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MUNICIPAL CORPORATIONS-CIRCUMVENTING MUNICIPAL DEBT LIMITATIONS

Joseph F. Gricar S.Ed.
University of Michigan Law School

MUNICIPAL CORPORATIONS—CIRCUMVENTING MUNICIPAL DEBT LIMITATIONS—Since municipalities are frequently indebted to the permissible extent of the constitutional, statutory, and charter debt limitations, they are constantly seeking methods of finance which avoid the debt limits. Three devices have received judicial sanction. First: Where a separate and distinct corporation such as a school or drain district has been created it may operate with a separate debt limit over the same territory as the governing municipality.[1] Second: Where the project to be financed is income-producing, the financing bond issue, if made self-liquidating, will not come within the debt limitations. Although incorporated authorities have been extensively used to administer self-liquidating bond issues,[2] the "special fund" doctrine has permitted cities to finance self-liquidating, income-producing projects without farming the job out to an authority.[3] Third: Where a city makes a long term lease for recurring needs, which is not a disguised contract of purchase, only the yearly instalment and not the aggregate rental is considered a debt for purposes of limitations.[4]

These methods of permissible finance have been the product of a slow evolution of judicial opinion. From an early strict interpretation of the debt limitations the tendency has been toward an increasingly liberal interpretation. The overlapping corporation device was first sanctioned because it was familiar. The school, drain and similar districts have roots as deep in history as the debt limitations themselves.[5] To build the special fund doctrine, it seems the courts resorted to the spirit of the debt limitations. The purpose of the limitations was to keep property from being subjected to an unrestricted and fixed tax

[1] Cerajewski v. McVey, 225 Ind. 67, 72 N.E. (2d) 650 (1947); Atty. Gen. v. Thompson, 168 Mich. 511, 134 N.W. 722 (1912); 94 A.L.R. 818 (1935); 171 A.L.R. 723 (1947). See 1 McQUILLIN, MUNICIPAL CORPORATIONS §283 (1940).

[2] Edwards v. Housing Authority of City of Muncie, 215 Ind. 330, 19 N.E. (2d) 741 (1939); In re Brewster Street Housing Site, 291 Mich. 313, 289 N.W. 493 (1939); 146 A.L.R. 328 at 339 (1943). See Foley, "Revenue Financing of Public Enterprises," 35 MICH. L. REV. 1 (1936).

[3] See Foley, "Low Rent and State Financing," 85 UNIV. PA. L. REV. 239, 248 (1937). For recent extensions of the special fund doctrine see 29 NEB. L. REV. 75 (1949). Most states now have revenue financing acts which in effect codify the special fund doctrine. See Underwood v. Fairbanks Morse and Co., 205 Ind. 316, 185 N.E. 118 (1933); Indiana Service Corp. v. Town of Warren, 206 Ind. 384, 189 N.E. 523 (1934); Young v. City of Ann Arbor, 267 Mich. 241, 255 N.W. 579 (1934). See also Foley, "Revenue Financing of Public Enterprises," 35 MICH. L. REV. 1 (1936).

[4] 71 A.L.R. 1318 (1931); 145 A.L.R. 1362 (1943). See also 103 A.L.R. 1160 (1936).

[5] Atty. Gen. v. Thompson, 168 Mich. 511, 134 N.W. 722 (1912).

burden; the financing of an income producing project through a self-liquidating bond issue does not create a tax burden.[6]

At some point, of course, inroads through liberal interpretation will spell disintegration of an effective debt limit. It is apparent that this tendency must be kept within bounds; the problem is to fix the bounds. Two recent cases, from Indiana and Michigan, present an interesting contrast in judicial attitude toward financing methods which attempt to circumvent the debt limitations.

The Indiana court, in *Rappaport v. Department of Public Health,*[7] had to pass upon a use of the overlapping corporation device. Legislation had permitted the creation of new health departments and taxing districts in cities with a population of over 300,000. Such departments and districts were to have a separate debt limitation and the power to issue bonds and lay a special tax on district property for the construction and maintenance of hospitals. The Indiana court recognized that the state constitutional debt limit does not prevent more than one municipal unit from operating in identical territory. The court, however, in declaring the legislation unconstitutional avowed a purpose to "look through form to substance"[8] to see if the legislative intent had been to evade the debt limitation. The degree of city control over the new department was a factor in determining the question of evasion. More important, it seems, was the fact that the court viewed the building and maintenance of hospitals as a traditional and typical city function. The court hypothesized that if a separate governmental unit may be created to finance hospitals "why not a city hall or any other essential city function or building?"[9] In looking to the *purpose* of debt limitations and to the *nature* of the function which the new district is to perform, the Indiana court seems to have found a working general approach which it can apply to all methods of municipal finance. There is no indication that the court will limit this approach to the device of the overlapping corporation.

The Michigan court, in *Walinske v. Detroit-Wayne Joint Building Authority,*[10] had to pass upon a more recent and more subtle device. After the voters of Wayne County rejected a proposal to increase tax

[6] Hight v. City of Harrisonville, 328 Mo. 549, 41 S.W. (2d) 155 (1931); Edwards v. Housing Authority of City of Muncie, 215 Ind. 330, 19 N.E. (2d) 741 (1939).

[7] (Ind. 1949) 87 N.E. (2d) 77.

[8] Id. at 80.

[9] Id. at 82.

[10] 325 Mich. 562, 39 N.W. (2d) 73 (1949).

millage and create an eight million dollar bond issue for the construction of a joint City of Detroit-Wayne County administration building, the state legislature passed an enabling act under which the city and county jointly incorporated a Building Authority empowered by the enabling act to construct an administration building financed by a self-liquidating bond issue. The bonds to be issued by the Authority, were to be payable solely from the revenue from the building; the revenue would be the rent which the city and county would pay for the use of the building. No lease had yet been drawn but the enabling act permitted, and the Authority charter required, the building to be conveyed to the city and county after the bond issue had been retired. The charter provided for a thirty-year lease with power in the Authority to adjust rentals to retire the bond issue within that time.

The Michigan court, in upholding the enabling act, has sanctioned an ingenious combination of Authority financing, the special fund doctrine, and the doctrine of the lease for recurring needs. It is clear that cities may be enabled to incorporate Authorities with a separate and distinct legal entity that may own, finance, and administer a self-liquidating project.[11] From the standpoint of this legally separate Authority the project is income-producing and self-liquidating albeit the income, in the form of lease rentals, is tax money. As far as the city is concerned it is merely making a long term lease which is not a debt in its aggregate.[12] By a very legalistic approach the Michigan court was able to say that this is a debt of the Authority and not the debt of the city and county. The Authority cannot tax and so the scheme does not come within the prohibitions of the debt limitations.

It would seem that the reasoning upholding this particular device is the direct antithesis of the reasoning behind the special fund doctrine.

[11] See note 2, supra.

[12] The Michigan court had to answer the objection that the enabling act and the authority charter contemplated a contract of purchase which would constitute a debt in the amount of the aggregate rental. The court reasoned that since the final disposition of the building was not being decided, and since the lease had not yet been drawn, the proposed transaction could not be called a contract of purchase. The lease when drawn will undoubtedly reflect the guidance of the court and make no provision for conveying the building to the city and county. After the bond issue is liquidated, there would seem to be nothing to prevent the authority from donating the building to the city and county. A very similar situation was before the Pennsylvania court in Kelley v. Earle, 320 Pa. 449, 182 A. 501 (1936). The court held that a contemplated conveyance from authority to state made the lease a contract of purchase. On rehearing, in Kelley v. Earle, 325 Pa. 337, 190 A. 140 (1937), noted in 85 UNIV. PA. L. REV. 518 (1937), the court upheld an amended plan which called for title to remain in the authority. If so obvious a device can make the difference, it would seem the Michigan court is realistic in upholding the device in the first instance.

The special fund doctrine proceeds on the theory that even though a particular bond issue represents a city debt, the debt does not come within the purpose of the debt limitations because it is not liquidated by tax money. To sanction this latest device the court must say, in effect, that even though this bond issue is liquidated by tax money, it is not a city debt. In Michigan, it seems, a scheme may be successful if it appeals either to purpose or to form; it need not appeal to both.[13]

The Indiana and the Michigan cases can undoubtedly be distinguished on their facts. In their reasoning, however, the two opinions seem to be squarely opposed. The Indiana court looks through form to the substance of the scheme. If the effect is merely to increase borrowing power rather than to perform a public service better the Indiana court will find an evasion of the debt limit. The Michigan court is content if the form of the scheme of finance is legally defensible since "there is no fraud in reaching a desired end by legal means even though some other means to the end would be illegal."[14] The Indiana court seems to be on more solid ground. It will, according to the *Rappaport* case, examine each scheme of finance by the admittedly fluid tests of the constitutional purpose of debt limitations and the legislative intent to evade such limitations. In Michigan, on the other hand, it seems the bars are down. Consistently with the *Walinske* case there would appear to be nothing to prevent the legislature from enabling authorities to build and finance, and cities to lease non-revenue-producing museums, fire houses, police stations or other similar projects.

The result in the Michigan case may be laudable. Detroit and Wayne county will, at the end of thirty years, be the owners of a ten

[13] The general trend of the decisions seems to be in favor of the device of leasing from an authority. The Pennsylvania court in Kelley v. Earle upheld the device. See note 12, supra. The Illinois court, in People v. Green, 382 Ill. 577, 47 N.E. (2d) 465 (1943), distinguished the Kelley case on the ground that in the Kelley case there was an element of income which saved the plan. In a later Illinois case, People v. Green was in turn distinguished. The court held an act valid which created an armory authority with power to lease to the state. The plan in the Green case was said to be bad because there was no legal separation of identity between authority and state since the directors of the authority were to be the governor and other state officials. Loomis v. Keehn, 400 Ill. 337, 80 N.E. (2d) 368 (1948). In Ohio there were two attempts to finance the building and maintenance of mental institutions through the authority device. Both the original and the revised plan were held invalid. State v. Griffith, 135 Ohio St. 604, 22 N.E. (2d) 200 (1939), and State v. Neffner, 137 Ohio St. 390, 30 N.E. (2d) 705 (1940). All the cases in this note involve the creation of state authorities. The Michigan court seems to have been the only court to rule squarely that municipalities may use this particular device. There would seem to be no logical basis to distinguish between state and municipal authorities.

[14] The court quotes from Bacon v. City of Detroit, 282 Mich. 150 at 158, 275 N.W. 800 (1937).

million dollar building at a cost of only slightly more than they would have to pay in rentals to private parties over the same period. No doubt this was a major factor in the court's decision. Almost every relaxation in the application of the debt limits has been prompted by the realization that the debt limits do very often lead to inefficient methods of finance and curtailment or denial of vital services. On the other hand, debt limits were imposed not to promote economy and efficiency, but to prevent municipalities from overpledging themselves and to keep the fixed tax burden within definite bounds. It is no wonder that these conflicting factors have impressed courts in unequal degree. By reverting to the fundamental purpose, the Indiana court has made the debt limit a living thing. In Michigan, for many practical purposes, the debt limit is dead. Although it blocks the path in which it died, the detours are open.

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