Volume 16 | Number 4 Article 1

6-1-1938

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CONSTITUTIONAL RESTRICTIONS UPON PUBLIC DEBT IN NORTH CAROLINA

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At the November, 1936, general election the voters of North Carolina approved an amendment to Section 4 of article V of the state constitution, which was certified by the governor to the secretary of state on November 25, 1936, and thenceforth that section has read as follows:

"Sec. 4. *Limitations upon the increase of public debts.* The General Assembly shall have the power to contract debts and to pledge the faith and credit of the State and to authorize counties and municipalities to contract debts and pledge their faith and credit for the following purposes:

"To fund or refund a valid existing debt;

"To borrow in anticipation of the collection of taxes due and payable within the fiscal year to an amount not exceeding fifty per centum of such taxes;

"To supply a casual deficit;

"To suppress riots or insurrections, or to repel invasions.

"For any purpose other than these enumerated, the General Assembly shall have no power, during any biennium, to contract new debts on behalf of the State to an amount in excess of two-thirds of the amount by which the State's outstanding indebtedness shall have been reduced during the next preceding biennium, unless the subject be submitted to a vote of the people of the State; and for any purpose other than these enumerated the General Assembly shall have no power to authorize counties or municipalities to contract debts, and counties and municipalities shall not contract debts, during any fiscal year, to an amount exceeding two-thirds of the amount by which the outstanding indebtedness of the particular county or municipality shall have been reduced during the next preceding fiscal year, unless the subject be submitted to a vote of the people of the particular county or municipality. In any election held in the State or in any county or municipality under the provisions of this section, the proposed indebtedness must be approved by a majority of those who shall vote thereon. And the General Assembly shall have no power to give or lend the credit of the State in aid of any person, association, or corporation, except to aid in the completion of such railroads as may be unfinished at the time of the adoption of this Constitution, or in which the State has a direct pecuniary interest, unless the subject be submitted to a direct vote of the people of the State, and be approved by a majority of those who shall vote thereon."

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Except for the last sentence, which survived unchanged, the amendment constitutes a radical revision of the old section, which, for convenient comparison, is set out below.[1] In brief, the amendment (1) does away with the former state debt limit of 7½% of assessed values, (2) authorizes the contracting of state and local debt for four enumerated purposes, and (3) forbids the contracting of new debt by the state in any biennium, and new debt by a local unit in any fiscal year, in excess of two-thirds of the amount by which its outstanding debt was reduced during the like period next preceding, unless the proposed debt is approved by the voters. The exception based upon debt reduction is unique, we believe, in state constitutions.

The salient features of the amendment were salvaged from the wreckage of the proposed constitution which was scheduled for submission to the voters at the 1934 general election but went aground upon an election technicality.[2] That instrument contained a section identical with the amendment, except that, like the old Section 4 of article V, it applied only to the state.[3] All debt restrictions affecting local units were embodied in a separate section of the proposed constitution, the content of which was quite different.[4] It is evident that the draftsmen of the amendment adopted the state model and simply extended its field of application to "counties and municipalities."

So far as it concerns state debt, the amendment seems less restrictive than the former limitation. It sets up a qualified election requirement

[1] "Sec. 4. *Restrictions upon the increase of the public debt except in certain contingencies.* Except for refunding of valid bonded debt, and except to supply a casual deficit, or for suppressing invasions or insurrections, the General Assembly shall have no power to contract any new debt or pecuniary obligation in behalf of the State to an amount exceeding in the aggregate, including the then existing debt recognized by the State, and deducting sinking funds then on hand, and the par value of the stock in the Carolina Railroad Company and the Atlantic and North Carolina Railroad Company owned by the State, seven and one-half per cent of the assessed valuation of taxable property within the State as last fixed for taxation. . . ."

[2] The act submitting the proposed constitution to the voters, N. C. Pub. Laws 1933, c. 383, was ratified on May 8, 1933. It provided for submission "at the next general election." On May 9, 1933, an act (N. C. Pub. Laws, c. 403) was ratified which called a "general election" for November, 1933, to decide whether a convention should be called to consider the proposed Prohibition Repeal Amendment. Since this 1933 election turned out to be the "next general election" and since the proposed North Carolina constitution was not voted on then it could not be submitted at the 1934 general election.

[3] PROPOSED N. C. CONST. art. V, §2.

[4] PROPOSED N. C. CONST. art. V, §5. (1) Like N. C. CONST. art. VII, §7, this provision applied to any "county, city, town, or other municipal corporation," not to "counties and municipalities"; (2) the election requirement prescribed was stated as a prohibition subject to exceptions and not in part as a grant of power as is the amendment; (3) it did not permit non-electoral debt to supply a casual deficit or to suppress riots, etc., as does the amendment; (4) it set no limit on non-electoral tax anticipation borrowing, whereas the amendment confines it to fifty per centum of taxes of a fiscal year; (5) it had a materially different debt-reduction provision confined to bonded debt and limiting new non-electoral bonded debt (presumably in the next fiscal year) to one-half the previous year's reduction; and (6) it contained a much more drastic election requirement.

in lieu of the former 7½% limit. The state debt was not far below the 7½% limit when the amendment was proposed in 1935.[5]

So far as it concerns debt of local units of government, the amendment imposes an additional restriction. The old Section 7 of article VII, which is not greatly affected by the amendment, if modified at all, forbids any local unit to incur debt without an election, except for "necessary expenses," but nearly everything, except schools, hospitals, airports, golf courses, and aid to railroads has been held to fall within the exception. Thus the section was so ineffective as a check on abuse of public credit that the tide of defaults in local debt in North Carolina had reached a level second only to that in Florida when the amendment was adopted.[6] On January 1, 1936, according to one reliable authority,[7] there were no less than 130 cities and towns, 45 counties, and 75 other local units in default in North Carolina. In some instances bonded debt was in the neighborhood of 50% of taxable values.[8] It is thus easy to understand how the voters could have been in a mood at the 1936 general election to take from their representatives in local government much of the power hitherto held by them to incur new debts and thenceforth to have a direct hand in the matter themselves.

The purpose of this paper is to explore the legal implications of the amendment. Necessarily, many questions must be left open. The best that can be done here is, so far as space permits, to raise the more important legal questions likely to arise under the amendment and to discuss considerations affecting the answers to them. We are not unmindful of the remark of Mr. Justice Barnhill in the recent case of *Hallyburton v. Board of Education of Burke County*,[9] that the limitations of the amendment "are in such terms that 'he who runs may read' and understand." With deference, we believe that, far from being so simple, the amendment is heavy laden with legal questions which are likely to plague the supreme court for a long time to come.[10]

[5] According to the STATE AND MUNICIPAL COMPENDIUM, Part II (Dec. 31, 1935) 214, the recognized debt of the state, adjusted to June 30, 1935, was $170,548,000, the sinking fund balance was then $13,478,424 and the par value of the stock of the N. C. R. R. and the Atl. and N. C. R. R. was $4,266,800. Thus the net debt was $152,802,776. The COMPENDIUM gives 1934 total assessed valuations of $2,152,443,146. The limit would have been 7½% of this sum or $161,432,236.

See Gardner, *The Proposed Constitution for North Carolina* (1934) I POP. GOV. 62 *et seq.*

[6] That is, if special improvement districts are excluded.

[7] See the summary of defaults as of January 1, 1936, prepared by THE BOND BUYER and reproduced in HILLHOUSE, MUNICIPAL BONDS (1936) 25.

[8] See HILLHOUSE, *op. cit. supra* note 7, at 9, listing North Carolina and Florida as the only states in which debt service on local public debt, as of 1932, constituted over 25% of total expenditures.

[9] 213 N. C. 9, 14, 195 S. E. 21, 25 (1938).

[10] In the celebrated case of Levy v. McClellan, 196 N. Y. 178, 89 N. E. 569 (1909), a test case involving the application of the New York constitutional debt limit governing counties and cities to New York City's then financial circumstances, forty-three questions relating to the meaning and application of the limitation

Up to the present writing but few of the questions considered in this paper have been passed upon by the supreme court.[11] Thus frequent reference to the decisions interpreting constitutional debt limitations of other states will be made in this paper, but it must be borne in mind that those decisions are so numerous as to preclude detailed comparative consideration. The emphasis in the discussion that follows will be upon the meaning of the amendment as applied to local units on the assumption that the bulk of the difficulties will arise in local administration.

One preliminary question demands notice: Does the amendment apply to all local governmental units? It applies in terms to "counties and municipalities," whereas, the limitations of Section 7 of article VII apply to any "county, city, town or other municipal corporation." The latter provision, as construed by the supreme court, must be taken to apply to all local units;[12] it shows on its face that it was intended to be inclusive. But is "municipalities," taken alone, to be deemed to cover all sorts of special-function local units, such as sanitary districts, as distinguished from those organized for general purposes of local government, such as cities and towns? It is unfortunate that literally inclusive terms were not used, but the comprehensive character of the amendment is so dominant in an over-all view of the matter that it may well be said that this is no place for linguistic refinements. Any other view would open the way to evasion of the election requirement by the creation of special-function local units with the power to contract debts and to levy taxes to provide for their payment.[13]

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were certified to and answered by the court of appeals. The New York limitation was, moreover, much simpler than the amendment. It would be a boon to the court and to those to be governed by the amendment if a similar case were instituted in North Carolina.

On the economic aspects of the subject see SECRIST, RESTRICTIONS ON PUBLIC INDEBTEDNESS (1914) *passim.*

[11] Thomson v. Harnett County, 212 N. C. 214, 193 S. E. 158 (1937); Hallyburton v. Board of Education, 213 N. C. 9, 195 S. E. 21 (1938); Gill v. Charlotte, 213 N. C. 160, 195 S. E. 368 (1938). See Williamson v. High Point, 213 N. C. 96, 103, 195 S. E. 90, 94 (1938).

[12] Smith v. Bd. of Trustees of Robersonville Graded School, 141 N. C. 143, 53 S. E. 524 (1906) (school district); Reed v. Howerton Engineering Co., 188 N. C. 39, 123 S. E. 479 (1924) (sewer district). N. C. CONST. art. V, §5, exempts property belonging to the state and municipal corporations from taxation. It has been held that a drainage district is not a municipal corporation within the sense of this section. Board of Comm'rs of Muddy Creek Drainage Dist. v. Webb, 160 N. C. 594, 76 S. E. 552 (1912).

Viewing the amendment as a whole it is a bit startling to face the notion that a school or sanitary district could borrow to repel invasions.

[13] Effective evasion would include hurdling the necessary expense limitation of §7 of art. VII but there are purposes which have been held to be necessary expenses of special public corporations or districts. Reed v. Howerton Engineering Co., 188 N. C. 39, 123 S. E. 479 (1924) (sanitary sewers); Town of Kenilworth v. Hyder, 197 N. C. 85, 147 S. E. 736 (1929) (water and sewer system).

FUNDING OR REFUNDING VALID EXISTING DEBT

The first of the four enumerated purposes for which the legislature is granted express authority to contract state debt and to authorize the contracting of county and municipal debt, without regard to the election requirement, is "to fund or refund a valid existing debt." The first and most important question under this topic turns upon the effect of the word "existing." Does this refer to the time that the amendment took effect or to the time of a proposed funding or refunding? As a matter of grammar, the use of the word "existing" in the latter sense would be tautological, for the very idea of funding or refunding presumes the existence of a debt to be funded or refunded. While too much stress should not be placed on nicety of language in constitutional interpretation, it is also true under a respected rule of constitutional and statutory construction that every word in the written law is to be given some effect if possible since it is reasonably to be supposed to have been used meaningfully.[14] As this section stood prior to the 1936 amendment it contained an exception under which the general assembly was authorized to refund "valid bonded" debt of the state. The word "existing" did not appear in this provision. Is it to be said that the amendment alters the section so radically that the word "existing" is not to be accorded any significance?

On the other side of the scale rests the rather persuasive point that, viewed as a whole, there is no question but that in applying the amendment we would not ordinarily be concerned with the date of its taking effect but would seek to determine its meaning as to the particular circumstances at the particular time. This factor is reinforced by the practical consideration that, even where constitutional debt limitations do not expressly except funding and refunding obligations, they are deemed by the courts not to be included because they involve merely the extension of the life of existing debt in new form, not the contracting of new debt.[15] The Supreme Court of North Carolina has recently emphasized this characteristic of funding and refunding obligations.[16]

The next question is whether this provision is confined to debt valid in its inception or, at least, valid in a technical sense when funding or refunding is proposed. The answer to the first part of this question is fairly simple—original validity is not essential. But is it sufficient that a debt be enforceable? Whatever practical importance this question may have is due to the so-called estoppel doctrine, which is recognized and applied by the courts of North Carolina,[17] and which precludes a

[14] II LEWIS' SUTHERLAND, STATUTORY CONSTRUCTION (1904) §380.
[15] I DILLON, MUNICIPAL CORPORATIONS (5th ed. 1911) §202; 6 McQUILLIN, MUNICIPAL CORPORATIONS (Rev. ed. 1937) §2385.
[16] Bryson City Bank v. Bryson City, 213 N. C. 165, 195 S. E. 398 (1938).
[17] The leading case is Belo v. Comm'rs of Forsyth County, 76 N. C. 489 (1877).

unit from showing defects or irregularities in the issuance of bonds inconsistent with recitals on the face of the bonds, as against bona fide purchasers for value. Thus we may have bonds that are enforceable although not technically valid. But such a distinction appears tenuous indeed for present purposes. To confine the term "valid" to debt which was essentially valid, aside from considerations of remedy and enforcement, would be highly artificial.

For the most part, little would turn upon the character of the debt proposed to be funded or refunded, whether the obligation was contractual, quasi-contractual, delictual, or what not, and whether it was incurred for current expenses or capital outlay, whether for necessary or non-necessary expenses, and whether for special or ordinary purposes. All that is required is that it be valid and existing.

An interesting question is presented in this connection by a line of Florida cases. Not unlike the new North Carolina limitations, Section 6 of article IX of the Florida constitution excepts refunding bonds from a requirement that bonds of local units be voted. The Supreme Court of Florida has said that this exception contemplates a renewal of the old debt and ". . . any attempt to add to, enhance, enlarge or increase such obligation by means of a pledge of special revenue, properties or income not theretofore obligated or pledged in the original bonds will be held to be in violation . . ." of Section 6 of article IX of the state constitution, unless approved by the voters.[18] This idea, that to add to the security behind the old debt renders refunding bonds new debt, is novel and seems to be peculiar to Florida. It is obvious that such a rule tends to embarrass a unit in working out an advantageous readjustment of its debt with its creditors because it greatly restricts the bargaining field.

It is not material that refunding bonds bear a higher rate of interest than the old.[19] But the issuance of refunding bonds at a discount would raise a more substantial question since that might involve an increase in the principal amount of debt outstanding.[20]

Tax Anticipation Borrowing

The second enumerated purpose to which the election requirement does not apply is borrowing in anticipation of the collection of taxes due and payable within the fiscal year to an amount not exceeding 50% of such taxes. What taxes may thus be anticipated? Since it is unqualified in that respect the term "taxes" literally includes all forms of taxes levied by the particular unit. It is doubtful, however, whether it

[18] State v. Citrus County, 116 Fla. 676, 157 So. 4, 11 (1934).
[19] Bolich v. Winston-Salem, 202 N. C. 786, 164 S. E. 361 (1932).
[20] But note the Florida view, Sullivan v. Tampa, 101 Fla. 298, 134 So. 211 (1931).

would include taxes not levied by or upon behalf of the unit, such as state taxes the proceeds of which were allocated to counties for county purposes. In such a case it would seem that the state would be the unit qualified to borrow against the tax, because it would be the unit actually levying the tax regardless of the distribution of the proceeds therefrom. In the not uncommon situation where the taxes of a school or other district are levied and collected for its benefit by the officers of another unit, such as a county or city, which would be the proper unit to do the borrowing? Presumably, the district, because the taxes are essentially its taxes regardless of the method of levy and collection in operation.

This sort of borrowing is confined to anticipating taxes "due and payable" in the then current fiscal year. What of uncollected taxes of previous years? They are clearly "payable" in the current fiscal year but became "due" earlier. The provision has specific reference to a fiscal year and a certain percentage of taxes which conveys the idea that the only taxes concerned are taxes which became due in that fiscal year.

Revenues other than taxes would not come within the language of this provision. Thus income from public services which are paid for on a fee basis, more commonly termed rates in the case of utility services, would not be included. (We are referring here to general obligation borrowing; as we shall indicate later special revenue obligations payable solely from the revenues of the project for which they were issued are not debts within the meaning of the amendment.) It has been suggested that this fact may work a substantial hardship upon municipalities which are able to pare down their operating levies by applying net utility earnings to general municipal expenses.[21] It seems, however, that the point is not a serious one because under existing general law, at least, only net utility revenues, after payment of expenses of operation and maintenances and making provision for debt service on obligations issued to finance the particular utility, could be used in this way.[22] Net revenues are not determinable until the end of the operating period, the fiscal year, and it is difficult to see how they could properly be anticipated by borrowing. Were net revenues determined on a monthly basis, moreover, the money would come in regularly, thus mitigating the need of anticipation.

[21] GRICE, A SUMMARY OF CITY AND COUNTY FINANCIAL PROBLEMS RAISED BY THE RECENTLY ADOPTED AMENDMENT TO THE NORTH CAROLINA CONSTITUTION (Institute of Government, Chapel Hill, N. C., Dec. 1936) 8.

[22] N. C. CODE ANN. (Michie, 1935) §2959 provides:

> "So much of the net revenue derived by the municipality in any fiscal year from the operation of any revenue producing enterprise owned by the municipality after paying all expenses of operating, managing, repairing, enlarging and extending such enterprise, shall be applied, first to the payment of the interest, payable in the next succeeding year on bonds issued for such enterprise, and next, to the payment of the amount necessary to be raised by tax in such succeeding year for the payment of the principal of said bonds."

Net revenues of one year are cash on hand for the next.

Probably the most important question under this provision is whether the amount which may be borrowed at any given time against taxes of the current year, when added to the amount of outstanding previous loans against those taxes, is limited to 50% of the amount of the taxes remaining uncollected at the time of the proposed loan. It would seem that this question should be answered in the affirmative, if the purpose of the 50% limitation was to provide an ample margin to insure payment of such loans from collections of the taxes anticipated. On the other hand, if the purpose was to enable a unit to finish out a year's operations despite inadequate tax collections during the year, then it would seem permissible to borrow up to the full amount of the taxes remaining uncollected at the time of the proposed loan, so long as the total loans do not exceed 50% of the amount of the levy.

There is also a question whether the provision relates only to borrowing against taxes already levied. Prior to levy the amount is unknown although within limits there is no genuine uncertainty. The amendment, moreover, refers to borrowing in anticipation of the collection of taxes, not the *levy* and collection of taxes. At present the question is an open one.[23]

Must unvoted tax anticipation loans be payable within the fiscal year in which made? Since no limit on maturities is expressly established it may reasonably be assumed that the grant of power to borrow in anticipation of taxes is not qualified in that respect. Obviously there are practical limitations upon the maturities of such paper. On the other hand, by a literal interpretation of the debt-reduction provision of the amendment the payment of such paper in a subsequent year would be a reduction of outstanding indebtedness even though made from the collections anticipated.[24]

Supplying a Casual Deficit

This provision is a carry-over from the old Section 4 of article V of the constitution. It is new, of course, as to local units. There appear to have been no decisions of the supreme court spelling out its meaning. Constitutional limitations upon state debt quite generally contain such an exception,[25] but there are only a few instances of its use in the field of local government.[26] The late proposed new constitution for North Carolina confined this provision to state debt. Prediction is hazardous

[23] For comparative material see 6 McQuillin, Municipal Corporations (Rev. ed. 1937) §2379.

[24] See the discussion under the topic *What Is Outstanding Indebtedness? infra.*

[25] This sort of thing seems to date from §10 of art. VII of the N. Y. Constitution of 1846; the provision still exists as §2 of art. VII of the present N. Y. Constitution.

[26] See particularly Ga. Const. art. VII, §7; and Md. Const. art. XI, §7 (applicable only to city of Baltimore).

but we risk the guess that this provision will prove to be a rubber link in the chain of limitation which circumscribes local borrowing, unless very narrowly construed. As applied to local units, moreover, its very vagueness is calculated to render its administration difficult and to invite litigation.[27] This is not true as to the state because ordinarily the courts may be expected to consider a finding by the legislature that a "casual deficit" exists conclusive.[27a]

This subject has two major aspects. As a practical matter a deficit may arise either because of increased expenditures or due to deficient revenues. If by "casual" is meant unanticipated, unforeseen, or unexpected,[28] then this provision would seem to cover a deficit caused by either unforeseen expenditures or an unexpected failure of revenues.

While existing general law does not appear to permit supplemental appropriations by counties or municipal corporations,[29] there is nothing to prevent the legislature from abandoning this policy and were it to do so the danger of deficit financing of current expenses by local units would be greatly increased. Ultimately, the inquiry whether a particular deficit is casual is a judicial question as to the local units, but the courts will have so little to go on that predictability will probably be low indeed. For instance, how can one be certain until a court of competent jurisdiction has spoken to the point whether a given expenditure in excess of appropriations made in the general appropriation measure adopted at the begining of a fiscal year was unanticipated? Is the real question whether the expense was in fact anticipated or whether it reasonably should have been anticipated? In addition to the difficulty of applying a subjective test it is to be presumed that local officers have acted in good faith until the contrary is shown,[30] and thus it would seem that only by adopting the objective test could the courts perform their function in the administration of the provision effectively.

Getting down to cases, expenditures occasioned by extraordinary circumstances, such as a flood or cyclone, might safely be labeled unanticipated, whereas serious questions might arise as to outlay for routine

[27] The Supreme Court of Georgia has struggled with the subject in numerous cases, but it may be questioned whether that court has been able to put the matter on a reasonably predictable basis.

[27a] See GRAY, *op. cit. infra* note 48.

[28] In Lewis v. Lofley, 92 Ga. 804, 808, 19 S. E. 57, 59 (1894), we find the following definition:

"The word 'casual' means that which happens by accident, or is brought about by an unknown cause; and we think the framers of the constitution, in using this language, meant some unforeseen or unexpected deficiency, or an insufficiency of funds to meet some unforeseen and necessary expense."

[29] The subject is governed by the County Fiscal Control Act, N. C. Pub. Laws 1927, c. 146, which is made applicable to cities and towns by §65 *et seq.* of the Local Government Act, N. C. Pub. Laws 1931, c. 60.

[30] The point seems obvious. See Russell v. Whitt, 161 Ky. 187, 170 S. W. 609, 611 (1914).

matters such as ordinary maintenance of public buildings or salaries of officials.

In course of time the supreme court will probably be asked to decide whether an expenditure for other than essential governmental functions of a unit, or for capital outlay, may create a "casual deficit." Since the term has no fixed meaning, it is open to interpretation on this point.

The second division of the subject relates to failures of current revenues to meet valid appropriations. An anticipated failure of revenues could hardly be casual. Just as in the matter of determining the propriety or necessity of expenditures for lawful municipal purposes, so with the business of estimating revenues the courts will not interfere except in the case of plain abuse of discretion,[31] but there can be scant doubt about the power of the courts to review revenue deficiencies for the purpose of determining whether they are "casual." But once again the rub comes in administration. Be it assumed that the governing body of a city in making provision for the appropriations of a given year estimated one hundred per cent collection of *ad valorem* taxes for that year. Even were this done in a era of great prosperity common experience tells us that the estimate would be arbitrary. But no matter what the size of the ensuing deficit, and even though unexpected circumstances cropped up to contribute to it, it would ordinarily be impossible to determine what part was casual and what part deliberate.

For all that appears a casual revenue deficiency might occur with respect to any legitimate sort of revenue relied upon to meet appropriations and would not be confined to any particular form of taxation, or even to taxes for that matter. Nor does it appear to be confined to deficiencies due to failure of revenues to come in; tax receipts might be unexpectedly lost due to failure of a properly selected depository bank, or the defalcations of a public officer or employee. The ensuing deficit under such circumstances surely could not have been anticipated when the revenue estimate of that year was made unless at that time it was known that the depository of the unit was in failing circumstances or that there were untrustworthy people handling the funds of the unit.

The question has been raised whether a deficit represented by interfund advances instead of claims held by creditors, would be within the sense of the amendment.[32] Ultimately the court must clarify the matter. It would seem that there is ground to support an affirmative answer where the lending fund had to be restored to meet demands on it.

It is significant that a casual deficit represented by floating debt can be funded into long-term obligations. This sort of thing was an im-

[31] East St. Louis v. United States *ex rel.* Zebley, 110 U. S. 321, 4. Sup. Ct. 21, 28 L. ed. 162 (1884), is the leading case. See also State v. Staples, 157 N. C. 637, 73 S. E. 112 (1911); Brown v. Hillsboro, 185 N. C. 368, 117 S. E. 41 (1923).

[32] GRICE, *op. cit. supra* note 21, at 9.

portant factor in the flood of defaults on obligations of local units which inundated the state during the depression. Since the amendment places no limit on debt contracted to supply a casual deficit, unlike constitutional provisions in other states,[33] the general assembly might well embody such a policy in legislation. It may, of course, deny the power to contract such debts to local units altogether, if it sees fit.

Suppressing Riots or Insurrections or Repelling Invasions

"Suppressing invasions or insurrections" was an object excepted from the old state debt limit.[34] The amendment added the suppression of riots to this category and so changed the wording as to authorize non-electoral borrowing both by the state, counties and municipalities "to suppress riots or insurrections, or to repel invasions." It is rather extraordinary that such a provision should be applied to local units. Suppressing riots is part of the normal local function of keeping the peace, but keeping down revolt or repelling invaders is hardly a local responsibility in the accepted sense, although there may well be local participation in such matters simply as a matter of mobilizing for the common good. It will be remembered that the Federal Constitution imposes a duty on the United States to come to the aid of a state faced with such an exigency.

While this provision will doubtless be of no great practical importance in the ordinary administration of public affairs,[35] one further point deserves brief comment. Suppression assumes the existence of a condition to "quell" or "subdue" and thus it may be questioned whether the provision applies to debt contracted "to prevent" riots or insurrections.[36] The apparent significance of this difference is probably diluted materially by the fact that the business of suppression would comprehend the making of provision in advance for an emergency.

The Debt-Reduction Provision

Thus far we have dealt with the four enumerated purposes for which the amendment authorizes the contracting of public debt without electoral approval. We come now to the important general restriction set up by the amendment, namely, that the contracting of new debt be approved

[33] See Ga. Const. art. VII, §7, limiting such loans to one-fifth of one per cent of the assessed value of taxable property in a unit.

[34] This provision also seems to have originated in §10 of art. VII of the N. Y. Constitution of 1846 and to have been widely employed as an exception in state debt limitations.

[35] It could well become significant in time of serious industrial or social conflict, however.

[36] Thus, the preferred connotation given by the Standard Dictionary of the English Language is: "To put down or put an end to by force; overpower; crush; subdue; as, to *suppress* an insurrection."

by a vote of the people. The general restriction is that the contracting of public debt must first be approved at an election in the unit at which a majority of those voting on the proposition vote for the indebtedness. This is a much less rigid requirement than that of Section 7 of article VII of the constitution. The latter requires that non-necessary expense debt of a local unit have the approval of a majority of the qualified voters of the unit, given at an election on the subject.[37]

A debt proposition might be submitted repeatedly to the voters until a favorable vote was finally obtained.[38] On the other hand, once such approval has been given is it to be deemed irrevocable? It seems clear beyond reasonable doubt that it would not be at any time prior to the contracting of the proposed debt. Would approval by the voters after the fact serve to validate unauthorized efforts by a governing body to incur debt? The amendment refers to voting upon "proposed indebtedness," which lends some countenance to the notion that it was contemplated, that electoral approval be a condition precedent rather than an authorization[39] but the supreme court has taken the opposite view under Section 7 of article VII.[40]

It is the novel debt reduction exception to the election requirement more than the general restriction itself that calls for extended comment. The exception permits the incurring of state debt during a biennium[41] without a state election up to two-thirds of the amount by which the state's outstanding indebtedness shall have been reduced during the next preceding biennium and grants like permission, on a fiscal year basis to counties and municipalities.[42] It seems reasonably clear that "outstanding" refers to the time as of which any given computation of debt is to be made and not to the time when the amendment took effect. It is to be noted that there is a statute in New Jersey which bases an exception to restrictions upon municipal debt upon retirement of debt existing

[37] "Qualified" means registered voters. Thus a special registration for a bond election may take much of the sting out of the requirement. Hammond v. McRae, 182 N. C. 747, 110 S. E. 102 (1921).

[38] This seems obvious and attention is called to it simply because of its practical implications.

[39] But even under this theory, that electoral approval is a matter of affecting the method of incurring, not the power to incur, debt, there is authority that there can be validation by a subsequent election held pursuant to statutory authority. I DILLON, *op. cit. supra* note 15, at 432, and cases cited.

[40] Hammond v. McRae, 182 N. C. 747, 110 S. E. 102 (1921); Jones v. New Bern, 184 N. C. 131, 113 S. E. 663 (1922).

[41] A biennium, according to North Carolina fiscal practice, is a span of two consecutive fiscal years following a regular session of the general assembly. It is a perfectly good North Carolina term, but the lexicographers have taken scant notice of it.

[42] With reference to the state the amendment speaks of contracting "new" debt but drops this term in connection with local debt. It is not believed that the omission carries any significance.

when the limitation was imposed, but the statute speaks explicitly to the point.[42a]

To live under this provision a borrowing unit will have roughly three times as onerous a problem of debt computation and thus a proportionately greater burden of administration and risk of error than has a unit in a state which has a conventional percentage-of-taxable-values debt limit. To determine how much debt may be contracted at a given time without a vote it will be necessary (1) to determine the outstanding debt of the unit at the start of the preceding fiscal period, (2) to make a like finding as of the end of that period, and (3) to determine how much debt has already been contracted in the current fiscal period. In determining the reduction in the preceding fiscal period, new debt incurred during and which survives that period must, of course, be taken into account.[43]

There is no cumulation of non-electoral borrowing power built up by debt reduction. If the reduction of one biennium of fiscal year is not availed of in the next it is lost for it is only the reduction of the "next preceding" biennium or fiscal year that counts.

Could the general assembly alter or permit changes in the biennium or the fiscal year? One thing seems clear—a biennium means two years and any period of more or less than twenty-four months would not meet the test. Likewise, a fiscal year is a period of twelve months and neither more nor less. The only apparent alternative to these assumptions is chaos.[44] Within these limitations, the legislature, doubtless, may change the date of beginning of the fiscal year and of the biennium and thus automatically the end of such a period. Suppose the present fiscal year were changed to conform to the calendar year. There would be an odd interval of six months that would appear to be neither flesh, fish, nor fowl; it could not safely be deemed a fiscal period or part of one for purposes either of determining debt reduction or of contracting new debt against a previous reduction. It could not be tacked onto either the last of the old or first of the new fiscal years without making the period more than a "year." Possibly, an exception might be implied to cover such a transitional odd interval.

[42a] N. J. Acts of 1935, c. 77, §208. For a statutory exception of this sort antedating the amendment see the charter of the City of High Point, N. C. N. C. Private Laws 1931, c. 107 art. XIII §5, as amended by N. C. Private Laws 1931, c. 158, §7.

[43] There is a possible exception in the case of current expense items and tax anticipation loans. See the topic WHAT IS OUTSTANDING INDEBTEDNESS? *infra*.

[44] If a fiscal year could be other than twelve months in duration the legislature could juggle the subject at pleasure and make the "fiscal year" as long or short as it saw fit.

1

WHAT IS NEW DEBT?

It would be most comforting if one could approach this subject with a precise and reliable definition of "debt." Unfortunately, at least for purposes of its use in constitutional limitations upon public debt, there is no such thing. There is a zone of doubt which remains to be charted by the supreme court. Meanwhile, however, a few general observations may be ventured.

The restriction upon the incurring of new debt applies, in terms, to any debt contracted by a unit. It is thus not confined to funded debt or borrowing evidenced by formal obligations but extends as well to simple contracts for things or services furnished on credit.[45]

It seems to apply, moreover, whether the amount which the unit may be called upon to pay under contract is fixed or determinable from the outset, so long as there is a legal commitment to pay something. The fact that the unit is receiving a consideration under the contract of equal or even greater value than what it undertakes to pay is not material; the question is one of debt, not of solvency.[46] It is not essential that state contracts be judicially enforceable,—otherwise, as Dillon has pointed out,[47] the state would never incur debt except where it had consented to be sued. An undertaking of a local unit, however, not supported by any remedial sanction, would be a mere shell.

While there is some language in the opinions of courts of other states relating to constitutional debt limitations to the effect that the word "debt" is used in its ordinary sense, the decisions generally do not go that far. On the contrary, while the courts have shown themselves, naturally enough, to be debtminded just like the rest of us in times of stringency, they have found the term "debt" to have a materially more restricted meaning as used in constitutional debt limitations than its meaning in common parlance.[48] It is evident that to give the provision we are considering literal effect would be to hamstring public administration. On its face, it would apply to the use of credit for the most routine operating expenses. Experience elsewhere suggests a number of possible qualifications.

[45] In the opinion in the *Hallyburton* case, 213 N. C. 9, 195 S. E. 21 (1938), the court discussed the amendment in terms of funded debt, but there is no reason to suppose that it was doing so otherwise than by way of illustration.

For convenience, the term "borrowing" will be used freely in this paper to include both its common meaning and the direct use of credit.

[46] I DILLON, *op. cit. supra* note 15, at 352. See especially Stone v. Chicago, 207 Ill. 492, 69 N. E. 970 (1904).

[47] *Id.* at 351.

[48] This will appear from the discussion that follows. See generally 6 McQUILLIN, *op. cit. supra* note 15, §2374. Compare the strict view taken by GRAY, LIMITATIONS ON TAXING POWER AND PUBLIC INDEBTEDNESS (1906) §1061.

a. Current Expenses

First in importance come current expenses. By the great weight of authority general liabilities incurred for current operations which are within current revenues, whether on hand or yet to be collected, are not debts for present purposes.[49] In practice this means that to enjoy the favored status an item must be (1) for a current expense, (2) charged to a valid appropriation, and (3) covered by estimated current revenues. In the normal course of events such transactions are strictly current, involving no additional burden upon the taxpayer, and can with some reason be said to fall beyond the design of the constitutional restriction. It is obvious, too, that this rule of exemption is strongly buttressed by necessity. Government has become a big and complex business, strictly cash operation of which is out of the question.

There are two special considerations bearing upon the interpretation of the amendment in relation to this subject. It might be urged, on the one hand, that express provision for tax anticipation borrowing enables a unit to put itself in funds before revenue collections begin to come in and thereby to operate on a pay-as-you-go basis. But that this militates strongly against the existence of an intent to permit current operations on credit is not evident, even if true; rather, it would seem that non-electoral tax anticipation borrowing is permitted as a convenience and was not intended as a device whch must be employed regularly by the state and local units in order to carry on. On the other hand, unvoted debt is expressly authorized to supply a casual deficit. If an absolute pay-as-you-go scheme was in contemplation, how could a casual deficit arise?

What are "current expenses" in the sense of this rule? Dillon has listed a great number of items which have been judicially placed in this category.[50] Such conventional expenses of a city as salaries of officials, maintenance of streets, police and fire protection and routine health and sanitary services are easily classified for this purpose, even if the rule be rested upon necessity instead of legitimate interpretation of "debt." Logically, it may be questioned whether the element of necessity should be considered for, strictly speaking, the constitution knows no necessity which would disallow any of its provisions.[51]

If the true test be whether the given financial commitment is one that in the normal course of administration will be met by current funds because fully provided for by current operating revenues, any proper current operating expense, whether incurred in the perform-

[49] For a collection of cases see I DILLON, *op. cit. supra* note 15, §195; and 6 MCQUILLIN, *op. cit. supra* note 15, §2378.

[50] I DILLON, *loc. cit. supra* note 49. [51] GRAY, *op. cit. supra* note 48, at 1051.

ance of an essential function or not, would be within the rule. Thus, if a special tax had been voted in a North Carolina county for the establishment and maintenance of a hospital, which the supreme court has ruled is not a necessary expense under Section 7 of article VII of the constitution,[52] liabilities incurred in operating the hospital, if within estimated current receipts from the hospital tax, would not be "debts" when incurred.

Logically, the rule might well be deemed to apply to budgeted capital outlay, sometimes termed extraordinary expenses for contrast. But the courts, for the most part, have regarded this notion with disfavor, due mainly, no doubt, to the absence of impelling necessity.[53] It is true, too, that the risk of deficits would be greater here. It is difficult to weigh such considerations against the countervailing factor that to hold the rule inapplicable is to discourage the meeting of capital needs as far as possible from current funds.

If the use of credit directly in obtaining current supplies and services would not be contracting debts, the question arises whether the same would be true of borrowing to put a unit in funds to pay for such items. The Georgia Court has said, for one, that it would not be so.[54] That would seem to be the correct answer in our case because such borrowing would in fact be done in anticipation of the collection of taxes and thus would be governed by the express provisions of the amendment on the subject.

b. Cash on Hand

Even in the case of capital outlay, if the unit has cash on hand appropriated to that object and sufficient to cover all liabilities contracted, there is ample authority that no debt is incurred within the meaning of a constitutional debt restriction.[55] The proposition has been stated more liberally,—Dillon says that to the extent of such cash no debt is created.[56] That is not open to objection where the contract is divisible, but where the cash on hand is less than the amount involved in an indivisible contract there is a question whether it would stand or fall as a unit.[57] Technically, where a unit has issued $1,000,000 of bonds for a public work and then lets a contract for the job it has contracted liabilities aggregating $2,000,000 even though the bond proceeds

[52] Palmer v. Haywood County, 212 N. C. 284, 193 S. E. 668 (1937), citing earlier cases. Two judges dissented.

[53] I DILLON, *loc. cit. supra* note 50; I JONES, BONDS AND BOND SECURITIES (4th ed. 1935) §106.

[54] Butts County v. Jackson Banking Co., 129 Ga. 801, 60 S. E. 149 (1908).

[55] Levy v. McClellan, 196 N. Y. 178, 89 N. E. 569 (1909); 6 MCQUILLIN, *op. cit. supra* note 15, §2386.

[56] I DILLON, *op. cit. supra,* note 15, §197.

[57] See the topic, *The Effect of Contracts Exceeding the Limit, infra.*

are on hand. What this common-sense rule does is permit the making of contracts covered by such cash on hand without regard to a debt limitation.

c. Continuing Contracts

In some jurisdictions the current expense rule has been extended to contracts covering the furnishing of services or supplies, needed for current operations, for a period of years,[58] and the Supreme Court of the United States has given this step its benediction.[59] The rational basis of this view is that unless the contract by its terms requires a different interpretation it is to be deemed not to create a debt at the outset for the full price of all services or supplies that may be furnished under it but only to impose periodic liability at the stipulated rate as performance on the part of the opposite party takes place. If the periodic payments falling within a given fiscal year are within current revenues it is held that no debt has been contracted.[60]

Such treatment of continuing contracts seems to be a logical extension of the current expense rule even though the unit is firmly bound by the contract from the outset for if annual requirements are fully budgeted no real increase in the debt burden of the unit is to be anticipated. The rule does not apply to capital expenditures.[61] The case is clearer than where the entire cost is to be provided from revenues of the current year, since it involves the anticipation of taxes of future years for extraordinary expenses much as does a bond issue, with like effect on the taxpayer.

d. Instalment Contracts

Efforts to evade debt limitations by resort to instalment payments have met with scant success.[62] Such a scheme involves a present consideration moving to the unit as distinguished from the future con-

[58] A recent case in point is Scranton Electric Co. v. Borough of Old Forge, 309 Pa. 73, 163 Atl. 154 (1932). For collections of cases see I DILLON, *op. cit.* supra note 15, §196; and 6 MCQUILLIN, *op. cit. supra* note 15, §2392.

[59] Walla Walla City v. Walla Walla Water Co., 172 U. S. 1, 19 Sup. Ct. 77, 43 L. ed. 341 (1898).

[60] It will be seen that under this view, even though the payments falling due within the first fiscal year of the contract, for example, were not covered by current revenues, the debt contracted would be only the amount of those payments. This does not fit well into the debt-reduction scheme for no one can say in advance whether the payments required in a subsequent year would be within two-thirds of the preceding year's reduction. Since under the County Fiscal Control Act, N. C. Pub. Laws 1927, c. 146, such items would have to be budgeted, it should be presumed that the law will be complied with and thus that payments of a future year will be within current revenues.

The rule has been criticized in I JONES, *op. cit. supra* note 53, §105.

[61] See note 62, *infra*.

[62] Renfroe v. Atlanta, 140 Ga. 81, 78 S. E. 449 (1913); Spilman v. Parkersburg, 35 W. Va. 605, 14 S. E. 279 (1891); I JONES, *op. cit. supra* note 53, §107, citing a number of cases.

sideration involved in continuing contracts of the type just discussed. A conditional sale of a fire truck to a municipality is a fair sample of such a contract; its provision for deferred payments puts it on the same basis as serial bonds issued for a like purpose, and in each case debt for the full amount is contracted at the outset. But suppose the contract relates to an ordinary expense. Assume, for example, that at a time of extremely low prices a city with adequate storage facilities wanted to buy enough coal to meet its estimated needs for three years, and the seller was willing to have payment of one-third of the price deferred for one year and a third for two years, each payment to be budgeted as a current item in the appropriate year. Even though the calculated effect of the transaction is to save the taxpayer money, a present debt for the total price is created for a present consideration and thus cannot be rationalized as persuasively as a continuing contract.

e. Contingent Claims

The decisions of courts of other states on the question whether contingent liabilities are debts for purposes of constitutional debt limits are not in harmony.[63] Probably the most satisfactory test that has been enunciated is whether the contingency is a matter subject to the control of the unit. If the unit is committed from the start and the event upon which its liability becomes fixed is an external matter beyond its control, even though not bound to happen, it may be said that a debt is incurred *ab initio,* but if the unit is left to control the event no debt is incurred until the condition is met.[64]

f. Obligations Payable from a Special Fund

It has not been many years since special assessments for benefits were a highly favored means of financing local improvements, the idea being to place the burden on property specially benefited instead of increasing the *ad valorem* tax burden on property generally.[65] One factor which stimulated the use of this device in other states was the inability of particular local units to finance local improvements by general obligation borrowing due to constitutional and statutory restrictions upon such debt. While special assessment financing has taken varied forms the important development to which we wish to advert here was the practice of making the contract for an improvement pay-

[63] It is held in South Carolina that they are not debts. Lillard v. Melton, 103 S. C. 10, 87 S. E. 421 (1915). *Contra:* Smith v. Guin, 229 Ala. 61, 155 So. 865 (1934). See generally I JONES, *op. cit. supra* note 53, §94; 6 MCQUILLIN, *op. cit. supra* note 15, §2377.

[64] This is the Iowa theory of the matter. Burlington Water Co. v. Woodward, 49 Iowa 58 (1878). See also I DILLON, *op. cit. supra* note 15, §200.

[65] The idea is an old one. It is said that the use of special assessments in New York goes back to 1691. Williams and Nehemkis, *Municipal Improvements as Affected by Constitutional Debt Limitations* (1937) 37 COL. L. REV. 177, 187 n. 56.

able solely from special assessments on property in the affected area.[66] Such assessments constituted the sole source of payment to the creditor,[67] and the courts are agreed that such financing does not constitute debt within the sense of constitutional and statutory debt limitations.[68]

In recent years, due to the sobering influence of the depression and the relatively high general obligation debt of many local units the country over, together with the active stimulus of federal loans and grants in aid of local self-liquidating public works, which accentuated the apparent painlessness of such borrowing, so-called revenue bonds have become a favored instrument of public finance. The kinship between revenue bonds and special assessment financing of the character just described is obvious. There is no precise usage, but broadly speaking a revenue bond is a public obligation payable solely from the net revenues of the improvement for which it was issued.[69] Such obligations may be issued either as special obligations of the state or a local unit, which is organized for governmental purposes with the power to tax to effectuate those ends, or as general obligations of a public corporation organized to perform a particular public service, which can be made to pay its way, and having no source of revenue other than the income of the public improvements and activities under its control. The term most commonly applied to special corporations of this character is "authority,"[70] the most conspicuous instance of which is the Port of New York Authority. This type of financing, while most frequently resorted to in aid of utilities such as electric and water systems, has been brought into play in financing a great variety of public works.[71]

The not inconsiderable learning which has accumulated on the question of whether revenue bonds are debts in the sense of constitutional debt limitations is focalized in the so-called special fund doctrine. In its more general sense the gist of this doctrine as applied to revenue bonds, is that public obligations payable solely from a special fund derived from the revenues of the property or undertaking financed by such obligations are not debts within the meaning of a constitutional

[66] HILLHOUSE, *op. cit. supra* note 7, c. VI.

[67] For a collection of authorities see Williams and Nehemkis, *supra* note 65, at 188 n.

[68] *Ibid.*

[69] While not always so stated the rule is confined to obligations payable only from net, not gross, revenues. Were gross revenues pledged with the effect of rendering expenses of operation and maintenance a tax burden (there is usually a covenant to maintain and operate until the bonds are paid) debt would be created. Smith v. Guin, 229 Ala. 61, 155 So. 865 (1934); *In re* Opinion of the Justices, 226 Ala. 570, 148 So. 111 (1933).

[70] See generally Nehemkis, *The Public Authority: Some Legal and Practical Aspects* (1937) 47 YALE L. J. 14.

[71] The new gymnasium and women's dormitory of the University of North Carolina at Chapel Hill were financed in part in this way. The device has been used conspicuously in aid of bridge construction. Its use for such purposes as hospitals and auditoriums is not uncommon.

debt limitation. There are decisions on the subject from over half the states and not more than three can be listed as not having embraced the doctrine either with or without reservations.[72] The weight of authority supports the "broad special fund doctrine," the purport of which is that no debt is created so long as the special fund is derived from net non-tax revenues. The typical case is that where the net income from existing properties, improved with the aid of the revenue obligations, is included. It doubtless would apply where net revenues of distinct and independent property or services are pledged.[73] A few states, however, following the lead of Illinois,[74] are committed to the "restricted special fund doctrine,"[75] which narrows the protection of the rule to obligations payable solely from the net revenues of the specific properties paid for with the proceeds of the obligations. The fundamental test under either view is whether the obligation is payable from taxes. It is held that since the prime object of debt limitations is to keep the tax burden in bounds only obligations payable from taxes are within their purview.[76] In an important sense general obligation municipal bonds are simply a means of anticipating the taxes of future years. But the restricted theory holds that to pledge revenues of existing properties is to require indirectly taxation to pay the revenue obligations since it absorbs net revenues of those existing properties which would otherwise go into the general fund of the unit in reduction of taxes.

In 1903 the Supreme Court of North Carolina adopted the broad special fund doctrine. In *Brockenbrough v. Board of Water Commissioners,*[77] it appeared that the city of Charlotte, acting under special enabling legislation, was about to issue revenue bonds without a vote of the people of the city to finance improvements to its existing water

[72] All but the most recent cases are collected by Foley, *Revenue Financing of Public Enterprises* (1936) 35 MICH. L. REV. 1, app., and Williams and Nehemkis, *supra* note 70, at 209 *et seq.* See also the collection of cases in Fairbanks, Morse & Co. v. Wagoner, 81 F. (2d) 209, 216 n. 4 (C. C. A. 10th, 1936). The dissenting states are *Idaho:* Feil v. Coeur D'Alene, 23 Idaho 32, 129 Pac. 643 (1912); *Maryland:* Baltimore v. Gill, 31 Md. 375 (1869); and *New Jersey:* Wilson v. State Water Supply Comm., 84 N. J. Eq. 150, 93 Atl. 732 (1915). Georgia has been put in this group by Williams and Nehemkis, *supra* note 53, at 210.

[73] The point was noticed but not passed on in State v. Fort Pierce, 126 Fla. 184, 170 So. 742 (1936), where the net revenues of existing water and electric properties were pledged to pay bonds issued to finance improvements to the electric properties. Both properties were operated as a single system.

[74] The leading case is Joliet v. Alexander, 194 Ill. 457, 62 N. E. 861 (1902). *Cf.* Hairgrove v. Jacksonville, 366 Ill. 163, 8 N. E. (2d) (187) (1937).

[75] See the collection of cases referred to in n. 72. See also Smith v. Waterworks Bd. of Cullman, 175 So. 380 (Ala. 1937); Cartledge v. City Council of Augusta, 183 Ga. 414, 188 S. E. 675 (1936).

[76] See the oft-cited New York case, Bank for Savings v. Grace, 102 N. Y. 313, 318, 89 N. E. 569, 573 (1886). This idea underlies the decision in Brockenbrough v. Board of Water Comm'rs, 134 N. C. 1, 46 S. E. 28 (1903).

[77] See note 76, *supra.*

system.[78] The bonds were payable from the revenues of the entire system and enjoyed the additional security of a mortgage upon the system as a whole. It was held that regardless of whether a water supply was to be deemed a necessary expense within the meaning of Section 7 of article VII of the constitution,[79] the bonds were valid without electoral approval because they were not "debts." This decision goes beyond the broad special fund theory because the bonds were secured by a mortgage on existing property paid for by the taxpayers of the city. The opinion contains no comment on this aspect of the case.[80]

In the recent case of *Williamson v. City of High Point,*[81] the court announced the conclusion that "debt" meant the same in the amendment as in Section 7 of article VII and reaffirmed the special fund doctrine in the following language:

"The prevailing opinion in other jurisdictions is that the special fund doctrine, as enunciated in the *Brockenbrough* case, *supra,* to the effect that a contract by a municipality to purchase and pay for property for public purposes solely out of the net earnings of the property, without resort directly or indirectly to revenue derived from taxation, does not create a debt within the meaning of such constitutional provisions."

This statement was apparently not intended to be a departure from the *Brockenbrough* decision, but it comes close to being a recital of the restricted doctrine. Since the situation before the Court met the restricted theory there was no occasion to review the subject, so it seems fair to state that the broad special fund theory still obtains in North Carolina.

It is to be observed that revenue financing is not limited to formal obligations or certificates of indebtedness. The seller of equipment may agree to payment of the purchase price solely from the revenues produced thereby.[82] There are, in addition, a number of legal questions

[78] The defendant board, which was created a separate corporation by the revenue bond enabling statute, was authorized to take title and control over the old and new properties, and the bonds were to be issued in its name. The court treated these facts as immaterial for purposes of the case and decided it as though the city were acting directly.

[79] In a case decided only eighteen days later electric and water systems were held to be necessary expenses. Fawcett v. Mt. Airy, 134 N. C. 125, 45 S. E. 1029 (1903); overruling earlier decisions to the contrary. See the critical comment in GRAY, *op. cit. supra* note 48, at 1060.

[80] If the mortgage was confined to the property acquired with the bond proceeds that would be a different matter, not involving an indirect tax burden. See Clarke v. S. C. Public Service Authority, 177 S. C. 427, 181 S. E. 481 (1935).

[81] 213 N. C. 96, 105, 195 S. E. 90, 96 (1938).

[82] Fairbanks, Morse & Co. v. Wagoner, 81 F. (2d) 209 (C. C. A. 10th, 1936); Fuller, *Conditional Sales Contracts in Municipal Purchases—Financing Self-Liquidating Activities* (1938) 3 LEG. NOTES ON LOCAL GOV'T 267.

bearing upon the debt status of revenue obligations which, for want of space, cannot be explored here.[83]

g. Assumption of Debt of Another Unit

Assumption by one unit of debt of another may or may not involve the element of contract. Obviously an assumption by a county of township road bonds issued for improvement of county roads which took the form of an exchange of county for township bonds or the issuance of the former to provide funds to pay the latter would involve the contracting of new county debt. The mere passage of a resolution assuming the district debt pursuant to statute, which made such an act binding on the county, would, under the decisions, involve the creation of county debt.[83a] It has been held, since the adoption of the amendment, that a pre-amendment assumption of township road debt rendered it county debt, which could be refunded by the issuance of county bonds after the amendment took effect without regard to electoral approval.[84] In that case the county had passed a resolution authorizing the issuance of refunding bonds and the making of agreements with the holders of the old bonds as to the purchase or exchange of those bonds. The trial court found that the county had agreed to assume the debt and this fact is probably the real basis for the decision. It is quite doubtful whether the same result would have been warranted had the county board done no more than pass a resolution providing for the issuance of the refunding bonds.

h. Non-Contract Liabilities

Broadly speaking liabilities not arising *ex contractu* are not within the terms of the restriction upon the creation of new debt. But, here again, it is not safe to be too literal and generalization is hazardous. The subject can be considered under three main heads,—(1) torts, (2) quasi-contractual claims, and (3) liabilities imposed by statute.

(1) *Torts.* This phase of the subject is relatively simple,—tort liabilities are not in their inception the sort of debt the amendment is concerned with; it has to do with the use of credit, not with responsibility for civil wrongs. It would appear that the matter does not depend upon the element of fault; otherwise the amendment would constitute

[83] They arise largely from the covenants commonly made in support of revenue bonds, such as an agreement by the unit to pay for service it takes from the revenue project for its uses. The sounder view is that this sort of covenant does not render the bonds debts; although the contrary might be true were there an unqualified covenant to take and pay for the service. See the well-reasoned Florida case, State v. Punta Gorda, 124 Fla. 512, 168 So. 835 (1936); also Street v. Ripley, 161 So. 835 (Miss. 1936).

[83a] See Hickory v. Catawba County, 206 N. C. 165, 172, 173 S. E. 56, 60 (1934).

[84] Thomson v. Harnett County, 209 N. C. 662, 184 S. E. 490 (1936), 212 N. C. 214, 193 S. E. 158 (1937).

a limitation upon the power of the general assembly to impose rules of absolute liability upon local units, instanced by statutes imposing liability to a traveler for any injury due to defects in streets,[85] or rendering a local unit responsible in damages to the victim of mob violence.[86]

(2) *Quasi-contractual Liabilities.* Serious questions can undoubtedly arise with respect to this type of claim which theoretically arises by operation or implication of law and not from voluntary agreement. For it so often happens that the occasion for seeking quasi-contractual relief against a local unit is the invalidity or unenforceability of a voluntary undertaking of the unit. As to that sort of case this much can be said at once,—if the reason that the contract is invalid is that it was made in violation of the amendment the courts cannot be counted upon to say that the law implies an obligation and thus permit the amendment to be defeated by indirection.[87] There is a plausible distinction, however, between imposing a general liability upon a unit for money had and received or upon a *quantum meruit* or *quantum valebat,* and imposing a constructive trust upon money received from a claimant or assets into which it can be traced not dedicated to a public purpose.[88] In the latter situation unjust enrichment can be prevented by specific redress which does not substitute an implied obligation for the invalid voluntary one.[89]

It may well be that liabilities arising by operation of law which do not contravene the policy of the amendment will be accorded favorable treatment by the supreme court. Doubtless, municipal liability for the amount or value of monies, goods or services furnished by mistake and not pursuant to contract will fall in this category as would a liability to refund an illegally collected tax.[90]

[85] For a discussion of statutes relating to municipal liability in connection with defective streets see 7 McQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1927) §2904 *et seq.*

[86] N. C. CODE ANN. (Michie, 1935) §3945 (relating to civil liability of a county in case of a lynching). See JONES, *op. cit. supra* note 53, §97.

[87] The leading case is Litchfield v. Ballou, 114 U. S. 190, 5 Sup. Ct. 820. 29 L. ed. 132 (1885). Note the discussion of the point in the recent Alabama case, Oppenheim v. City of Florence, 222 Ala. 50, 155 So. 859 (1934).

[88] Once there has been dedication to a public purpose the public interest would seem to prevail over that of the claimant just as fully as though he were seeking to levy an execution against such property, which, of course, could not be done. Fordham, *Methods of Enforcing Satisfaction of Obligations of Public Corporations* (1933) 33 COL. L. REV. 28.

[89] Nuveen v. Bd. of Public Instruction of Gadsden County, 88 F. (2d) 175 (C. C. A. 5th, 1937), (1937) 16 N. C. L. REV. 42. (Constructive trust imposed on school building, which was not a proper municipal purpose).

[90] See I DILLON, *op. cit. supra* note 15, §201, especially at 378, note 3. The right to damages for the taking of private property for public use without making just compensation would hardly be debt within the spirit of the amendment in the ordinary case, else the property owner would be without redress were it too late to get preventive relief. Dillon distinguishes cases like Keller v. Scranton, 200 Pa. 130, 49 Atl. 781 (1901), as essentially based on the element of contract. For purposes of computing outstanding debt, liabilities for property taken

(3) *Liabilities Imposed by Statute.* This topic poses knotty questions. The safe course for public officials for the time being is to act on the view that the legislature cannot impose or compel the assumption of a liability where a unit could not incur it voluntarily, consistently with the amendment. Thus a legislative mandate to construct a new courthouse or jail because the old was unsafe or a health hazard would not enable the unit to use its credit for the purpose free of the restrictions of the amendment. Constitutional debt restrictions draw arbitrary lines and cannot be disallowed by legislative mandate no matter how pressing the need.[91]

Suppose municipal bonds were issued in the fiscal year 1936-37 in violation of the debt-reduction provision of the amendment and that in a subsequent fiscal year they were validated by special act of the legislature which took effect on a date when the unit could have issued bonds without electoral sanction. Would the statute be valid? If the act was effective the validity of the bonds would derive more from the statute than the attempted contract. The accepted theory is that a legislature may validate any transaction it could have authorized in the first instance.[92] Consider the converse situation where unvoted bonds lived up to the debt-reduction requirement but were invalid because issued in violation of statute and were later made the subject of a validating statute enacted when the unit had no non-electoral borrowing power for such a purpose. Would the statute be effective?

So far as the restriction on incurring new debt is concerned neither the letter nor the spirit of the amendment would seem to affect the power of the legislature to merge, consolidate, split up, or otherwise alter local units.[93] Thus, were the general assembly to consolidate two contiguous towns into a single city there would be no increase in public debt although technically the city would be a new juristic entity and as to it the debt of the constituent units would be new.[94] The element of contract, moreover, is obviously wanting here.

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for public use should be included at their estimated amount where their value has not been finally determined. Levy v. McClellan, 196 N. Y. 178, 89 N. E. 569 (1909).

[91] *Cf.* Eaton v. Mimnaugh, 43 Ore. 465, 73 Pac. 754 (1903), and the discussion of that case by GRAY, *op. cit. supra* note 48, at 1054.

[92] But this assumes the existence of the power to authorize at the time of ratification. "The general and established proposition is that, what the legislature could have authorized, it can ratify if it can authorize at the time of ratification." Charlotte Harbor & N. Ry. v. Welles, 269 U. S. 8, 11, 43 Sup. Ct. 3, 4, 67 L. ed. 100. 102 (1922). See JONES, *op. cit. supra* note 53, for a discussion of the cases on the subject.

[93] True v. Davis, 133 Ill. 522, 22 N. E. 410 (1889); People *ex rel.* Haight v. Brown, 169 App. Div. 695, 155 N. Y. Supp. 564 (1915), *aff'd on another ground*, 216 N. Y. 674, 110 N. E. 171 (1915).

[94] This technical point is of no moment because the successor corporation would simply stand in the shoes of the old ones.

One interesting feature of the amendment is that a unit which is overwhelmed with debt may, under the debt reduction scheme, incur new debt without a popular vote whereas a completely new unit with no debt whatever could not because it has no debt to reduce. That would be the status, for example, of a populous community like Kannapolis were it incorporated today. This is not to condemn the general requirement of an election, but to hold up the debt-reduction notion for scrutiny.

2

WHAT IS OUTSTANDING INDEBTEDNESS?

While the restriction upon new debt is confined to contractual debt there is no such qualification as to outstanding debt to be computed in determining debt reduction. Thus, "outstanding indebtedness," broadly speaking, would comprehend all existing liabilities without regard to their origin, form, or legal nature.[95] Debt contracted for any of the four enumerated purposes, not subject to the election requirement, would be literally included in computing outstanding indebtedness.[96] But proposed indebtedness, although fully authorized and although all steps preliminary to the incurring of the obligation have been taken, would hardly seem to merit the label "outstanding."[97]

It has been held in other jurisdictions that claims which are both unliquidated and disputed are not to be included in computing outstanding debt.[98] Theoretically such a claim could be outstanding indebtedness but the matter is too speculative for consideration. As to undisputed, unliquidated claims, however, the prudent course is to estimate their amount.

Should current expense items and tax anticipation loans remaining unpaid at the end of the fiscal year be counted? There can be no denying that, strictly speaking, they would be outstanding debt at the end of that fiscal year and the beginning of the next. The real question is whether uncollected taxes for that fiscal year should be offset against debts of this sort since, loosely speaking, those taxes are pledged to their payment. This is one of the more vexing questions raised by the amendment about which speculation is not very fruitful. The matter rests on the doorstep of the court. Concerning current expense items,

[95] Note the discussion of the "debt" and "indebtedness" terms in 6 MCQUILLIN, *op. cit. supra* note 15, §2374.

[96] This statement is subject to a possible practical qualification as to tax anticipation obligations, presently to be stated.

[97] *Cf.* the rather remarkable Pennsylvania decision in Duane v. Philadelphia, 322 Pa. 33, 185 Atl. 401 (1936), where the circumstances were such that by holding authorized bonds to be existing debt the court enabled Philadelphia to exceed the constitutional debt limit.

[98] Levy v. McClellan, 196 N. Y. 178, 89 N. E. 569 (1909); I JONES, *op. cit. supra* note 53, §96.

it will doubtless be contended that if they were not debts in their inception their payment after the close of the fiscal year should not be deemed to reduce debt, even though paid from new tax revenues.

Overdue interest is outstanding indebtedness. And it has even been said that accrued, but not unearned, interest should be included in computing existing debt.[99] This treatment of accrued but unmatured interest is rather artificial, at least, where funds have already been raised in the old fiscal year to cover the interest instalment which happens to overlap the end of one and the start of another fiscal year.

a. *Gross Debt versus Net Debt*

How must payments into and from sinking funds be treated in calculating debt reduction?[100] In states where the conventional type of debt limit obtains it is now generally agreed that sinking funds must be deducted in determining the debt of a unit.[101] And the rule applies as well to cash, and securities of other debtors in which sinking funds have been invested, as to obligations of the unit held by a sinking fund.[102] The reason of this net debt theory is quite compelling—liquid assets dedicated by law to the payment of public debt are, as a matter of economic fact, provision for an amount of outstanding debt equal to their value, and if the law be complied with technical retirement of that amount of debt must follow as of course. In other words, payments into sinking funds reduce net debt; the application of such funds to the payment of debt does not; the one is the substance, the other the formality of debt retirement.

The real question is, then, whether there is anything in the language or purpose of the amendment to exclude the application of the net debt theory. There are at least three considerations which the supreme court should weigh when it comes to settle this question. (1) The inviolability of sinking funds is specifically ordained by the constitution itself.[103] Thus, to employ the language of equity, there is ample legal

[99] I DILLON, *op. cit. supra* note 15, §205.
Invalid and unenforceable claims, represented by bonds or otherwise, are not debt. Thus, even a claim barred by limitations should not be counted.

[100] This question was raised in Gill v. Charlotte, 213 N. C. 160, 195 S. E. 368 (1938), but the court disposed of the case on another ground and did not consider it.

[101] The leading case is probably Levy v. McClellan, 196 N. Y. 178, 89 N. E. 569 (1909). See generally I DILLON, *op. cit. supra* note 15, §§205, 206; 6 MCQUILLIN, *op. cit. supra* note 15, §2397.

[102] *Ibid. Contra:* Brooke v. Philadelphia, 162 Pa. 123, 29 Atl. 387 (1894). The sense of the rule is that sinking funds are a proper offset against gross debt because dedicated to the payment of the outstanding debt, so sinking fund assets, including bonds of the unit held in the sinking fund, should be taken at their actual, not their face value.

[103] N. C. CONST. art. II, §30. This applies to sinking funds of local units. Mewborn v. Kinston, 199 N. C. 72, 154 S. E. 76 (1930).

basis for deeming that to be done which ought to be done. (2) Section 4 of article V, prior to the amendment, expressly provided for deduction of sinking funds. Is the revision of the section to be regarded as so thoroughgoing that the dropping of this provision is to be accorded no significance? (3) The reduction must be in "outstanding indebtedness." Literally, this ignores sinking funds. Should it be given the same meaning as "existing debt" as used in debt limitations in states which embrace the net debt theory?[104]

The net debt theory treats current tax monies collected to pay serial bonds in the same way as payments into sinking funds supporting term bonds.[105] This is important because there is a strong tendency to use only serial bonds wherever practicable. To illustrate, let us assume that a city had $1,100,000 of debt outstanding on June 30, 1937, the end of the fiscal year, and at that time had $100,000 in cash collected that year to meet a serial bond maturity of $100,000 on August 1, 1937. This sum would have to be deducted from the debt total of $1,100,000 in determining the net debt at the end of that fiscal year. In other words, the net debt theory would, in effect, treat the debt reduction of $100,000 as occurring in 1936-37, and not in 1937-38, the fiscal year in which the particular debt was actually paid. Assume further that the cash were lost in a defunct bank or misappropriated in July, 1937, and the bonds taken care of by refunding, the result would be that the net debt theorist, who would still claim a reduction for the preceding year, would logically have to treat the loss of the asset as a debt increase for the fiscal year 1937-38.

There is some authority that uncollected taxes,[106] even though delinquent,[107] levied to meet debt principal, are a proper deduction from gross debt. This is relevant to the North Carolina limit only in the case of delinquent taxes because the reduction is calculated on the basis of debt at the beginning and end of a fiscal year and the only uncollected debt service taxes at those times would be delinquent taxes. The case for permitting the deduction is not clear because the value of the asset is difficult to determine and the burden is still on the taxpayer even though his responsibility for the given year has been fixed.

[104] Illinois follows the net debt theory. Stone v. Chicago, 207 Ill. 492, 69 N. E. 970 (1904). ILL. CONST. art. IX, §12, provides in part:

"No county, city, township, school district, or other municipal corporation shall be allowed to become indebted in any manner or for any purpose to an amount, including existing indebtedness in the aggregate exceeding five per centum on the value of the taxable property therein, to be ascertained by the last assessment for state and county taxes previous to the incurring of such indebtedness."

[105] Kronsbein v. Rochester, 76 App. Div. 494, 78 N. Y. Supp. 813 (4th Dep't 1902).

[106] See 6 MCQUILLIN, *op. cit. supra* note 15, §2396, n. 88.

[107] Graham v. Spokane, 19 Wash. 447, 53 Pac. 714 (1898).

It is the sounder view that only cash and other assets required by law to be applied in retirement of existing debt may properly be deducted.[108] Funds and other assets which may lawfully be used for other municipal purposes are hardly within the reason of the net debt theory.[109]

b. *Overlapping Units; Merger and Consolidation*

In determining outstanding indebtedness it is not required that debt of overlapping units be considered.[110] Thus, debt of a special school district coterminous with a city would not be included in computing the debt of the city, and were the city to make payments on the district's obligations no reduction of city debt would be effected. Once, however, the city effectually assumed the debt of the district the converse would be true.

What would be the effect of merger or consolidation of local units? That would depend upon the terms of the enabling statute. If town *B* were annexed by city *A* pursuant to a statute which did not impose the debt of *B* upon *A* but required its payment from *ad valorem* taxes levied in the territory that was *B*, the town debt would simply not be counted in computing that of the city. On the other hand, the statute might give the annexation the effect of shifting the town debt to the city's back.[111] In the now quite commonplace situation where a county has assumed school district debt incurred for the maintenance of public schools in the county for the constitutional six months' term, it is not entirely clear just what the relation of the county is to the creditor,[112] where there is no agreement with him, but it seems safe to assume that the debt is to be treated as that of the county for present purposes.

3

WHAT DEBT OF A CURRENT YEAR IS TO BE CHARGED AGAINST THE REDUCTION

In determining whether a given debt may be contracted without a vote of the people it is obviously necessary, after the debt reduction of

[108] See Kronsbein v. Rochester, 76 App. Div. 494, 78 N. Y. Supp. 813 (4th Dep't 1902), for a good statement of the matter.

[109] But there is some authority for their deduction. 6 McQUILLIN, *op. cit. supra* note 15, §2396.

[110] Where the overlapping local units are really full-blown, distinct governmental units there is no question about the matter, but when it comes to debt nominally incurred by an independent unit which is essentially a mere department or agency of the state or a local unit a real question is presented. *Cf.* McCabe v. Gross, 274 N. Y. 39, 8 N. E. (2d) 269 (1937).

[111] In the less likely case where a unit is split up a nice question is presented. Suppose a county were divided into two counties, how would credit for debt reduction be apportioned?

[112] The cases have dealt with the relation of the district to the county. See the topic, SECTION 3 OF ARTICLE IX, *infra*.

the preceding fiscal year has been determined, to determine further how much of the non-electoral debt-incurring power of the current fiscal year has been exhausted. For this purpose it is clear that debt contracted for any one of the four expressly authorized purposes is not to be considered.[113] With respect to debts outside the enumeration doubtless the most important question is whether voted debt is to be counted. The supreme court has already decisively answered this question in the affirmative. In *Gill v. Charlotte*,[114] it was shown that on any basis of computation the amount by which the city of Charlotte reduced its debt during the fiscal year 1936-37 was materially less than the amount of bonds issued early in the fiscal year 1937-38 after approval by the voters. The city sought to issue additional bonds for street and sewer purposes without a vote of the people to an amount within two-thirds of what it conceived to be the city's debt reduction during the preceding fiscal year. The supreme court upheld the plaintiff taxpayers' right to an injunction restraining the bond issue on the ground that the voted bonds were to be counted in determining whether debt up to two-thirds of the preceding year's reduction had already been contracted in the current fiscal year. In a brief opinion, the meat of which was a dictum quoted from the opinion in the *Hallyburton* case,[115] the court adopted a literal view of the matter. No mention was made of a line of decisions of other courts cited in the brief of counsel for the city. In several states there are constitutional debt limitations which set a general limit but allow it to be exceeded up to a higher limit; some, for certain special purposes such as utility services likely to be self-liquidating,[116] and others, where the debt has been voted.[117] It is the weight of authority that under such a limitation, special purpose or voted debt, as the case may be, is not to be counted in computing debt-contracting power under the primary limit.[118] It is reasoned that the limitation bases the distinction on the purpose of debt or the fact of a popular vote but lays no store by the order of time in which existing debts were incurred.

The practical effect of the decision in the *Gill* case is to give the governing body of a unit a strong incentive to use up the non-electoral borrowing power of the unit for a given year early in the year, particularly if new debt has been voted but not incurred or there is any prospect that new debt may be voted later in the year. In other words, the governing body would naturally be inclined to exercise its unfet-

[113] See Hallyburton v. Bd. of Education, 213 N. C. 9, 14, 195 S. E. 21, 25 (1938).
[114] 213 N. C. 160, 195 S. E. 368 (1938).
[115] See note 9, *supra*.
[116] *E.g.* UTAH CONST. art. XIV, §3; WASH. CONST. art. VIII, §6.
[117] *E.g.* ARIZ. CONST. art. IX, §8; PA. CONST. art. IX, §8.
[118] For a collection of cases see 44 C. J. 1124, n. 66-68. See also JONES, *op. cit. supra* note 53, §103; I DILLON, *op. cit. supra* note 15, §214.

tered authority to contract debt before it could be wiped out as in the Charlotte situation.

4

THE EFFECT OF CONTRACTS EXCEEDING THE LIMIT

Situations will undoubtedly arise where a unit has attempted to contract debt in excess of two-thirds of the preceding year's reduction in violation of the amendment. It must be assumed that such a contract would be void.[119] A difficult question would be presented where a particular debt straddled the limit, so to speak, in that the margin of non-electoral borrowing power when it was incurred was less than the amount of the debt. The question is whether the debt would be void *in toto* or only to the amount that the limit had been exceeded. There are decisions of courts of states having the conventional type of limitation to support both of these alternatives.[120] A typical case is that of a bond issue which overruns the limit. If the bonds were issued in blocks, the answer would be easy because those blocks issued within the limit would be fully separable for present purposes and thus valid. On the other hand, if the bonds were all issued as a unit, or a particular block straddled the limit, there is no fully satisfactory way of separating the sheep from the goats; even though each bond is a separate debt (if valid) all of them, being issued at the same time and, under current practice, to the same purchaser or purchasers, are on an equal footing. Thus there is no choosing between bonds in such a case, and the decisions favoring the bondholder have usually simply apportioned the actual margin of borrowing power among them *pro rata* so that were the margin $100,000 and the bond issue $200,000, each bond would be enforceable to the extent of fifty cents on the dollar. Formal logic seems to be on the side of total invalidity because the entire obligation is tainted by the defect unless the parties themselves have made it separable, but a cold syllogism would hardly do equity to the bondholder who had put up his money in good faith for a useful public improvement. It can, moreover, be urged with force in his behalf that *pro rata* enforcement would be, not remaking contracts for the parties, but forcing the borrower to go as far toward meeting its word as the constitution permits.[121]

Would the fact that a municipal bond ordinance passed in the fiscal year 1937-38 authorized bonds exceeding in amount two-thirds of the

[119] Whether by reason of recitals in bonds that all statutory and constitutional requirements, including a vote of the people, have been met, a unit would be estopped to show invalidity is beyond the scope of this paper. On this important question see generally I DILLON, *op. cit. supra* note 15, §204; 6 MCQUILLIN, *op. cit. supra* note 15, §2498 *et seq.*; I JONES, *op. cit. supra* note 53, §272.

[120] For a collection of cases see 6 MCQUILLIN, *op. cit. supra* note 15, §2398.

[121] I DILLON, *op. cit. supra* note 15, §203. The remedy would be equitable, as Dillon points out, and not legal.

1936-37 reduction render it invalid *per se* or would it be valid as to any bonds issued under it within the limit? The latter view seems the sounder one because, so far as action by the local unit is concerned, it is not the authorization but the contracting of new debt that the amendment restricts. But, as applied to the general assembly the amendment expressly forbids it to authorize a county or municipality to contract debt in a given year in excess of the limit without a vote of the people. This does not mean that a statute, unqualified in this respect, which authorized a county or municipality to issue bonds, would be invalid. Such a statute would doubtless be read in the light of the amendment and conflict avoided. If this were not so the County and Municipal Finance Acts would be incompatible with the amendment as they now stand. The point is that a positive statutory authorization which could not be so harmonized with the amendment, as where a statute in terms required a county to issue a certain amount of bonds in a given year without regard to any other debt incurred that year, comes under the ban of the amendment and could not safely be relied upon as authority for issuance of the bonds.[122]

The Relation of the Amendment to Other Provisions of the Constitution

This phase of our subject could be dismissed rather cursorily were it not for the fact that the first part of the amendment, relating to the four enumerated purposes that are not subject to the election requirement, is cast in the form of a positive grant of power to the general assembly to contract debt, or to authorize local units to contract debt, rather than in the form of exceptions to a general restriction or limitation. This section of the constitution formerly was set in the latter mold, as is Section 7 of article VII. Whether there was actually any intention to make the amendment a grant of power, and not merely a set of "limitations upon the increase of public debts," as described in its caption, is one thing, and what the words used mean is another.

Can it be said that the language used is so ambiguous in this respect as to require or even warrant "construction"? We do not venture to predict the answer of the supreme court. If the court construes the amendment to be simply a limitation, existing limitations will be unaffected. But if the court construes it to be a grant of power, it will prevail, as the latest expression of the sovereign will, over any pre-existing constitutional provision at any point of irreconcilable conflict.

[122] It is well to observe here that the court still recognizes the old "inherent right" theory that a municipal corporation or county may issue bonds without statutory authority for necessary expenses. Williamson v. High Point, 213 N. C. 96, 103, 195 S. E. 90, 94 (1938).

The only old limitation with which it would appear clearly to collide is the limitation of Section 7 of article VII.[123]

1. *Section 7 of Article VII*

This section forbids a local unit to levy a tax, contract a debt or lend its credit without the approval of a majority of its qualified voters, except for necessary expenses. If the amendment is to be regarded as a grant of power with respect to the enumerated purposes, would it not permit the contracting of debt for those purposes without the approval of the voters, even if those purposes were not "necessary expenses"? That is the major question, and it is hardly worth while to pursue the subject further until the question whether the amendment grants power has been authoritatively answered. It may be said in passing, however, that quite probably each of the four enumerated purposes covers some non-necessary expense territory.

There is no reference in the amendment to taxation, whereas the limitation of Section 7 of article VII applies both to taxes and to debts. The Federal and North Carolina Supreme Courts have embraced the view that a grant of power to a local unit to incur bonded debt carries with it by necessary implication the power to levy sufficient taxes to pay the bonds, unless the contrary clearly appears.[124] If the amendment grants power to the general assembly to authorize the contracting of non-necessary expense debt in certain cases, does the grant carry with it by implication the power to authorize the levy of a tax to pay such debt, without regard to the election requirement of Section 7 of article VII? While the courts may be expected to try to harmonize the two sections of the constitution so far as legtitimate interpretation permits, there is a statement in the opinion in the *Hallyburton* case[125] which seems to imply that there might be points of conflict.

2. *Section 6 of Article V*

This section is strictly a tax limitation, applicable only to state and county taxes. The maximum *ad valorem* tax for state and county purposes is fifteen cents on the hundred dollars of taxable value, but a

[123] N. C. CONST. art. II, §14, and art. VIII, §4, affect the subject of local debt but it seems evident that there is no conflict with them.

[124] United States v. New Orleans, 98 U. S. 381, 29 L. ed. 225 (1878); Charlotte v. Shepard, 122 N. C. 602, 29 S. E. 842 (1898).

[125] 213 N. C. 9, 14, 195 S. E. 21, 25 (1938):

"It follows that the provisions of article 5, Sec. 4, now constitute the dominant or controlling limitation upon the power of local units to contract debts or to issue its bonds, and its provisions are superimposed upon the limitations contained in article 7, Sec. 7, and in article 5, Sec. 6, of the Constitution. To the provisions of the section under consideration the former decisions of this court must likewise yield and are no longer authoritative except within the limitations of this section."

county may exceed the limit for a "special purpose" with the special approval of the legislature. If the amendment grants power to contract debt, is the power accompanied by an implied power to levy a tax to pay the debt, without regard to this section? It would seem that a new constitutional debt provision which does not mention taxation and in no wise refers to this section would not have any effect upon it.[126] Recent opinions of the supreme court, however, treat the two sections together and contain several important dicta on the subject.

1. Some time ago the court referred to the tax limit of Section 6 of article V as applicable to cities and towns.[127] This misconception has been repeated in three opinions handed down since November, 1936.[128] This is unfortunate and the court will doubtless clarify the matter at the first opportunity.

2. In the *Hallyburton* opinion[129] it was said: "This section (referring to the amendment) now further limits the right of governing authorities of local governmental units in respect to the creation of debts and the levy of taxes for the payment thereof." It is not perceived how the amendment limits taxes except indirectly by limiting debt.

3. In the *Hallyburton* opinion[130] the following appears:

"So that now, local units may create debts and issue their bonds for necessary expenses without a vote of the people and without special approval of the Legislature, provided that by so doing taxes in excess of the limitations provided in article V, section 6, are not required, and provided further that the total amount of such bonds and such other bonds as may have been issued during that particular fiscal year do not exceed two-thirds of the total amount by which the public debt of the unit was decreased during the preceding fiscal year. Such local unit may exceed the constitutional limitation on the taxing power by legislative authority without the approval of the voters, provided the total amount of bonds issued by such unit during any fiscal year does not exceed two-thirds of the amount by which the debt of the unit was decreased during the preceding fiscal year."

The first sentence implies that a tax limit operates as a debt limit but it had been thought that the court had abandoned this view.[130a] The

[126] Charlotte v. Shepard, 122 N. C. 602, 29 S. E. 842 (1898), does not seem to require a different conclusion; a maximum tax can be squared with the notion of implied power to levy a tax to pay an authorized debt—the implied power theory would operate freely within the outside limit.

[127] See Henderson v. Wilmington, 191 N. C. 269, 275, 132 S. E. 25, 28 (1926).

[128] See Palmer v. Haywood County, 212 N. C. 284, 286, 193 S. E. 668, 670 (1937); Hallyburton v. Bd. of Education, 213 N. C. 9, 14, 195 S. E. 21, 25 (1938); Williamson v. High Point, 213 N. C. 96, 103, 195 S. E. 90, 94 (1938).

[129] See note 9, *supra*. [130] *Ibid.*

[130a] It was held in Proctor v. Board of Commissioners of Nash County, 182 N. C. 56, 108 S. E. 360 (1921), that school district bonds could not be issued where the limited tax authorized by statute was not adequate to provide for their payment. But this view seems to have been repudiated in Glenn v. Board of

second sentence, since it contains no qualification in that respect, implies that the fifteen cents tax limit may, since the amendment, be exceeded for ordinary, as distinguished from special, purposes, whereas under Section 6 of article V that can be done only for special purposes. The more disturbing point is that, if this be true under the debt reduction provision, it is even more true of the enumerated purposes as to which the power to contract debts is expressly granted. In short, the subject will bear elucidation. It is hard to believe that any one concerned had any notion that the amendment had anything to do with tax limitations.

3. *Section 3 of Article IX*

This section provides:

"Each county of the State shall be divided into a convenient number of districts, in which one or more public schools shall be maintained at least six months in every year; and if the commissioners of any county shall fail to comply with the aforesaid requirement of this section, they shall be liable to indictment."

The supreme court has already squarely decided in the *Hallyburton* case[131] that new county debt for the constitutional six months' school term is subject to the limitations of the amendment. This seems entirely sound. The amendment is a comprehensive scheme of limitation and, since the present purpose was not specified among those not subject to the election requirement, it comes within that restriction.[132] In its opinion the court went on to observe that the duty to provide for the six months school term rested primarily upon the state. It is hardly to be inferred from this, however, that the state could contract debt to maintain the minimum school program without regard to the amendment, for, there again, one finds no exception made to cover the case. Doubtless, current expense debts contracted within current revenues for the six months school term would fall within the current expense theory to which we have already adverted.[133]

Comm'rs of Durham County, 201 N. C. 233, 239, 159 S. E. 439, 442 (1931), where it was said:

> "The statute provides that funding and refunding bonds may be issued where taxes for their payment are limited by the Constitution, as well as in other cases. But this is only declaratory of the law as heretofore announced in a number of cases. . . ."

There seems to be little authority on the subject in other states, doubtless because ability to pay is not commonly regarded as any qualification upon the *legal authority or power* to borrow, unless expressly made so. The view that a tax limit operates as a debt limit was definitely rejected in Coles County v. Goehring, 209 Ill. 142, 70 N. E. 610 (1904).

[131] *Ibid.*

[132] Thus county commissioners who fail to abide by N. C. CONST. art. IX, §3, solely because the amendment precludes their doing so would doubtless not be liable to indictment.

[133] See the topic, CURRENT EXPENSES, *supra.*

Is county assumption of school district six-months-term debt contracted before November 25, 1936, subject to the election requirement? The answer would seem to be no, at least where the county had not become legally bound to assume such debt prior to the taking effect of the amendment. It has recently been held that if a county has not already assumed such debt of one or more districts within its limits it has a discretion under the school law as to whether it shall assume any school district debt whatever.[134] But under earlier decisions once such debt of one district has been assumed there appears to be a duty to assume like debt of all the others in the county.[135] It was so held in one decision rendered since the amendment, where the question whether that duty of assumption survived the adoption of the amendment was not raised.[136]

[134] East Spencer v. Rowan County, 212 N. C. 425, 193 S. E. 837 (1937).
[135] The earlier cases are cited in Mebane Graded School Dist. v. Alamance County, 211 N. C. 213, 189 S. E. 873 (1937).
[136] *Ibid.*