NOTES

CONSTITUTIONAL LIMITATIONS ON INDEBTEDNESS OF LOCAL GOVERNMENTS IN MISSOURI

INTRODUCTION

For many years states have been faced with the problem of controlling the indebtedness incurred by their local political units.[1] When a unit becomes "excessively indebted," local taxes very often become extremely high and few benefits are realized by the taxpayers; the bulk of the local revenue is expended in an attempt to reduce the debt, or in discharging the interest as it becomes due. In order to alleviate the problem of over-indebtedness of local units, states have imposed constitutional limitations on the power of local units to incur financial obligations.[2] The principal objective of these provisions is to limit the amount of indebtedness a unit may incur in excess of its current revenue and income.

Constitutional limitations on indebtedness fall into four categories. The first allows a unit to incur unlimited indebtedness when approved by the qualified voters in the unit.[3] A second type limits the indebtedness to a stated percentage of the assessed valuation of tangible property in the unit.[4] The third type provides a limitation based on a fixed percentage of the assessed property valuation, and a higher percentage limitation on approval of the qualified voters.[5] The fourth type, found in Missouri, limits the indebtedness above current revenue and income to a fixed percentage of the assessed property valuation when approved by the qualified voters.[6]

The first constitutional limitation on indebtedness of local units in Missouri was embodied in the Constitution of 1875.[7] The need for such a constitutional provision which would put local units on a cash basis stemmed from a realization that many local units were, at the time, in

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1. See Stason, *State Administrative Supervision of Municipal Indebtedness*, 30 MICH. L. REV. 833, 833-37 (1932).

2. See notes 3-6 *infra*.

3. See, *e.g.*, IDAHO CONST. art. VIII, § 3.

4. See, *e.g.*, ALA. CONST. art. 12, § 224.

5. See, *e.g.*, NEB. CONST. art. XIII, §§ 1-2.

6. See, *e.g.*, MO. CONST. art. VI, §§ 26(a)-(b).

7. MO. CONST. art. X, § 12 (1875). There was no similar section in the Constitution of 1865. BRADSHAW, COUNTY GOVERNMENT MANUAL FOR THE MISSOURI CONSTITUTIONAL CONVENTION OF 1943, at 55 (1943).

"Local government" and "local unit" as used throughout this note include the counties, cities, incorporated towns or villages, school districts, and other political corporations and subdivisions of the state.

near ruinous financial condition[8] due to poor administration by local officials,[9] poor investments in railroads,[10] and the depression of 1873.[11] Since 1875 the Missouri Supreme Court has been called upon to determine whether the obligations incurred by local units under a variety of financing devices are debts which would cause the unit to exceed the constitutional limitation.[12] The court has permitted use of certain of these devices while the use of others has been prohibited on the ground that they create indebtedness beyond the constitutional limitation. The purpose of this note is to examine the various devices used by local units and the obligations incurred thereunder, with particular regard to their treatment by the court, in an effort to determine the effectiveness of the constitutional provisions.

Two provisions of the Missouri Constitution are of peculiar significance to the discussion which follows. Article VI, section 26(a), provides:

> No county, city, incorporated town or village, school district or other political corporation or subdivision of the state shall become indebted in an amount exceeding in any year the income and revenue provided for such year plus any unencumbered balances from previous years, except as otherwise provided in this constitution.

Under this provision if an obligation is incurred and the current revenue and income or unencumbered balances from previous years is not sufficient to meet it, the obligation is void unless the unit has complied with the provisions of article VI, section 26(b) which provides:

> Any county, city, incorporated town or village, school district or other political corporation or subdivision of the state, by vote of two-thirds of the qualified electors thereof voting thereon, may become indebted in an amount not to exceed five per cent of the value of taxable tangible property therein as shown by the last completed assessment for state and county purposes.

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8. The inclusion in the Constitution of 1865 of a provision on indebtedness of local units was characteristic of this period of history. The people did not have faith in the legislature and, accordingly, the legislative power over finances, as well as other areas, was restricted by the constitution. LOEB, *Constitutions and Constitutional Conventions in Missouri*, in 1 JOURNAL MISSOURI CONSTITUTIONAL CONVENTION OF 1875, at 25-42 (1920).

9. See Barnard & Co. v. Knox County, 105 Mo. 382, 16 S.W. 917 (1891); Holmes, *Constitutional Limitations Upon Municipal Debt in Missouri*, 6 U. KAN. CITY L. REV. 85, 93 (1937).

10. *In re* Barnard & Co., *supra* note 9; BRADSHAW, *op. cit. supra* note 7, at 14; Holmes, *supra* note 9, at 91-92.

11. LOEB, *op. cit. supra* note 8, at 25-42; Holmes, *supra* note 9, at 93.

12. "Obligation" and "debt," as used in this note, are used in a technical sense: "Obligation" is used to denote any situation in which the unit is financially obligated—whether or not the amount would exceed the constitutional limitation. "Debt" is used to denote a situation in which an "obligation" will cause the unit to exceed its constitutional limitation.

INVOLUNTARILY INCURRED DEBTS

1. Obligations Incurred by Performance of Mandatory Duties

A unit, of course, incurs many obligations as a result of its executive or administrative officers performing various duties. These duties have been classified as either mandatory or voluntary. A mandatory duty, as distinguished from a voluntary or discretionary duty, is one which has been prescribed by the constitution or state legislature. An initial problem that arises is whether the constitutional limitation is applicable to render void obligations incurred as the result of the performance of a mandatory duty.

In *Potter v. Douglas County*,[13] an obligation was incurred as a result of the sheriff (plaintiff) of another county keeping and transporting prisoners of Douglas County (defendant). At the time the sheriff presented his bill, the defendant had already expended all its current revenue so that the only method of paying the bill was by issuance of warrants in excess of revenue and income for that year. The court stated that the constitutional limitation did not apply to "debts of law"—*i.e.*, debts incurred in the performance of mandatory duties.[14] The court was influenced by the fact that the amount for expenses of this type could not be ascertained in advance of its incurrence and consequently the county would neither be able to budget the expense nor get the consent of two-thirds of the voters prior to its incurrence.

Six years later the *Potter* case was expressly overruled by *Barnard & Co. v. Knox County*.[15] The county clerk, in the performance of a mandatory duty, obligated the county by purchasing stationery. Warrants were issued to the plaintiff-seller at a time when previously-issued warrants exceeded current income. Heavily influenced by the factors which led to the adoption of the constitutional provision—corruption and ineconomy—the court refused to give "debts of law" preferential treatment, stating that the limitation "includes indebtedness *in any manner or for any purpose.*"[16] The debt, therefore, was held void. It would seem that under the *Barnard* case funds necessary for the operation of the local government could be subjected to the mercy or whim of the local administrators. If these officials choose to spend current revenue in the performance of their discretionary duties prior to the incurrence of expenses necessary for the perform-

13. 87 Mo. 239 (1885).

14. The court stated that the debt limitation was applicable only to debts incurred "through the ordinary channel, the action of the county court, the financial agent of the county." *Id.* at 244. See also George D. Barnard & Co. v. Knox County, 37 Fed. 563 (E.D. Mo. 1889).

15. 105 Mo. 382, 16 S.W. 917 (1891).

16. *Id.* at 389, 16 S.W. at 919.

The performance of discretionary duties has always created obligations which may be proscribed by the constitutional limitation. Linn Consol. High School Dist. v. Pointer's Creek Pub. School Dist., 356 Mo. 798, 203 S.W.2d 721 (1947); Book v. Earl, 87 Mo. 246 (1885).

ance of mandatory duties, it is hardly likely that necessary services will be rendered to the unit when it will not be obligated to pay for them.

The court in later decisions, however, has not been so quick to declare "debts of law" invalid when current funds have been spent or obligated in the performance of discretionary duties. In *Gill v. County of Buchanan*,[17] involving salaries of county officials, the court was of the opinion that "no part of any such obligation could become invalid because the county court decided to incur other obligations for different purposes during the year."[18] If the total obligations exceeded current revenue and income so that all obligations could not be validated, debts arising from the performance of discretionary duties would be invalidated to the extent that the obligations exceed the constitutional limitation. This applies even though the "discretionary" debts are incurred prior to the "debts of law." In *State ex rel. Taylor v. Wade*,[19] a mandamus action to force the county to publish a financial statement in accord with sections 13827-28, Missouri Revised Statutes (1939), the county contended that, as the income and anticipated income for the year had been obligated, the amount necessary to publish the statement would be the creation of a debt proscribed by the constitution. The court, refusing to let executive and administrative officials defeat their duties created by the legislature, held that obligations incurred through performance of mandatory duties have priority over obligations incurred through performance of discretionary duties. Therefore, the report had to be published and its cost was a valid debt taking preference over the obligations incurred in the performance of discretionary duties. These latter cases indicate a tendency by the court, in determining the constitutional validity of debts, to validate obligations incurred in the performance of discretionary duties only where there is an excess of current revenue or income above the amount needed to pay "debts of law."[20] This is especially true if the amount of a "debt of law" is reasonably ascertainable at the beginning of the year.

Under the *Potter* case obligations incurred in the performance of discretionary duties which arose prior to the incurrence of a "debt of law" remained valid if there were current funds to pay them when incurred. Also, the "debt of law" subsequently incurred was validated even though the incurrence put the unit beyond the debt limit prescribed in the constitution. On the other hand, under the *Barnard* case "debts of law" were given no preference. The more recent cases seem

17. 346 Mo. 599, 142 S.W.2d 665 (1940) (county judge recovered salary for the year 1934).
18. *Id.* at 605, 142 S.W.2d at 668.
19. 360 Mo. 895, 231 S.W.2d 179 (1950).
20. See Holmes, *supra* note 9, at 101-05.

much sounder than either the *Potter* or *Barnard* case for the unit is compelled to pay for the performance of the necessary functions of the unit—"debts of law"—but still must confine its expenditures within the constitutional limit. Thus, the court, by giving preference to "debts of law,"[21] has avoided their evasion and the constitutional provision has remained effective.

2. Judgment Debts Arising from Ex Delicto Actions

Debts arising from acts *ex delicto* do not fall within the constitutional limitation.[22] In *Conner v. City of Nevada*,[23] the city defended a tort action arising from the defective condition of its street on the ground that the city's indebtedness had already reached the constitutional limit. The court held that by the language of article X, section 12,[24] the limitation is to be applied only to indebtedness incurred by assent, agreement, or contract. The word "indebted" was held to refer to debts *ex contractu* as distinguished from debts arising from tort liability. A claim for damages reduced to a judgment debt is incurrence of a debt in only a most technical sense, said the court, and one not intended to be included within the purview of the constitutional limitation.

The wording of the constitutional limitation would seem to be sufficiently broad to cover debts *ex delicto*. It should be recalled, however, that one of the main objectives of the constitutional provision was to eliminate corruption and inefficiency. While it may be possible for corrupt public officers to gain benefits at the expense of the taxpayer in the performance of various duties which obligate the unit *ex contractu*, problems of corruption and inefficiency of operation have little or nothing to do with incurrence of tort liability. Furthermore, if the framers of the constitution intended that the limitation should apply to debts *ex delicto*, they could have so stated expressly when drafting the Constitution of 1945.

VOLUNTARILY ASSUMED OBLIGATIONS

1. Payment Out of Special Funds

Although the unit may have assumed the obligation voluntarily, *i.e.*, without compulsion of law—statutory or judicial—the obligation may not come within the constitutional limitation on indebtedness where

21. Preference has also been given to "debts of law" in another way: an obligation voluntarily assumed is void if beyond the revenue actually received, whereas a "debt of law" is valid if within the revenue which could have been provided. Linn Consol. High School Dist. v. Pointer's Creek Pub. School Dist., 356 Mo. 798, 203 S.W.2d 721 (1947).

22. State *ex rel.* Pyle v. University City, 320 Mo. 451, 8 S.W.2d 73 (1928); Conner v. City of Nevada, 188 Mo. 148, 86 S.W. 256 (1905); Smith v. City of St. Joseph, 122 Mo. 643, 27 S.W. 344 (1894).

23. 188 Mo. 148, 86 S.W. 256 (1905).

24. Mo. CONST. art. X, § 12 (1875).

the general revenue and income of the local unit is not obligated to discharge the debt. The court has adopted the "special fund" doctrine: where the debt is to be paid out of a special fund which is neither raised nor replenished by taxation, the constitutional limitation is not applicable.[25] The units have taken advantage of this doctrine to finance many large projects, such as sewerage systems, waterworks, and electric power plants, the cost of which would otherwise be beyond their financial limits as prescribed by the constitution.

a. Payment with Revenue from the Financed Project

A unit may obtain funds to finance a particular project by issuing revenue bonds—bonds the principal and interest of which are to be paid solely from the revenue received from the project so financed. For example, in *State ex rel. Hannibal v. Smith*,[26] bonds issued to finance the construction of a bridge were to be paid wholly from bridge tolls. The city was not obligated to pay any part of the principal or interest out of its general revenue funds, nor did the bondholders secure a lien on other city property. The court held that since the bonds were secured and payable only from the revenues to be realized from the particular project purchased with the proceeds of the bonds, they did not create a debt within the meaning of the constitutional provisions. Since neither taxation nor income from *other* property owned by the unit need be resorted to to pay the debt, it is submitted that the limitation has been correctly held inapplicable.

A more difficult problem arises where the unit pledges the *entire* revenue from a project to pay an indebtedness which exists only in relation to part of the project. For example, the unit may issue revenue bonds to cover the cost of additions and improvements to an existing utility and pledge the income of the entire utility to pay the indebtedness,[27] *i.e.*, the income resulting from the extension or improvement plus the income from the existing project. Or, the city may finance a completely new project by outright purchase of part of the system (perhaps through the issuance of bonds within the debt limitation) and issuance of revenue bonds to pay the balance, pledging the income from the entire plant to pay the bonds.[28] The court, in *Bell*

25. Holmes, *supra* note 9, at 112-13.

26. 335 Mo. 825, 74 S.W.2d 367 (1934). See also City of Maryville v. Cushman, 363 Mo. 87, 249 S.W.2d 347 (1952) (financed combined waterworks and sewerage system with proceeds from sale of revenue bonds); State *ex rel.* City of Excelsior Springs v. Smith, 336 Mo. 1104, 82 S.W.2d 37 (1935) (construction of a mineral water system).

27. See, *e.g.*, Woodmansee v. Kansas City, 346 Mo. 919, 144 S.W.2d 137 (1940) (bonds issued to enlarge and modernize market facilities to be paid from revenue of the facilities after renovation).

28. See, *e.g.*, Grossman v. Public Water Supply Dist., 339 Mo. 344, 96 S.W.2d 701 (1936) (financed the *utility* by issuing both general bonds as provided in the constitution and revenue bonds).

v. City of Fayette,[29] took notice of such a situation, and in dictum indicated that it might adopt the "segregation of funds" doctrine—*i.e.*, failure to segregate funds from the existing project makes the debt one proscribed by the constitution since the revenue from the existing project might be considered part of the unit's general revenue funds. When the issue was squarely presented to the court in *Grossman v. Public Water Supply Dist.*[30] and *City of Lebanon v. Schneider*,[31] however, it rejected the "segregation of funds" doctrine. The court felt the improvements were necessary and that the existing facilities or that part that could be constructed by outright purchase would be inadequate and worthless without the additions. Thus, if *only the income of the utility* is resorted to to pay the obligation, the constitutional limitation is inapplicable. It is submitted that, although this is indirectly obligating general funds of the unit—obligating funds prior to their becoming a part of the general fund—the result is sound in practice, for it allows the unit to utilize an otherwise inadequate or worthless plant.

A further problem is presented if a unit pays for services, such as light, power, and water, which it receives as a consumer from a utility financed by means of a "special fund." As this is indirectly obligating tax revenue, the court has been quick to find a "debt" within the constitutional sense and has prevented such expenditures.[32] The court has reasoned that the amount the unit pays for use of the service of the project comes from the general tax fund, and therefore, because the "special fund" includes monies raised by taxation or which must be replenished by taxation, the "special fund" doctrine is inapplicable, *i.e.*, the purchase price of the utility is held to be an obligation of the local unit.[33] From a practical standpoint this view seems inappropriate. One need only use a little imagination to go behind the reported facts to see that the seller-contractor wants to be sure that there will be sufficient revenue collected, and his best assurance is for the unit to pay for what it uses. If the unit has sufficient current revenue there exists no reason why it should not pay for that which it uses if the amount is fair and reasonable,[34] for under these circumstances, the unit would be required to pay a similar price for power, water, or light from a plant in which it did not have an interest, in which

29. 325 Mo. 75, 28 S.W.2d 356 (1930) (conditional sale of two engines to be paid for from earnings of same—distinguishing situation where funds of entire plant are used).
30. 339 Mo. 344, 96 S.W.2d 701 (1936).
31. 349 Mo. 712, 163 S.W.2d 588 (1942).
32. Sager v. City of Stanberry, 336 Mo. 213, 78 S.W.2d 431 (1934); Hagler v. City of Salem, 333 Mo. 330, 62 S.W.2d 751 (1933); Hight v. City of Harrisonville, 328 Mo. 549, 41 S.W.2d 155 (1931).
33. See note 32 *supra*.
34. See City of Maryville v. Cushman, 363 Mo. 87, 249 S.W.2d 347 (1952).

case the expenditures would not be proscribed. It would seem the taxpayer would be subject to no greater burden if the payments are made to a utility the unit is attempting to purchase.

b. Special Assessment of Benefit Districts

Through the creation of benefit districts local units have found an effective means of financing desired civic improvements and at the same time circumventing the constitutional limitation on indebtedness.[35] The local unit may designate a geographical area within its limits which is to be the beneficiary of a proposed improvement, such as roads, sewers, or parks. To finance the construction of these improvements, the unit may levy a special assessment against the property which is to be benefited. The special assessment does not affect the general taxable community for whose protection the constitutional provision was adopted, for it only obligates the local unit to pay with funds collected from these special assessments.[36] The court, treating the collection of the special assessment by the unit in the nature of a condition precedent to the unit's obligation to pay, has consistently held that this method of financing does not create a debt within the meaning of the constitutional limitation. The reasoning of the court is clearly illustrated in *Kansas City v. Ward*,[37] where the court stated that since the city was obligated to pay only to the extent of the sums collected from the special assessment, it was merely an agent of the creditors to collect the special assessments.

It is submitted that such reasoning enables the local unit to circumvent the spirit, if not the letter of the constitutional limitation.[38] For example, suppose a unit which does not have a sewerage system desires to construct one, the cost of which would greatly exceed the constitutional limitation. By dividing the unit into separate sewerage benefit districts and levying special assessments, the unit is able to do indirectly that which it could not constitutionally accomplish directly.

35. See State *ex rel.* Webster Groves Sanitary Sewer Dist. v. Smith, 342 Mo. 365, 115 S.W.2d 816 (1938); Kansas City v. Bacon, 147 Mo. 259, 48 S.W. 860 (1898); Kansas City v. Ward, 134 Mo. 172, 35 S.W. 600 (1896).

It has also been held that housing authority obligations are not debts of the city. Bader Realty and Inv. Co. v. St. Louis Housing Authority, 358 Mo. 747, 217 S.W.2d 489 (1949).

36. *In re* State *ex rel.* Webster Groves Sanitary Sewer Dist., *supra* note 35; Embree v. Kansas City & Liberty Boulevard Road Dist., 257 Mo. 593, 618, 166 S.W. 282, 289 (1914).

37. 134 Mo. 172, 35 S.W. 600 (1896).

38. See Holmes, *supra* note 9, at 100-01.

If a special corporate district is formed, however, it is itself bound by Mo. CONST. art. VI, § 26(a). State *ex rel.* Dalton v. Metropolitan St. Louis Sewer Dist., 275 S.W.2d 225 (Mo. 1955); Bader Realty and Inv. Co. v. St. Louis Housing Authority, 358 Mo. 747, 217 S.W.2d 489 (1949). See Arnold v. Hawkins, 95 Mo. 569, 8 S.W. 718 (1888) (county cannot levy a special assessment upon the benefit district beyond the constitutional limit on taxation).

MO. CONST. art. VI, § 26(d) has lessened the need for this type of financing by providing for additional indebtedness for "public improvements—benefit districts —special assessments."

2. Conditionality of the Obligation to Pay

a. The Public Utility Lease—A Conditional Obligation

Utilization of the "special fund" doctrine is not the only method which may be used to finance public improvements and avoid the constitutional limitations. For example, to finance waterworks, power plants, and other public utilities, the unit may enter into an agreement whereby it is to lease the utility, usually with an option to buy for a nominal amount at the end of a specified term of years.[39]

As might be expected from considering the treatment the court has given to obligations incurred for benefit districts, the court has been most liberal concerning lease-financing of improvements.[40] If the court were to construe the aggregate amount that the unit would have to pay during the life of the lease as the incurrence of a debt upon the signing of the contract, the aggregate amount could be expected to exceed current income and revenue if the utility were of any size, and often exceed the extended five per cent limit as well. Under such a construction, the lease would give rise to a debt proscribed by the constitutional limitation. The court, however, apparently feeling the real need of the unit for such improvements, has construed the obligation of the unit not as one of the aggregate amount, but rather as one of each installment as it becomes due.[41] This result is reached by viewing the obligation of the unit to pay as conditional on the rendering of the service;[42] thus an unconditional obligation is created each year the service is rendered. Since the annual payment may not cause the unit to exceed the constitutional limitation, this view allows the unit to incur a large indebtedness without violating the constitutional restrictions. It is submitted, however, that this type of financing is in fact an attempt to anticipate income of future years. The unit is fairly certain that it will become obligated to pay in those future years, and therefore it obligates funds not yet collected. If the purpose of the constitutional limitation is to put the unit on the cash basis, the pro-

39. Lamar Water & Elec. Light Co. v. City of Lamar, 128 Mo. 188, 31 S.W. 756 (1895); Saleno v. City of Neosho, 127 Mo. 627, 30 S.W. 190 (1895).

40. Although the court's policy toward lease-financing is liberal today it has not always been so. The early attempts to use this method of financing were held invalid on the ground that they created debts proscribed by the constitution. Lamar Water & Elec. Light Co. v. City of Lamar, 26 S.W. 1025 (Mo. 1894), *rev'd by court en banc*, 128 Mo. 188, 31 S.W. 756 (1895); State *ex rel.* Robinson v. Town of Columbia, 111 Mo. 365, 20 S.W. 90 (1892). For a discussion calling for clarification of this point, see Skinker, *Constitutional Limitations on Municipal Taxation in Missouri*, 6 ST. LOUIS L. REV. 61 (1921).

41. Saleno v. City of Neosho, 127 Mo. 627, 30 S.W. 190 (1895). See also Kansas City Power & Light Co. v. Town of Carrollton, 346 Mo. 802, 142 S.W.2d 849 (1940).

42. A debt is understood to be an unconditional promise to pay a fixed sum at some specific time, and is quite different from a contract to be performed in the future, depending upon a condition precedent, which may never be performed, and which cannot ripen into a debt until performed. *In re* Saleno, *supra* at 639, 30 S.W. at 192.

vision should apply to this type of financing which seems to be in the nature of a credit transaction.[43] Thus, it seems the court is placing form over substance in an effort to reach a desired result.

b. Other Contingent Obligations

As shown above, the court may permit the constitutional limitation to be circumvented by treating the obligation of the unit as contingent upon performance of another party or upon the happening of an event, rather than as an absolute obligation to pay. The "contingent obligation" doctrine is not restricted to the field of public utility leasing. In *Tate v. School Dist.*,[44] for example, the school board executed a contract with a teacher in December for services to be performed the following year—payment to be monthly "for services properly rendered." The contract was found to be executory and the unit's liability contingent on the teacher rendering personal services. The court said "executory and contingent contracts which are to be performed *in futuro* do not constitute an indebtedness against the [local unit] . . . in the sense of constitutional inhibition, until such contracts have been performed."[45] If the court had held that the debt created by the execution of the contract in December was the aggregate amount of the monthly payments, the unit would have incurred an obligation exceeding its current revenue and income so that the contract would have involved anticipation of revenue of future years. In *City of Lebanon v. Schneider*,[46] the city was to pay into a revenue fund, created to retire revenue bonds which had been issued to finance a public waterworks, if the revenue collected from other users was insufficient. If the obligation had been held to be absolute, the "special fund" doctrine would have been inapplicable since the unit would have an unconditional obligation to replenish the "special fund" with tax funds. The court, however, held that the liability of the general revenue of the city was merely contingent, and consequently, a debt was not created within the meaning of the constitutional limitation. Query if this is not putting form over substance, as in the public utility lease situation, to achieve a desired result.[47]

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43. See Missouri Toncon Culvert Co. v. Butler County, 352 Mo. 1184, 181 S.W.2d 506 (1944); Hawkins v. Cox, 334 Mo. 640, 66 S.W.2d 539 (1933).

44. 324 Mo. 477, 23 S.W.2d 1013 (1929).

45. *Id.* at 501, 23 S.W.2d at 1024.

46. 349 Mo. 712, 163 S.W.2d 588 (1942).

47. At present it is not clear whether the court will allow a unit to purchase needed services from a utility financed with the use of the "special fund" doctrine. See text supported by notes 29-31 *supra*. It seems that the same argument —replenishing the "special fund" with tax revenue invalidates the "special fund" —would lie in the present situation. Furthermore, the contingency is not the performance of service usually relied on, but an inability of the utility to be financed from the "fund."

c. Unconditional Obligations

When the court has found the obligation to be absolute and unconditional, the constitutional inhibition on indebtedness has been strictly applied. In *Book v. Earl*,[48] one of the first cases involving indebtedness of local governments to be decided under the Constitution of 1875, the unit entered into a contract in 1881 for additions to, and remodeling of, its courthouse; the work was to be done in 1881. At the time warrants were issued, the current revenue for the year had already been exceeded by expenses. Consequently, the court found anticipation of revenue of future years and held the contract void.[49]

Apparently, the possibility of circumventing the constitutional limitation if the obligation was conditional rather than absolute encouraged the local governments to attempt to effect various absolute purchases by the use of transactions similar to a leasing arrangement. For example, to obtain funds to construct a county courthouse and poorhouse, and to remodel a jail, a county issued and sold bonds, the value of which was twice current revenue and income. It was held that an absolute obligation was created upon negotiation of the bonds —payment thereon was not contingent upon beginning work on, or completion of, the projects.[50] Also, an attempt by a unit to delay payment for construction of a bridge by issuing warrants in the year the bridge was completed rather than in the previous year when the unit became contractually obligated to pay, has been held to be an invalid debt in the year the warrants were issued.[51] In *Missouri Toncon Culvert Co. v. Butler County*,[52] the unit, unable to pay for culvert material in the year in which it contracted to buy, provided that it was not to be billed until the following year. The court found that there could not possibly be a contingent obligation since the vendor had fully performed by delivering the material in the year of contracting, and therefore the obligation anticipated revenue of future years. Thus, the court has held that attempts to delay payment where the obligation is absolute—the only contingency being the passing of time—are prohibited by the constitution. The court, by looking to the substance rather than the form, is effectively applying the constitutional provision in these cases.

48. 87 Mo. 246 (1885).

49. The court said that the purpose of the provision was "to abolish . . . the credit system and establish the cash system by limiting the . . . expenditures in any given year to the amount of revenue . . . for that year." *Id.* at 252. See also Anderson v. Ripley County, 181 Mo. 46, 80 S.W. 263 (1904).

50. State *ex rel.* Christian County v. Gordon, 265 Mo. 181, 176 S.W. 1 (1915).

51. Trask v. Livingston County, 210 Mo. 582, 109 S.W. 656 (1908). Plaintiff was a holder of the county's warrants issued in 1890—the same year the warrants for the bridge were issued. If the warrants for the bridge were valid, then plaintiff's were invalid because the ones for the bridge were prior in time and there was not sufficient revenue to pay both. See also Ebert v. Jackson County, 70 S.W.2d 918 (Mo. 1934); Hawkins v. Cox, 334 Mo. 640, 66 S.W.2d 539 (1933).

52. 352 Mo. 1184, 181 S.W.2d 506 (1944).

A remaining problem is to determine how far the framers intended to put the unit on the cash basis. It should be recalled that the constitutional provisions provide that the unit shall not become indebted in an amount which exceeds the income and revenue for the year plus any unencumbered balances from previous years, or, on approval of the qualified voters, in an amount which exceeds five per cent of assessed property valuation. Assume that a unit incurs a debt which at the time of incurrence could have been discharged out of current revenue or income, or, if not, could have been met by unexpended balances carried over from previous years. Assume further that the unit fails to use these unexpended funds to pay the debt, planning to make payment in future years. Is this anticipation of future revenue within contemplation of the constitutional provision? In the case of *Grand River Township v. Cook Sales & Service, Inc.*,[53] the unit had agreed to purchase a road grader in 1951, payments to be made in 1952 and 1953. The machines were continually breaking down and the unit sued to rescind the contract. The court, without qualification and without having determined if there were sufficient funds in 1951 to discharge the entire purchase price, stated that "no contract . . . is valid which obligates it [the unit] to make payments in subsequent calendar years."[54] This decision would indeed put the unit on a cash basis. A few months later, the court, in *State ex rel. Strong v. Cribb*,[55] held that if there remained in the county treasury sufficient unencumbered funds to discharge the entire obligation in the year in which the unconditional obligation was incurred, it was not "anticipation" to agree to make payments in future years. A strong dissent by Judge Hyde questioned the computation of unencumbered funds on hand, and pointed out that the unit would easily be able to return to the credit basis as a result of the decision.[56] He reasoned that the unit could use the unencumbered balance to validate a debt but need not use the balance to pay the indebtedness, so that the unit could again use the same funds for validating other installment contracts. He argued that the majority position was not a holding that incurrence

53. 267 S.W.2d 322 (Mo. 1954). The court indicated that it would not be bound by the "title" of a contract in determining the relationship established. That is, although a contract was denominated a lease, they would look to the substance to determine if it was a lease or a contract of purchase.

54. *Id.* at 325.

55. 273 S.W.2d 246 (Mo. 1954). A similar ruling is found in Shiedley v. Lynch, 95 Mo. 487, 8 S.W. 434 (1888) (semble).

56. Judge Hyde pointed out the fallacies of the majority opinion: Evidence showed that the county was already obligated on two other leases in the aggregate of $16,000 yearly, and this should have been taken into consideration in determining whether there were unencumbered funds available to meet this contract. Further, the court did not earmark the funds to this contract, but left all county funds available to meet other obligations which the county court might lawfully direct to be paid. Perhaps Judge Hyde has pointed out another phrase in MO. CONST. art. VI, § 26(a) which will call for judicial determination in the future, *i.e.*, "unencumbered balance."

of indebtedness per se encumbers the funds. If Judge Hyde is correct, the effect of the constitutional provision is now nil. However, if the incurrence of indebtedness is considered as an encumbrance on the funds—a point which calls for clarification by the court—it is submitted that the unit will remain on the cash basis.

d. Issuance of Bonds

While bonds create unconditional obligations, it is generally held that "special purpose" bonds do not create debts. When dealing with bonds issued to pay judgments—judgment debt bonds—however, the court has not been consistent in holding that they create valid obligations. In *State ex rel. Clark County v. Hackman,*[57] the issue was whether the constitutional provision could be construed to authorize a unit to issue bonds, not whether the amount of the bonds exceeded the constitutional limitation. The court reasoned that since the provision recognized the unit's power to become indebted, the unit could become obligated by issuing bonds. However, the phraseology that no unit shall "become" indebted was construed by the court to mean that the debt to be incurred by the bond issue must be a new one and not merely a substitute for an old one. Therefore, the court, to be fair to judgment creditors, held that the bonds when sold create new debts, notwithstanding the fact that the funds thereof would be used to discharge prior obligations.[58] While this case was in the appellate court the legislature granted authority to the units to issue bonds to pay judgment debts.[59] In *State ex rel. City of Sedalia v. Weinrich,*[60] the city, in accord with the new statute, issued bonds to refund a judgment debt for overdue water rentals. Following the rationale of the *Hackman* case, that the issuance created a new debt, the city would have exceeded its constitutional debt limitation. It was held that there was not the creation of new indebtedness, but merely a change in form.

57. 280 Mo. 686, 218 S.W. 318 (1920). The obligations to be retired resulted from spending the anticipated, rather than the actual, revenue of the year. County courts may anticipate the revenue of the current year. See State *ex rel.* Rothrum v. Darby, 345 Mo. 1002, 137 S.W.2d 532 (1940). See also State *ex rel.* Nat'l Bank v. Johnson, 162 Mo. 621, 63 S.W. 390 (1901), to the effect that warrants valid when issued are not invalidated merely because the funds were less than anticipated.

58. To illustrate the point the court said:

> If I owe John Jones $1,000, evidenced by my note, I am indebted to him. If when that note reaches maturity . . . I go to John Smith and give him my note for $1,000 . . . I have created a new debt . . . . The obligation or debt in one instance was to Jones, but in the other it is to Smith . . . . [The latter is] a new debt.

State *ex rel.* Clark County v. Hackman, 280 Mo. 686, 703, 218 S.W. 318, 322 (1920).

The analysis in this case, known as the "dual debt" test, has been severely criticized. See, *e.g.*, State *ex rel.* Consol. School Dist. v. Smith, 343 Mo. 288, 121 S.W.2d 160 (1938).

59. See Mo. Rev. Stat. c. 15, § 2892 (1929).

60. 291 Mo. 461, 236 S.W. 872 (1922).

Hackman was distinguished on the ground that the proceeds from the bonds in that case would be used subsequently to discharge existing indebtedness, whereas in the *Sedalia* case, payment and extinguishment of the existing debt *preceded* or was *simultaneous* with any obligation on the bonds,[61] and therefore the issuance was not a new debt. Since, however, the statute allows the bonds to be sold first and then the proceeds to be applied to the extinguishment of the old debt, it is submitted that the court unnecessarily distinguished the *Hackman* case, and should have expressly overruled it—it had outlived its usefulness.

The *Hackman* case remains to plague the court. In *State ex rel. Consol. School Dist. v. Smith*,[62] the unit sought to issue bonds for the purpose of refunding outstanding bonds. The court held this was not the creation of new indebtedness within the meaning of the constitutional limitation but merely a change in form of the existing debt; it makes no difference whether the refunding bonds are exchanged for outstanding bonds or are sold for cash and the proceeds used for redeeming outstanding bonds. Instead of overruling the *Hackman* case, the court agreed with the result. The court reasoned that because the voters had a right to vote on incurrence of indebtedness and since they apparently did not vote on the warrants to be refunded in the *Hackman* case, it might be the debts were not in fact the same; thus, there might not be a mere "change in form." The Constitution of 1945 settled the problem in part by authorizing the issuance of refunding bonds to refund outstanding bonded indebtedness.[63] It is submitted that the court should expressly overrule the *Hackman* case and announce that the constitutional restriction does not apply to bonds issued to retire valid outstanding obligations of the local unit.

CONCLUSION

The primary purpose of the constitutional limitation on indebtedness of local units in Missouri is to avoid excessive taxation which may result from corruption and/or ineconomy in a local government. The court has correctly limited the application of the provision to contractual obligations incurred in the performance of discretionary duties.[64] Also, the court has wisely frustrated attempts by the local

61. *But see* State *ex rel.* Consol. Dist. C-4 v. Holmes, 362 Mo. 1018, 245 S.W.2d 882 (1952) (bonds create debts, not when they are sold, but when authorized by election).

62. 343 Mo. 288, 121 S.W.2d 160 (1938).

63. Refunding bonds.—For the purpose of refunding, extending, and unifying the whole or any part of its valid bonded indebtedness any . . . subdivision of the state . . . may issue refunding bonds . . . .
Mo. CONST. art. VI, § 28.

64. A trend in the recent decisions appears to remove "debts of law" from the operation of the constitutional limitation. See text supported by notes 17-20 *supra*.

units to return to the credit basis when the units have incurred unconditional obligations with payment postponed until future years. It is submitted, however, that the court has been unduly liberal in determining what constitutes a conditional obligation, and consequently, has permitted circumvention of the provisions. The court, moved by the argument of the local units' need for "necessaries," has been quick to label financial transactions "conditional," thus giving rise to obligations not prohibited by the constitution. (This liberalism is not confined to the court, but is apparent also in the Constitution of 1945.[65]) The recent decision in *State ex rel. Strong v. Cribb* ignored the "conditional" test and, it would seem, makes the sole requirement for validity the ability of the unit to pay the entire amount at the time of contracting. The fallacy is that the unit may elect not to pay until subsequent years, and thus, as the obligation may not encumber the funds on hand, the same funds may be used to validate other contracts. Under such a rationale the sky would seem to be the limit on the local units' power to incur obligations. It is submitted that when the court is again faced with the problem it should restrict, or better yet, eliminate, this possibility of circumventing the constitution: A working definition of "unencumbered funds," based on a full disclosure of all the outstanding obligations of the unit, will accomplish the purpose.

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65. *Compare* MO. CONST. art. VI (1945), *with* MO. CONST. art. X (1875).