated from a revenue-producing project by borrowing the present value of a fixed number of years' anticipation thereof, to be repaid with interest only out of the revenues anticipated, under contractual terms which deny a lien upon any assets of the municipality other than the special fund derived from revenues pledged, when, as, and if realized.

From the middle of the nineteenth century until approximately seventy-five years thereafter, money required by municipal corporations for capital investments was secured by the issuance and sale of municipal bonds payable in the exercise of the taxing power.¹ The law as to issuance of municipal bonds payable from taxation was the growth of substantially the first twenty-five years of this period. Simultaneously there developed a strong body of remedial case law in which the holders of such bonds could place reliance, and to which the holders of tax obligations yet unissued could look as a distinct element in the character of the security.²

By contrast, the municipal revenue bond payable solely from income occupies a situation unique at the present time. The majority of decisions

¹CLARK, *THE INTERNAL DEBTS OF THE UNITED STATES* (1931) table 71, p. 258; STUDENSKY, *PUBLIC BORROWING* (1930) table II, p. 13.

²DILLON, *MUNICIPAL BONDS*, Part I, §3 (1876): "The Supreme Court of the United States has upheld the rights of the holders of municipal securities with a strong hand, and has set a face of flint against repudiation, even when made on legal grounds deemed solid by the state courts, by municipalities which had been deceived and defrauded. That such securities have any general value left is largely due to the course of adjudication in respect thereto by the Supreme Court, and the reliance which is felt by the public that it will stand firmly by the doctrines it has so frequently asserted."

pertaining to revenue bonds deal, not with enforcement and bondholders' remedies, but rather with the power to issue.³ The history of municipal revenue bonds to the present time is concerned entirely with the effort to meet the demands of social necessity, to avoid the burdens of the bond payable from taxation, and at the same time to regard wise restrictions and limitations upon the power to incur indebtedness payment of which would throw a heavy burden upon tax-paying posterity. Over a period of forty years, the courts have been concerned primarily with the efforts to distinguish the revenue bond from the "debt" incurred by the issuance of a bond payable from taxation.⁴ The need to sustain the power to issue has been paramount. As a result, we find that the cases on municipal revenue bonds have not developed, as with municipal tax obligations, a body of remedial law upon which the holders of revenue obligations can place their reliance. The remedial law pertaining to revenue bonds is still distinctly in the constructive cycle. It is a field in which the courts are still at liberty to enunciate new and guiding principles.⁵

The municipal revenue bond has been the means of capitalizing the income earned by municipal projects. It has been the means of meeting urgent necessity for capital investment otherwise barred by legal or practical limitations upon the power to incur debt evidenced by tax bonds.⁶ The increased volume of municipal bonds payable from taxation has rendered operative

³See Foley, E. H., Jr., *Some Recent Developments in the Law Relating to Municipal Financing of Public Works* (1935) 4 *FORDHAM L. REV.* 13, for an excellent discussion of municipal revenue bond problems and for a complete list of cases involving such bonds. An analysis of these cases will reveal the absence of expressions on the subject of remedial law. In the main, they deal with suits to enjoin the issuance of alleged evidences of indebtedness, writs of mandamus to compel state officials to seal, execute, register or approve the bonds prior to issuance, taxpayers' interventions in validation proceedings, writs of prohibition, quo warranto proceedings, proceedings under declaratory judgment laws, and requests of the Governor for opinions of justices.

⁴*Winston v. Spokane*, 12 Wash. 524, 41 Pac. 888 (1895), is cited as the earliest decision sustaining the power to issue a municipal revenue bond payable from a special fund, in this case created from receipts of a waterworks system. The general question was before the New York courts in 1852 in *Newell v. People*, 7 N. Y. 9, although this case did not involve the question of the power of the municipality to pledge the revenue derived from a municipally owned utility. See *Kelly v. Merry*, 262 N. Y. 151, 186 N. E. 425 (1933).

⁵"We are of course at liberty to adopt any one of the rules stated, or we may formulate a rule of our own if none of those approved by text-writers and other courts appears to us sound, or we may, if we so choose, reject the majority rule and adopt the minority rule." *Board of Regents v. Sullivan*, 42 P. (2d) 619, 625 (Ariz. 1935).

⁶"We do not see why we should not give this language its natural meaning, or construe the act as creating a greater obligation, moral or otherwise, than it purports to create, when the terms thereof are clearly known before the proposed loan is made." *Arnold v. Bond*, 47 Wyo. 236, 251, 34 P. (2d) 28, 32 (1934).

⁷Comment (1934) 43 *YALE L. J.* 924, at 953.

constitutional and statutory limitations upon their issuance,⁷ and thus necessitated resort to revenue bonds.

An appreciation of the merits and defects of the remedial law upon which the holders of tax bonds rely and of the underlying differences between municipal tax obligations and municipal revenue obligations, is an appreciation of the problems yet to be solved in developing the remedial law of municipal revenue bonds.

Holders of municipal obligations which are payable in the exercise of the taxing power are possessed of well-understood⁸ and long-defined remedies.⁹ As early as 1867, the United States Supreme Court held that the proper mode of enforcing the duty of levying and collecting taxes was by mandamus, not by bill in equity.¹⁰ The law in existence at the time of incurring the debt payable from taxation enters into and becomes a part of the bondholder's contract, and from the standpoint of remedy is the ministerial duty to levy and collect taxes.^{10a}

When municipal revenue bonds are issued, provisions of the constitution and statutory law in force when they are issued become part of the bondholder's contract in all respects, in the same manner as the statutory law becomes a part of the contract evidenced by a municipal tax obligation.^{10b} But the extremely important difference is that the background of statutory law against which a municipal revenue bond may be issued, if in existence, is of infinite variety. The general uniformity of well-understood theory at the basis of constitutional and statutory provisions requiring the levy of a tax for the payment of municipal tax obligations is wholly lacking in the case of municipal revenue bonds.

Municipal revenue bonds may be issued in the absence of express statutory authority therefor.¹¹ From the standpoint of future remedy, the holder

⁷(1934) 23 NAT. MUNIC. REV. 309; (1934) 43 YALE L. J. 924, at 949.

⁸Fordham, *Methods of Enforcing Satisfaction of Obligations of Public Corporations* (1933) 33 COL. L. REV. 28. Comment (1934) 43 Yale L. J. 924, at 962.

⁹*City of Galena v. Amy*, 5 Wall. 705 (U. S. 1866); *City of Little Rock v. United States*, 103 Fed. 418 (C. C. A. 8th, 1900); *Hammond v. Place*, 116 Mich. 628, 74 N. W. 1002 (1898); *Wolff v. New Orleans*, 103 U. S. 358 (1880); *Seibert v. Lewis*, 122 U. S. 284, 7 Sup. Ct. 1190 (1886). Statutory restriction on mandamus held unconstitutional in *State ex rel. Buckwalter v. City of Lakeland*, 112 Fla. 200, 150 So. 508 (1933). See also *City of Victor v. Halstead*, 84 Colo. 450, 271 Pac. 185 (1928).

¹⁰*Walkley v. City of Muscatine*, 6 Wall. 481 (U. S. 1867). The remedy of mandamus after default is not always adequate and many times of little practical value. Where taxing structures have become complicated and operation and maintenance expenses of government high, the historic remedy of mandamus is of little benefit to the creditor where the only asset of the debtor, its taxing power, is still under the control of the debtor. See editorial, *Legal Problems of Debt Adjustments* (1935) 8 FLA. MUNIC. REC., no. 4.

^{10a}*Von Hoffman v. City of Quincy*, 4 Wall. 535, 544 (U. S. 1866).

^{10b}*Brewer v. City of Point Pleasant*, 114 W. Va. 572, 172 S. E. 717 (1934).

¹¹"The statute has conferred the power to purchase, lease, and construct waterworks

of a revenue bond issued in the absence of any express statutory authority is at once faced with perplexing questions. Is the revenue bond a negotiable instrument? Has the issuing body the power to charge and collect rates and to regulate rates to be charged for the use of the facilities rendered? In the event of default may a single bondholder have recourse to the courts without suing in a representative capacity? May the bondholder compel the appointment of a court officer to operate the project? In the event of diversion or misuse of the revenues collected from the operation of the undertaking, has the bondholder any remedy against the issuing body at large?

Municipal revenue bonds have been issued pursuant to general statutory authority but in the absence of any specification of detail by the legislature as to the manner of the creation of funds for the payment of the obligation.¹² In a suit to enjoin the issuance of revenue bonds under such general statutory authority, it has been stated: "If it is conceded that the right to contract exists on the part of the municipality with reference to the subject, then it is not material what form the contract shall take, as the statute is general in its terms."¹³ It is thus evident that the form of contract may cause embarrassment to the bondholder when it becomes necessary to enforce payment of the obligation.

Municipal revenue bonds may be issued pursuant to express statutory authority which is complete in detail.¹⁴ Such provisions become part of the bondholder's contract and give certainty to its details. Thus, when the bondholder finds it necessary to seek a remedy, he is not faced with a preliminary skirmish to determine whether important details of the contract are to be sustained as a proper exercise of an implied power.

It is fundamental law that municipal corporations can issue bonds only for public or municipal purposes.^{14a} Some statutes have authorized the

or water supply systems, but has not, other than already indicated herein, specified the manner in which, or means by which, the municipality may accomplish its purposes within the powers conferred. It is competent for a municipality to accomplish such purposes in any lawful manner . . ." *Fjeldsted v. Ogden City*, 83 Utah 278, 301, 28 P. (2d) 144, 153 (1933).

The Supreme Court of Georgia, in connection with a petition to enjoin a county from issuing revenue bonds, sustained the power to issue the bonds payable from a fund accumulated by the charge and collection of rates imposed as admission fees to a public park and tolls upon the avenue of ingress. The statute provided: "That the Board of County Commissioners . . . shall have authority to acquire, own, hold, and administer lands for the purpose of creating public parks, and for the preservation of historic sites . . ." *Williams v. McIntosh County*, 179 Ga. 735, 738, 177 S. E. 248, 250 (1934). See also *State v. City of Daytona Beach*, 117 Fla. 705, 158 So. 300 (1934).

¹²N. D. Laws 1929, c. 172.

¹³*Thomas v. McHugh*, 65 N. D. 149, 154, 256 N. W. 763, 766 (1934).

¹⁴For example, Miss. Laws 1934, c. 316; *Klein v. City of Louisville*, 224 Ky. 694, 6 S. W. (2d) 1104 (1928); *Bowling Green v. Kirby*, 220 Ky. 839, 295 S. W. 1004 (1927).

^{14a}1 JONES, BONDS AND BOND SECURITIES (1935) §§ 146, 160.

issuance of revenue obligations in terms so broad that there is doubt whether the public-purpose requirement is satisfied.¹⁵

It is apparent that the substance of the contract evidenced by the municipal revenue bond in any one of these instances is entirely different from that in any other instance. This becomes significant when it is considered that, except where special statutory provisions have changed the rule, the use of mandamus is limited to the enforcement of rights and duties imposed by statute. If the right or duty rests wholly upon contract, the writ will not be issued, since other legal and equitable remedies afford adequate relief.^{15a} This is true especially where the duties to be enforced, if the writ is allowed, arise out of a contract that requires a series of years for its performance and must of necessity involve in some degree the exercise of discretion, or where the duties imposed by the contract are of such a nature that the court would not be able to oversee the carrying out of the judgment if granted.¹⁶ Besides these difficulties, the petitioner for a writ of mandamus will be faced with delay and doubtful success when the existence or validity of the contract which forms the basis of the action is in dispute.

In the absence of any legislation, or even in the face of specific legislation, states in which constitutional home rule provisions exist present separate problems, for there, local legislation by ordinance or resolution may have the full effect of state legislation.

At the time the Supreme Court of Colorado sustained the power to issue revenue bonds,¹⁷ there was no general enabling legislation in existence. The absence of such legislation in Colorado, however, would not serve as a safe precedent in any other state. The bond ordinance contained many details which general state legislation might have contained.¹⁸ Article twenty of the Colorado constitution, known as the home rule amendment, was in effect since November, 1902. In speaking of article twenty, the court said it "is *sui generis*, is wholly unlike anything in the history of constitutional or legislative enactment, and no authority of any court can furnish any aid whatever in its construction."¹⁹ Ordinarily, municipal corporations are creatures of the legislature and possess and can exercise only the following powers and no others: first, those granted in express terms; second, those necessarily or fairly implied in or incident to the powers expressly granted; third, those essential to the accomplishment of the declared objects and purposes of the corporation, not simply convenient, but indispensable. The applicability

¹⁵Park v. Greenwood County, 174 S. C. 35, 176 S. E. 870 (1934); S. C. Acts 1933, art. 299; Acts 1934, art. 798.

^{15a}38 C. J., tit. "Mandamus", § 61.

¹⁶City of Mobile v. Marx & Co., 75 F. (2d) 569 (C. C. A. 5th, 1935).

¹⁷Shields v. City of Loveland, 74 Colo. 27, 218 Pac. 913 (1923).

¹⁸Franklin Trust Company v. City of Loveland, 3 Fed. (2d) 114 (C. C. A. 8th 1924).

¹⁹People v. Cassiday, 50 Colo. 503, 545, 118 Pac. 357 (1911).

of these general principles has been entirely swept away in Colorado by article twenty of the constitution. Home rule charters adopted pursuant to the provisions of the Colorado constitution become organic acts. The charter is to the city council what the constitution is to the state legislature.

In California, charter cities have become independent, upon municipal affairs, of general laws.²⁰ Upon such affairs, a general law is of no force. If the charter gives the city powers concerning municipal affairs, it has those powers. If the charter is silent as to any such power, no general law can confer it.

Thus, the substantive law of revenue bonds has been a subject of court decisions and other writings for some time. Little, however, has been written upon municipal revenue bond *remedies*. The topic is ripe for serious consideration. With the large increase in such financing, it is too much to expect that any considerable period will elapse without the necessity of an attempt to enforce such obligations upon default.

II.

In outlining the character and scope of remedies available to the holders of revenue bonds in the event of default in the performance of the terms and conditions of the contract evidenced by such an obligation and the statutory or local legislation constituting a part of that contract, judicial precedent will be the guide. Two principles will therefore lie consciously or unconsciously at the basis of thought in the future creation by the courts of a body of remedial law available to the municipal revenue bondholder: (1) The revenue bond, in effect, is a compromise which must meet imperative requirements for large expenditures and avoid conflict with constitutional or statutory prohibitions against burdening the public with debt. (2) Municipal corporations have only those powers expressly granted, necessarily implied, or essential to their corporate purposes. As an incident to this second principle, the distinction between governmental and proprietary functions of the municipality may be emphasized.²¹ Legislation with reference to public powers is construed strictly; that with reference to private powers, more liberally. Hence questions will continuously arise. Is the remedy such that the public debt will be increased and thus the principles of law applicable to tax bonds become controlling? Has the legislature conferred remedies in express terms or by necessary implication, and if so, does judicial precedent indicate the adequacy thereof?

In its business aspects, a municipally owned and operated income-producing undertaking does not differ from a similar business in private ownership. In its legal aspects, however, there is vast difference.

²⁰Griffin v. City of Los Angeles, 134 Cal. App. 763, 26 P. (2d) 655 (1933).

²¹1 DILLON, MUNIC. CORPS. (5th ed. 1911) § 109.

The grants of power to a private corporation are usually very broad, the limitations upon its powers few, and where restrictions are in existence, they may to a great extent be removed. The entire assets of a private corporation may be available to the extent provided by contract as security for the payment of its bonded obligations. Consequently, complete control of the assets of a defaulted debtor and power of disposition thereof are possible in private financing. Mortgages upon income and upon physical properties, and receivership in the event of default, are common to private financing. Contracts for management are ordinarily a matter of voluntary contractual relationship unless condemned by some public policy against the creation of voting trusts. In sharp contrast to the wide powers of enforcement held by the owner of a private corporate obligation, the holder of a municipal bond payable from taxation has an extremely limited control of such powers.²² American courts have been unwilling to interfere in the administration of public corporations. Waste and misuse of funds,²³ refusal of officials to collect taxes,²⁴ or abolition of the tax district²⁵ will not entitle creditors of a political subdivision to a receiver. The alienation by foreclosure, of public property from the public trust which is attached thereto, has been foreign to the experience of the courts.²⁶ And statutory authority for the appointment of a receiver may be the only ground upon which such appointment may be secured.^{26a}

The municipal revenue bond, in order to evidence a contract valid in its inception, must carefully avoid conflict with state constitutional limitations upon the power to incur an indebtedness or liability. A debt or liability in the constitutional sense may be created by indirectly burdening the taxpayer as well as by a direct obligation of the municipality. An analysis of the infinite variety of factual situations in which an indirect burden may be imposed upon the taxpaying body by the issuance of revenue bonds is extremely difficult, if not impossible. Because indirect burdens may be imposed in the future and at the time enforcement of a revenue obligation is sought,

²²*Depew v. Venice Drainage District*, 158 La. 1099, 105 So. 78 (1925). The Court said: "We know of no authority, and counsel has cited none, in which a receiver was ever appointed, in a contested case by a court of this state, to take over and administer the affairs of a public political corporation... A public corporation is one that is created for political purposes, with political powers, to be exercised for the public good in the administration of a civil government. It is an instrument of government, subject to the control of the Legislature, and its officers are officers of the government for the administration and discharge of public duties." *Id.* at 1101, 105 So. at 79.

²³*Marra v. San Jacinto*, 131 Fed. 780 (C. C. S. D. Cal. 1904).

²⁴*Thompson v. Allen County*, 115 U. S. 550, 6 Sup. Ct. 140 (1885).

²⁵*Meriwether v. Garrett*, 102 U. S. 472 (1880).

²⁶*City of Dayton v. Allred*, 123 Tex. 60, 68 S. W. (2d) 172 (1934).

^{26a}*Guardian Savings Co. v. Road District*, 267 U. S. 1, 45 Sup. Ct. 201 (1925); *Yost v. Dallas County*, 236 U. S. 50, 35 Sup. Ct. 235 (1915); *Thompson v. Allen County*, *supra* note 24; *Supervisors v. Rogers*, 7 Wall. 175 (U. S. 1868).

provisions of the bond contract creating the indirect burden may be concealed, and their invalidity or ineffectiveness may not be revealed until an issue is raised thereon and the remedy found to be unavailing.²⁷

Even though the municipal revenue bond is validly issued, the remedies of the holder may be doubtful unless clarified at the time of issuance. The following illustrations are illuminating: In Colorado, the trustees of the state normal school built a dormitory with the proceeds of bonds payable from student rentals. Prior to delivery of the bonds, objection was made that the board could not adopt valid rules requiring students to live in the dormitory at fixed rates. The court said:²⁸

“Such objection, presented by plaintiffs as taxpayers, house owners, and boardinghouse keepers, is without force and effect here. If it could effectively be made, and we do not decide whether it could or could not be successfully interposed by proper parties, we are of the opinion and so decide, that it is without force when presented by plaintiffs in the capacity in which they appear in this suit.”

Should the question be raised properly, the remedy of such bondholders may be seriously impaired. In Illinois, water revenue obligations were issued under a statute^{28a} providing:

“In order to secure in the most ample manner the payment of the water certificates authorized as aforesaid, any such municipality may convey by way of mortgage or deed of trust the waterworks system so acquired or enlarged, which said mortgage or deed of trust shall be acknowledged and recorded in the same manner as mortgages of real property, and which mortgage or deed of trust may contain such provisions and conditions as are reasonably necessary to fully secure the payment of said water certificates.”

After such obligations were outstanding, and notwithstanding the broad

²⁷*Fjelsted v. Ogden City*, 84 Utah 302, 314, 35 P. (2d) 825, 830 (1934). Ogden City, Utah, provided by ordinance for the issuance of water revenue bonds; the ordinance contained a provision that the “city will maintain insurance for the benefit of the holders of the bonds, on the waterworks system, of a kind and in amount which would be carried by private companies engaged in a similar type of business. The Utah Supreme Court held: “That part of the ordinance providing for the hypothecation or application of the revenue to any other purpose than that specially authorized violates the provisions of the law and may not be done. The insuring of the present or the improved or bettered system and making the proceeds therefrom in event of destruction usable for payment of the bonds secured only by the net percentage of the revenue derived may not be done. It is equivalent to pledging the property indirectly, and, in event of destruction, the insurance to a purpose not authorized. General funds of the municipality may not thus be used.” The remedy of the bondholder would have been adequate in this respect had the insurance been carried for the benefit of the city and required to be used in rehabilitating the system.

²⁸*Hoyt v. Trustees of State Normal School*, 96 Colo. 442, 447, 44 P. (2d) 513, 516 (1935).

^{28a}Act of April 22, 1899 (Laws 1899, p. 104).

powers expressly conferred by the statute, the court imposed strict limitations on the remedies that could be exercised by the bondholder. The language of the opinion is significant:

"Through the foreclosure of the trust deed appellant's plight in respect to its waterworks system is not substantially different from what it would have been had the trust deed not been given . . . Without the trust deed, the certificate-holders had the right to insist that the net income from the entire waterworks system be applied to the payment of the certificates. With the trust deed, the certificate holders, or their successor, the purchaser at the sale under the trust deed, would have no right beyond this. With or without the trust deed, only the net income of the system was applicable to the discharge of the certificates. With the regulatory power of the state, as prescribed by the statutes in force when the contract was made, even the purchaser at the foreclosure sale, in the operation of the plant for the time limited by his bid, would not likely be permitted to take unconscionable advantage of the city, nor of its water users, whose rates would in any case alone provide the fund out of which the purchaser would be reimbursed for his investment."²⁹

While in Texas, in answer to a constitutional objection to a statute authorizing a mortgage on a revenue-producing undertaking, the Supreme Court of that state said, before the bonds were issued:

"The contract or deed of trust under consideration here contains appropriate provisions authorizing sale by trustee. The ordinance authorizes such provisions. The pertinent statute . . . specifically provides for sales by trustees. It is settled in this state that sales made by trustees under voluntary deeds of trust, or mortgages duly authorized by law, with express power of sale, are not forced sales."³⁰

The inclusion in a revenue bond ordinance of covenants which will be operative only upon future facts and in the event of default,³¹ the imposition of proper statutory duties³² when the true context of the duty is unknown by practical experience, and the inclusion or exclusion of contractual obligations,^{32a} the importance of which is unknown to practical experience, are matters which call for careful scrutiny, in view of the analogies which must be drawn in building a body of remedial case law for revenue bonds.

Upon foreclosure, the courts will be faced with suits to compel the grant to private individuals of franchises to operate municipal revenue-producing

²⁹City of Jerseyville v. Connett, 49 F. (2d) 246, 249 (C. C. A. 7th, 1931).

³⁰Dayton v. Allred, 123 Tex. 60, 76, 68 S. W. (2d) 172, 179 (1934).

³¹Casto v. Town of Ripley, 114 W. Va. 668, 671, 173 S. E. 886, 887 (1934): "The declaration in the ordinance that the bonds are secured by a statutory mortgage lien is, therefore, mere surplusage without legal effect."

³²Dissenting opinion, Smith v. Guin, 229 Ala. 61, 155 So. 865 (1934). The duty to pay operating expenses out of general revenues, not properly imposed. Cf. Anderson v. Fargo, 64 N. D. 178, 250 N. W. 794 (1933).

^{32a}State v. MacConnell, 169 So. 628 (Fla. 1936).

undertakings.³³ This will involve a determination of the right to divert publicly owned property from public use, and the character of the franchise to be granted, whether exclusive or not exclusive.³⁴ The courts will be called upon to construe the provisions of contracts for management,³⁵ and to determine the effect of covenants to maintain rates³⁶ and the propriety of enforcing liens upon income derived from an undertaking distinct from that constructed or improved with bond proceeds.³⁷ The courts will be called upon to enforce contingent liabilities to pay operation and maintenance expenses from taxation.³⁸ It will be necessary to determine whether revenue obligations are properly payable from gross rather than net income.³⁹ Problems pertaining to negotiability will arise. Negotiability, from the standpoint of remedial law, is invaluable in cutting off equities. The municipal revenue bond is payable from a special fund; in the absence of statute, therefore, it is not negotiable. By statute, however, negotiability may be conferred upon such an instrument, with the attendant benefits from the remedial standpoint; but the courts must then determine whether the revenue bond thereby becomes a debt in the constitutional sense.⁴⁰ In answering these questions, and many others of concern to the holder of a defaulted revenue bond, the courts will follow the judicial custom of determining new questions by analogy where possible.

III.

In the earliest reported case upholding the power of a municipality to issue revenue bonds, the court drew an analogy to the special assessment obligation.⁴¹ The assessment obligation, like the revenue bond, was payable from a limited fund. The analogy, however, is more valuable in the ap-

³³*Cf.* Realty Co. v. Borough of Port Vue, 318 Pa. 366, 178 A. 466 (1935) and cases *supra* notes 30 and 31. See also Greaves v. City of Villisca, 217 Iowa 590, 251 N. W. 766 (1933).

³⁴Ohio Power Co. v. Craig, 50 Ohio App. 239, 197 N. E. 820 (1935). State v. Fricks, 126 Neb. 736, 254 N. W. 409 (1934). Boykin v. Town of River Jc., 121 Fla. 902, 164 So. 558 (1935).

³⁵Maricopa District v. LaPrade, 40 P. (2d) 94 (Ariz. 1935). State v. Smith, 335 Mo. 825, 74 S. W. (2d) 367 (1934).

³⁶City of Bowling Green v. Milliken, 257 Ky. 245, 77 S. W. (2d) 777 (1935) *Cf. supra* note 29. See also State v. MacConnell, 169 So. 628 (Fla. 1936).

³⁷Johnson v. City of Dermott, 189 Ark. 830, 75 S. W. (2d) 243 (1934).

³⁸State v. Smith, 335 Mo. 825, 74 S. W. (2d) 367 (1934); Tranter v. Allegheny Co. Authority, 316 Pa. 65, 173 Atl. 289 (1934); see *infra* note 57.

³⁹Street v. Town of Ripley, 173 Miss. 225, 161 So. 855 (1935). *Cf.* Fjeldsted v. Ogden City, *supra* note 27; Straughan v. City of Coeur D'Alene, 53 Idaho 494, 24 P. (2d) 321 (1933); Zachary v. City of Wagoner, 146 Okla. 268, 292 Pac. 345 (1930); Guthrie v. City of Mesa, 56 P. (2d) 655 (Ariz. 1936).

⁴⁰Oppenheim v. City of Florence, 229 Ala. 50, 62, 155 So. 859, 864 (1934).

⁴¹Winston v. Spokane, 12 Wash. 524, 41 Pac. 888 (1895).

preciation of its ineptness than in its conceived pertinency, as will become apparent.

A distinction has already been noted by the courts. It has been stated that the special assessment obligation is payable from a special fund which is a trust fund belonging to bondholders and which at no time has constituted property of the city. A municipal revenue bond, on the other hand, is said to be payable out of a special fund accumulated from the revenues of the undertaking, which belong to the city but have been pledged to the bondholder.⁴² The validity and significance of such a distinction may not be apparent immediately, but further analysis will reveal its bearing upon the power to issue municipal revenue bonds as well as upon the character of the remedy.

The trust-fund distinction between the special assessment bond and the revenue bond conflicts provokingly with the theory which permits the issuance of revenue bonds on the principle that they are not "debts" of the municipality within the meaning of constitutional and statutory limitations upon the power of municipalities to incur indebtedness. Where the income accumulated for the payment of municipal revenue bonds accrues from the operation of a *new* project constructed with the bond proceeds, most courts hold that such bonds do not constitute "debts", on the ground that the revenues of the undertaking were at no time commingled with the general funds of the municipality.⁴³ The *ratio decidendi* of these cases seems to be that the obligation is that of a department or entity legally separate from the entity against which the constitutional or statutory debt prohibition operates.⁴⁴ In fact, the income in question has never become property of the corporate body against which the prohibition runs.⁴⁵ On the other hand,

⁴²In *Wadsworth v. Santaquin City*, 83 Utah 321, 345, 28 P. (2d) 161, 170 (1933), the Court said: "The special fund doctrine had its rise in analogy to funds created by special assessment for public improvements. . . . The distinction, however, is clear. In case of special assessments, the moneys collected and placed in the special fund is a trust which is not owned by the city, and no part of it could be used by the city to pay current expenses. On the other hand, net revenues derived from the operation of a utility belong to the city and may be used for any corporate purpose."

⁴³1 JONES, BONDS AND BOND SECURITIES (1935) § 108.

⁴⁴*State v. Regents*, 179 Ga. 210, 175 S. E. 567 (1934); *Department of Water and Power v. Vroman*, 218 Cal. 206, 22 P. (2d) 698 (1933).

⁴⁵*Webb v. Port Commission of Morehead City*, 205 N. C. 633, 172 S. E. 377 (1934). In *McCutcheon v. City of Siloam Springs*, 185 Ark. 846, 850, 49 S. W. (2d) 1037, 1038 (1932), the Court said: "Amendment No. 10 forbids cities from making contracts in excess of their revenue for the current year. *The city incurred no liability payable out of its revenues on account of the instant contract.* The contract specifically provides to the contrary. *Under the act for operation of the system by the council, none of the proceeds therefrom became the city's funds until expenses of operation and maintenance had been fully paid.* The consideration for this contract or the purchase price must and can only be paid under its terms as maintenance charges out of the gross receipts derived from the operation of the system after operating expenses have been

where the income from an *existing* property is pledged, there is a greater tendency to declare revenue bonds payable from such income a "debt" within constitutional or statutory prohibitions, on the ground that the pledge deprives the municipality of property or resources otherwise available for the increase of the general fund.⁴⁶ But if the factor of property or ownership of the revenues to be pledged is to be determinative of the question of indebtedness, the courts must be careful not to extend the doctrine of distinguishing the special assessment bond from the revenue bond by declaring the former payable from a trust fund belonging to the bondholder and the latter payable from revenues belonging to the municipality but pledged to the bondholder.

Where the income earned by a revenue-producing undertaking is considered a trust fund, the property of the bondholder, and at no time municipal income (as in the case of assessment bonds), it is at once apparent that the nature of the remedy available to the holder of the revenue bond is materially affected. The field of equitable relief is extended. A bill in equity may lie to impress the bond fund with a trust. The bondholder may seek to control the application of the revenues by receivership and to secure an accounting with reference thereto.⁴⁷ If the revenues of the project are considered the property of the bondholders, the courts may not be so reluctant to control and administer the affairs of public corporations.

The holders of special assessment obligations often find it necessary to attempt recourse beyond the special fund and against the municipality generally in the event of derelictions of duty with reference to bringing the special fund into existence or diverting it after collection. The cases are in a state of confusion with reference to the existence and the scope of such a remedy.⁴⁸ Provisions similar to those appearing in revenue bond statutes, confining the bondholder's right to receive payment to a special fund only, have been held, in cases involving special assessment obligations, to negative liability in tort as well as liability in contract.⁴⁹ In the absence of such a statutory provision, however, a recital in the bond that it is payable out of and secured only by a special fund is ineffective to limit the bondholder's right of recovery to the special fund.⁵⁰ Diversion by a city of special assessments collected for bond sinking funds, to pay interest, has been held no violation of its duty as a collecting agent.⁵¹ The United States Supreme

paid *and not out of funds belonging to the city.*" (Italics ours.)

⁴⁶Foley, *supra* note 3. See also *Tranter v. Alleghany County Authority*, 316 Pa. 65, 173 Atl. 289 (1934).

⁴⁷*Boynton v. Moffat Tunnel Improvement District*, 57 F. (2d) 772 (C. C. A. 10th, 1932).

⁴⁸(1928) 51 A. L. R. 973.

⁴⁹*Town of Capitol Heights v. Steiner*, 211 Ala. 640, 101 So. 451 (1924).

⁵⁰*L. W. Hancock Co. v. City of Mt. Sterling*, 170 Ky. 207, 185 S. W. 856 (1916).

⁵¹*Bosworth v. Anderson*, 47 Idaho 697, 280 Pac. 227 (1929).

Court has declared that city officials, in adopting special assessment proceedings, act as the agents of the bondholders and not as the agents of the city, and that they are not performing a corporate function in making and collecting assessments.⁵² Recovery against the issuing body generally and apart from the special assessment fund has been permitted in many states,⁵³ but denied in others.⁵⁴ Under statutes providing that the holder of a bond shall have no claim against the city and that it shall be payable solely out of a special fund, the courts have held that the bondholder is bound by the law at the time the bonds were issued; that the city constitutes an instrumentality of the law to initiate and carry out the improvements and collect the assessments; that the bondholder is required to know what is being done or left undone, and is afforded ample remedy by mandamus to compel city officers to follow the mandates of the statute.

° As in the case of special assessment bonds, holders of revenue bonds will be faced by failure to collect charges and fees as agreed, and with diversions of collections when made. Keeping in mind the burden of supervision imposed by the cases upon the holder of special assessment bonds, it becomes at once apparent what burdens of supervision may be imposed upon the revenue bondholder. And for this reason the use of a trust indenture under which a trustee is furnished a periodical accounting, is desirable if authorized. If the holder of a municipal revenue obligation determines to seek recovery for negligence in the collection and payment over of revenues, is such a bondholder estopped if he fails to bring mandamus at a time such that negligence by the obliger would have been prevented? Are city officials

⁵²Moore v. City of Nampa, 18 F. (2d) 860 (C. C. A. 9th, 1927), *aff'd* 276 U. S. 536, 48 Sup. Ct. 340 (1928).

⁵³Oklahoma City v. Orthwein, 258 Fed. 190, 195 (C. C. A. 8th, 1919). The Court said: "Where a municipal or quasi municipal corporation, which has the power to make a contract for internal improvements contracts for them, and stipulates that the agreed price of the improvements shall be paid to the contractor out of funds to be realized out of special assessments, or out of the proceeds of bonds it has the power to issue, and the corporation has power to make the assessments or to issue the necessary bonds, but fails to make sufficient valid assessments, or to issue sufficient bonds to provide the necessary funds to pay the contractor the contract price of his material and labor, or if it *misappropriates such funds to other purposes*, the corporation becomes primarily liable to pay the contract price itself." (Italics ours.)

See also Reilly v. City of Albany, 112 N. Y. 30, 42, 19 N. E. 508 (1889); Meyer v. City and County of San Francisco, 150 Cal. 131, 88 Pac. 722 (1907); Barber Asphalt Paving Co. v. City of Denver, 72 Fed. 336 (C. C. A. 8th, 1896); Town of Windfall City v. First National Bank, 172 Ind. 679, 87 N. E. 984 (1909); O'Neil v. City of Portland, 57 Ore. 84, 113 Pac. 655 (1911); McEwan v. City of Spokane, 16 Wash. 212, 47 Pac. 433 (1896).

⁵⁴Life and Casualty Insurance Co. v. City of Florala, 63 F. (2d) 195 (C. C. A. 5th, (1933); Moore v. City of Nampa, 18 F. (2d) 860 (C. C. A. 9th, 1927); City of Pontiac v. Talbot Paving Co., 94 Fed. 65 (C. C. A. 7th, 1899); Gagnon v. City of Butts, 75 Mont. 279, 243 Pac. 1085 (1926).

agents of the revenue bondholder? Such unanswered questions must soon come before the courts.

The remedies available to the holders of municipal revenue bonds are already in dispute. This is indicated by statements in opinions dealing with the power to issue such bonds. The Alabama Supreme Court says:

"It is also contended that the rule should apply that, when the city obtains or uses the funds of another, it should be held to account in an action for money had and received or in tort for a conversion, and a recovery had to the extent that the assets of the city were thereby augmented, . . . But there is a limitation upon the principle which we think applies to the present situation — that such promise [to refund diverted money] will not be implied when the money is obtained in violation of the mandatory provisions of the law or under a contract which the law expressly prohibits. The transaction is then illegal, and the courts will leave them where they place themselves . . . The rights of the parties are confined to mandatory, injunctive, or other appropriate equitable proceedings . . . The obligation of the city to fix and maintain rates sufficient to pay the principal and interest with the stipulation that its breach shall never constitute an indebtedness is likewise a covenant *to do an act*, and not to pay money, as a present liability, and, if the city shall violate the covenant, it is not subject to pecuniary damages for so doing, by the very terms of the contract."⁵⁵

And just to the contrary, the Michigan Supreme Court says:

"Of course, if the city should misappropriate the funds to be derived from the operation of the plant so they are unlawfully diverted from the purposes for which they are appropriated by statute, the city may be held liable, not because of the statute, but because of its violation of a statutory duty."⁵⁶

In determining the right of the revenue bondholder to enforce his remedy beyond the special fund and against the municipality generally, it may be helpful to draw an analogy to those cases which hold that a contingent liability, upon property or funds other than the special fund, may exist as security for the ultimate payment of special assessment or revenue obligations.⁵⁷ Where such a contingent liability has been sanctioned as additional security, it seems that future recovery beyond the resources of the special fund should be permitted in the event of occurrence of acts which would be ground for a suit in tort.

The payment of a municipal revenue bond is dependent upon successful operation of the undertaking and the charge and collection of rates sufficient to pay operation and maintenance expenses and to accumulate an interest and bond retirement fund. Municipalities operating an undertaking

⁵⁵Oppenheim v. City of Florence, 229 Ala. 50, 55, 155 So. 859, 862 (1934).

⁵⁶Young v. City of Ann Arbor, 267 Mich. 241, 254, 255 N. W. 579, 584 (1934).

⁵⁷State ex rel. City of Hannibal v. Smith, 335 Mo. 825, 74 S. W. (2d) 367 (1934); Crawford v. Johnston, 177 S. C. 399, 181 S. E. 476 (1935).

which produces an income are usually exercising a proprietary, not a governmental, function. Such operation may constitute a matter of local or municipal concern and the rate regulatory power may thus be vested solely in the municipality.⁵⁸ In some jurisdictions, state commissions are empowered to regulate the rates of municipal utilities and have limited the municipality to a return either sufficient to pay only actual costs,⁵⁹ or equal to that allowed utilities privately owned.⁶⁰ Where the legislature has conferred power on a local legislative body to contract as to rates, enforcement is controlled by the terms of the contract, and the question whether rates are confiscatory is immaterial.⁶¹ It is obvious, then, that the revenue bondholder's remedy, in so far as control of rates is concerned, depends upon where the power to regulate lies,^{61a} whether with the municipality or with a state commission. And it depends upon the existence of a statutory power to contract with reference to rates. Important too are constitutional home rule guaranties extant in many states whereby certain classes of municipalities are permitted to frame their own charters and to govern their own affairs. The existence and application of these constitutional home rule provisions bear a direct relationship to the practical value of the remedy available to the holder of a municipal revenue bond, insofar as the remedy is dependent upon the ability to enforce the charge and collection of rates sufficient to pay operation and maintenance expenses and to accumulate an interest and bond retirement fund.

The distinction between proprietary and governmental functions is difficult to draw. It has been stated that community liability has become possible through the growth of the municipal corporation.⁶² Community

⁵⁸*Holyoke v. Smith*, 75 Colo. 286, 226 Pac. 158 (1924); *City and County of Denver v. States T. & T. Co.*, 67 Colo. 225, 184 Pac. 604 (1919).

⁵⁹*Matter of Niagara, Lockport & O. Co. v. Prendergast*, 229 App. Div. 295, 241 N. Y. Supp. 162 (3d Dept. 1930); *cf. Village of Boonville v. Maltbie*, 245 App. Div. 468, 283 N. Y. Supp. 460 (3d Dept. 1935).

⁶⁰*City of Logansport v. Public Service Commission*, 202 Ind. 523, 177 N. E. 249 (1931).

⁶¹*Karel v. City of Eldorado*, 32 F. (2d) 795 (E. D. Ill. 1929); *So. Iowa Electric Co. v. Chariton*, 255 U. S. 539, 41 Sup. Ct. 400 (1921).

^{61a}Consider the situation where jurisdiction may be divided because of a plant located partially outside municipal corporate limits. *Crandall v. Town of Safford* 56 P. (2d) 660 (Ariz. 1936); *cf. Bernard v. City of Bluefield*, 186 S. E. 298 (W. Va. 1936).

⁶²"The judicial door to community liability was first opened through the instrumentality of the municipal corporation. Partly because of the more limited size of the entity, partly because of the fact of incorporation, partly because of the more commercial nature of some of its enterprises, the halo of sovereignty proved vulnerable to juristic persuasion and theories were found upon which to assert community liability for functions deemed 'proprietary' or 'corporate'. Let us not be unduly disrespectful of the doctrinal — and perhaps practical — distinction between 'governmental' and 'corporate' functions, for it has an ancient lineage running back to the glossators

tort liability has been established by the distinction between proprietary (or corporate) and governmental powers. It seems that the distinction will have an added significance and a favorable effect upon the efforts of the revenue bondholder to compel foreclosure of a mortgage upon a municipal revenue-producing system, or to compel the grant of a franchise to operate such a system upon foreclosure. If, in operating a revenue system, the municipality is exercising only a corporate function, the courts should look with favor upon the attempt to secure the appointment of a receiver to operate such a property under the jurisdiction of the court, or to sustain a general liability against the municipality. The historical hesitancy of courts to permit alienation of public property or to sanction bankruptcy proceedings for a public corporation may be overcome or greatly affected by a clear distinction between those functions which are governmental and those functions which are proprietary.⁶³

IV.

The following conclusions with regard to the remedies of the revenue bondholder seem to be justified:

Mandamus. The writ of mandamus, now well known to the courts, will be a valuable but not an adequate remedy to the holder of a municipal revenue bond. The basis of mandamus is the imposition of a statutory duty. In the case of a tax bond, the real security available to the holder is the primary duty of municipal officials to levy and collect taxes and apply them to the payment of the bond. The control of the taxing power is almost without exception in the debtor. In direct contrast to this situation, the factual and legal background of the municipal revenue bond is infinitely complex. The ideal is to preserve the element of control in the creditor. Revenue bonds have

and since the Renaissance has served on the continent to break down the armor of the legally irresponsible State. It might have done so even sooner but for the long survival of the doctrine of the free will and the accompanying postulate that the inanimate corporation could be guilty neither of tort nor crime.

"But ultimately outworn legal doctrine, if necessary with the aid of legislation, gives way before the exigencies of modern life and public opinion. The barriers to community liability were gradually lowered. Then began in the United States the embarrassing effort to distinguish the functions which were corporate from those which were governmental, although unfortunately this effort was for historical reasons restricted to the incorporated municipality and did not extend to the county, even after incorporation, or to the state. While there seems to have been little difficulty in classifying profit-making or remunerative enterprises like railroads and transportation systems, gas, electric and water services as corporate, there has been a disposition to consider police, fire, health and education as governmental in character and free from tort liability." Borchard, *State and Municipal Liability in Tort — Proposed Statutory Reform* (1934) 20 A.B.A.J. 747, 748.

⁶³In re Cameron County Water Improvement Dist. No. 1, 9 F. Supp. 103 (S. D. Tex. 1934).

been issued in the absence of express statutory authority, pursuant to general grants of power only, and also pursuant to detailed legislative provision. It is needless to say that in such cases there is no uniformity and that it may be extremely difficult to find the statutory basis upon which the remedy of mandamus may lie. The desired element of control may be lacking. The holder of a municipal revenue bond should determine whether there exists a statutory duty to levy and collect rates sufficient to provide for operation and maintenance expenses, the accumulation of a bond fund, and the application of such fund to the payment of principal and interest on the bonds. He should determine the existence of express statutory authority for action by a trustee or right to the appointment of a receiver. Wherever possible, he should not rely upon implied powers. Mandamus cannot be an adequate remedy because control of the application of income involves future action; it requires knowledge of facts and duties in connection therewith in order to prevent failure of duty. Practically, the failure of duty will result and then a further remedy must be sought. But such a further remedy will be clarified when it rests upon a statutory duty carefully analysed in drafting the bond resolution or ordinance.

Money Judgment. Performance of its statutory duties would be a complete defense by a municipality to a mandamus proceeding, but neglect to perform its statutory duties should not be a defense in an action for damages and judgment against the municipality at large.

The confusion evidenced by judicial decisions, as a result of the effort by the holders of municipal tax bonds payable from a special fund accumulated from the levy and collection of a special assessment to impose a general liability upon the municipality at large in the event of a failure to levy and collect the special assessment, in the event of a failure to foreclose the lien of the special assessment, or in the event of a diversion of the special assessment fund, should be obviated as a body of remedial case law develops in connection with necessary attempts by the holders of municipal revenue obligations to establish such a general liability in case of a failure to charge and collect rates, to foreclose any lien attaching by virtue of unpaid charges, or in case of a diversion of the bond fund.

The levy and collection of a special assessment is an exercise of the power of taxation and a high prerogative of government. It involves an exercise of the police power, and the tax burden may be imposed involuntarily. The municipal revenue bond, however, is payable from a special fund accumulated from income earned in the operation of a project which is usually undertaken as a matter of convenience. The charges or rentals which produce the bond fund are voluntarily assumed. Again, although it is not always clear what functions are proprietary, it is generally clear that in the operation of an undertaking which is in all respects similar to one operated by private ownership, the municipality is acting in a proprietary capacity.

The hesitancy of the courts to impose a general liability upon municipalities when exercising governmental powers for the benefit of the compact community at large does not have the same justification when the municipality is acting as a business corporation. If the general community may be rendered liable in tort for injuries rendered in the exercise of proprietary or business functions, there seems to be no good reason why the holder of a municipal revenue bond should not be entitled to recover generally in the event the facts upon which recovery is based establish such negligence or dereliction of duty upon the part of municipal officials as would entitle an individual under parallel circumstances to recover in tort. Constitutional limitations on the power to incur debt have uniformly been held to apply only to a debt voluntarily contracted.^{63a} Such limitations do not apply to prevent recovery upon a judgment liquidating an involuntary obligation. Contractual limitations in the body of a municipal revenue bond or statutory limitations restricting the claim of the bondholder solely to the fund to be accumulated from income should not be construed as limiting the involuntary obligation of the municipality.

It has become well established law that the holder of a municipal tax bond has no right to levy execution upon municipal property for the payment of the bond.^{63b} The principle underlying such cases is again the principle which recognizes that property impressed with a public trust should not be diverted from its trust. It may well be, however, that the municipality, in the operation of a revenue producing undertaking, will have on hand a fund secured from such a source. There is no good reason why the income earned by the municipality operating as a business corporation, or any property to which it may readily be traced, should not be subject to execution for payment of moneys properly due the holder of a municipal revenue bond.⁶⁴

Control. Statutory provisions authorizing the appointment of receivers, or the execution and delivery of mortgages upon the foreclosure of which title may vest in the purchaser at foreclosure or a franchise may be given to operate the plant and to transfer possession during the enfranchised period, are important in serving to clarify and confirm the security which comes from the power of control over the source of payment in the event of default. Such statutory provisions are, however, of value chiefly in indicating the attitude of the legislature as to the position which it desires the holders of municipal revenue bonds to occupy when their remedies are judicially determined; they may be only declaratory of remedies which exist apart from the enactment.

Where there exist facts which would entitle holders of private corporate

^{63a}1 DILLON, *MUNIC. CORP.* (5th ed. 1911) § 201.

^{63b}3 *id.* § 992; 4 *id.* §§ 1513-14.

⁶⁴*Kubach v. City of Long Beach*, 8 Cal. App. (2d) 567, 48 P. (2d) 181 (1935).

securities to the appointment of a receiver to operate a business affected with a public interest, such facts may well compel a court to appoint a receiver of a municipal revenue-producing undertaking. But the rate regulatory power may be vested in the state legislature operating through a state commission or other agency, or because of home rule provisions the power may be vested in the municipality itself. Transfer of possession for a period of years under a franchise to operate a plant which during the period of operation is at all times subject to such regulatory powers, is an empty gesture. By virtue of the terms of the contract, the municipal revenue bondholder is at all times entitled to the application of the agreed income to the payment of the interest and principal of his obligation. If a clear recognition by the courts carries the inherent responsibility of business operations into the field of municipal operations, provision by statute for the appointment of a receiver will be unnecessary. The general equity powers of the courts, specific performance and mandatory injunction,⁶⁵ will furnish all remedies which may be available in the nature of the appointment of a receiver, the supervision of rates, and the application of their proceeds to the payment of the bonded debt.

⁶⁵*Puget Sound Power Co. v. Seattle*, 271 Fed. 958 (W. D. Wash. 1921); *City of Mobile v. Marx*, 75 F. (2d) 569 (C. C. A. 5th, 1935).