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# COUNTY DEBT DIFFICULTIES IN KENTUCKY

(Continued from January, 1943 Issue)

GLENN D. MORROW\*

## II. COUNTY DEBT ADMINISTRATION DIFFICULTIES<sup>102</sup>

Although counties may refinance their debts without state assistance,<sup>103</sup> most counties are electing to follow the procedure outlined in the County Debt Act of 1938.<sup>104</sup>

Brokers and bond houses generally have encouraged counties to seek the assistance of the local finance officer in reorganizing

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The writer is particularly indebted to Professor James W. Martin, Director of the Bureau of Business Research, University of Kentucky, for his guidance in the preparation of the article, for numerous suggestions relative to its content, and for editorial assistance. Acknowledgment is also due Dr. Harry Lynn, State Local Finance Officer, Kentucky Department of Revenue, Frankfort, Kentucky; Mr. Amos H. Eblen, Law Offices of Smith and Leary, Frankfort, Kentucky; Messrs. Ernest Woodward and Franklin P. Hays, Law Offices of Woodward, Dawson and Hobson, Louisville, Kentucky; and Judge Richard Priest Dietzman, Louisville, Kentucky, who kindly reviewed and criticized the unfinished manuscript. The writer also wishes to explain that nothing in the article reflects any views of the Department of Revenue; it was written while he was not associated with the Department.

<sup>102</sup> Discussion of county debt administration difficulties, for practical purposes, may be limited to problems confronting bondholders, the state local finance officer, and county officials in refinancing existing debts; since a \$100,000 Campbell County road and bridge bond issue is the only original county bond issue floated since enactment of the County Debt Act in 1938.

<sup>103</sup> Some of the bonds of Christian, Henry, Crittenden, Knox, Graves, and possibly other counties have been floated without the assistance of the local finance officer.

<sup>104</sup> Acts 1938, 1st ex. sess., chap. 31 (effective Apr. 20, 1938), Baldwin's Ky. Stats. (1939 Supp.), sec. 938q; Ky. Rev. Stats., secs. 12.020, 66.210, 66.280-390, 66.990, 68.210-220, 68.250, 68.270-290, 68.310-320, 68.370, 68.990. If original issues are floated, these have to be approved by the local finance officer if the amount exceeds 0.5 per cent of the assessed value of the county. Baldwin's Ky. Stats. (1939 Supp.), sec. 938q-4; Ky. Rev. Stats., secs. 66.210, 66.310.

their debt structures and in some instances have even demanded that they do so as a condition of handling refunding issues.<sup>105</sup>

Bond houses, owing to the bulk of county issues being composed of long-term, non-callable bonds which can be refinanced only with the holders' assent, are in a peculiarly advantageous position to influence clients to withhold assent in exchanging their bonds and can bring considerable pressure on county officials to refinance indebtedness under the provisions of the County Debt Act. Furthermore, except for the reluctance of some counties to place their sinking funds under state administration, as required by the County Debt Act if refinancing is under its provisions, there is little articulate objection to state assistance.<sup>106</sup> Generally, counties have welcomed the cooperation of an official state finance expert.

#### ADMINISTRATIVE POLICY

The local finance officer is required by law to withhold approval of any issue or re-issue of bonds if, among other considerations, "it appears that the bonds or the issuance thereof will be invalid."<sup>107</sup> Considerable ambiguity exists in this particular phrase of the statute. The Constitution clearly prohibits the existence of any courts in Kentucky except those of constitutional creation,<sup>108</sup> but the statute appears to imply that the local finance officer and the county debt commission, which is required to review decisions of the local finance officer, are in some instances to function in a quasi-judicial capacity. Neither has ever known whether it is to determine the validity of bonds to be refinanced as would a court or merely to ascertain as an administrative finding of fact whether the form and manner of their issuance were in compliance with requirements of law.<sup>109</sup> The question has never been judicially determined so

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<sup>105</sup> Correspondence with all bond houses which have handled Kentucky county bonds indicates they intend to continue this practice.

<sup>106</sup> A canvass of all local newspapers in counties where the local finance officer has approved bond issues shows a singular paucity of adverse criticism.

<sup>107</sup> Acts 1938, 1st ex. sess., chap. 31, Baldwin's Ky. Stats. (1939 Supp.), sec. 938q-4; Ky. Rev. Stats., secs. 66.210, 66.310 as amended by Acts 1942, chap. 179, sec. 2, p. 762.

<sup>108</sup> Sec. 135.

<sup>109</sup> See appellees' petition for extension of opinion in *Morgan County v. Governor of Kentucky*, 288 Ky 532, 156 S. W (2d) 498 (Oct. 14, 1941, extended Dec. 9, 1941).

as to remove all doubt. The principle announced in *County Debt Commission v Morgan County*<sup>110</sup> was followed in *Morgan County v. Governor of Kentucky* when the Court said.

"The provision of Section 839q-4 (938q-4) of the Statutes that the decision of the Local Finance Officer or the Commission as to the legality of a bond issue shall be 'res adjudicata in any subsequent case or cases raising such question of legality' is construed to mean 'final' in respect to the finding of fact by the administrative officers."<sup>111</sup>

But in *Estill County v. County Debt Commission* the Court remarked, in commenting on the statutory requirement that the approval of the local finance officer must be obtained before a county may contract an indebtedness in excess of 0.5 per cent of its taxable property, that "the legislative power to regulate procedure does not offend the constitutional provisions relating to debt limitations."<sup>112</sup> Clearly, these decisions do not determine definitely the nature and scope of inquiries to be made by the local finance officer. At present, he has taken a conservative position and has insisted that "when legal questions for which there is no clear answer arise in connection with bonds which he is asked to approve, such questions should be resolved by the courts."<sup>113</sup> This attitude is postulated on the assumption that "the courts alone are competent to make definitive interpretations of the law."<sup>114</sup> Whether such a policy is justifiable is open to question. No doubt refinancing has been done on a safe, conservative basis, but unconscionable delays, much litigation, and considerable expense in refinancing have resulted. It may be that the position taken is the only sane and constructive position that could have been taken, since the principal objective of the County Debt Act is to afford counties an opportunity to refinance their indebtedness on a fiscally constructive and sound legal basis, and, if this is to be achieved, the primary responsibility for establishing the validity of existing debts must rest on the counties concerned. To the contrary, however, responsible financial institutions are critical of the policy, maintaining that it has served to arouse rather than to allay fears and has lessened

<sup>110</sup> 279 Ky. 476, 483, 130 S. W. (2d) 779, 782 (1939).

<sup>111</sup> 288 Ky. 532, 535, 156 S. W. (2d) 498, 500 (1941)

<sup>112</sup> 286 Ky. 114, 118, 149 S. W. (2d) 735, 737 (1941.)

<sup>113</sup> H. Clyde Reeves, *Report of the State Local Finance Officer* (1941), p. 8.

<sup>114</sup> *Id.* at p. 13.

the confidence of the investing public generally in the financial integrity of Kentucky municipalities.<sup>115</sup>

#### DIFFICULTIES IN ADMINISTERING REFINANCING OPERATIONS

To appreciate current difficulties of administering refinancing operations in Kentucky, legal difficulties must be considered along with local administrative inefficiency and the prevailing character of local indebtedness.

*Inefficiency of local administration.*—Several influences are responsible for fiscal mismanagement in Kentucky counties. The propensity to incur obligations in excess of revenue receipts, especially during election years, suggests inadequate administrative control by local officials over county financial affairs. Though outright abuse of authority is sometimes evident, general diffusion of responsibility among county officials and lack of proper encumbrance accounting records are primarily responsible for the failure of most counties to observe sound budgetary practices. The free and easy spending during the 1920's and the large floating debts that were accumulated indicate that county officials sometimes exercised bad financial judgment. Similarly, the widespread diversion, improper investment, and dissipation of county sinking funds, though perhaps occasionally attributable to outright malfeasance, suggest generally the need for expert technical assistance and financial supervision.

The incompetence with which the finances of many counties have been managed may be observed in the following comments of the Court of Appeals.

"All persons having any knowledge of county affairs must recognize that many counties of the state are in a deplorable financial condition due to improvident spending during the last three decades and due to the unbusiness-like manner in which their fiscal affairs have been handled. It had almost become a custom (prior to enactment of the County Debt Act of 1938) for suits to be filed where those attacking the validity of the indebtedness of a county desired the indebtedness upheld, and the attack thereon was a mere sham. Oftentimes, the allegations of their pleadings and their proof were so made as to present the appearance that the indebtedness was valid when in reality it was not."<sup>116</sup>

<sup>115</sup> This attitude has been ascertained from correspondence with all financing institutions which have had experience with Kentucky county bonds and with many institutions which, though not having had such experience, are in a position to observe the situation.

<sup>116</sup> County Debt Commission v. Morgan County, 279 Ky. 476, 482, 130 S. W (2d) 779, 782 (1939). Cf. James W. Martin, "State Supervision of County Finance in Kentucky," 28 National Municipal Review 249 (Feb. 1939).

Basically, the financial plight of most counties is a result of the indiscriminate accumulation of floating debts, which have either been funded or are being carried over from year to year. In either instance they must be serviced out of general fund revenues, which are frequently inadequate both to retire the outstanding debt and to provide for the necessary functioning of county government. This is true despite the fact that as of June 30, 1940, road and bridge bonds accounted for about 90 per cent of the aggregate bonded indebtedness of Kentucky counties. Payment of principal and interest on the latter is restricted to a special levy, and the bonds may be refunded at maturity. Consequently, their retirement does not necessarily interfere with general fund revenues.

*Character of local indebtedness.*—The most limiting characteristic of Kentucky county bonds, as far as refinancing operations and the investing public are concerned, is their doubtful validity, especially those issued prior to 1932. Until then there was no requirement that bond issues should be reviewed by either the judiciary or a state administrative agency, and, as a consequence, the bulk of Kentucky county bonds have been issued solely on the authority of fiscal court orders. The incompetence of county fiscal courts to deal successfully with technicalities of funding operations<sup>117</sup> and the occasional shady practices incident to the manner in which bonds were issued<sup>118</sup> have made sound refunding exceedingly difficult and, in some instances, virtually impossible. Ascertaining the validity of original non-voted funding bonds is further complicated by the questionable character of floating debts that were funded. Frequently, county records and recitals of facts contained in bond resolutions are absolute contradictions. In this connection, as was observed earlier, the local finance officer has remarked that "few funding bond issues antedating 1932 will bear close scrutiny"<sup>119</sup>

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<sup>117</sup> See, for example, character of claims made and evidence presented in *Denton v. Pulaski County*, 170 Ky. 33, 185 S. W. 481 (1916); *Pendleton v. Letcher County Fiscal Court*, 194 Ky. 688, 240 S. W. 358 (1922); *Payne, Individually, etc. v. Fiscal Court of Carlisle County*, 200 Ky. 41, 252 S. W. 127 (1923).

<sup>118</sup> *County Debt Commission v. Morgan County*, 279 Ky. 476, 482, 30 S. W. (2d) 779, 782 (1939); *Fulton County Fiscal Court v. Southern Bell Telephone and Telegraph Co.*, 285 Ky. 17, 36, 146 S. W. (2d) 15, 25 (1940), same, 289 Ky. 159, 158 S. W. (2d) 420 (1942).

<sup>119</sup> *Reeves, op. cit.*, p. 13.

Other characteristics of county bonds which have caused considerable refinancing difficulties may be noted briefly. During the 1920's, when most county bonds were issued, there was no official financial expert in the state to advise with local officials, and technical assistance was afforded voluntarily by interested financing institutions. Counties were influenced generally to issue those particular types of bonds currently marketable. Since long-term, non-callable bonds were about the only type of bonds carrying an interest rate below the 5 per cent statutory maximum which could be sold above par (also required by statute), the preponderance of the outstanding indebtedness of Kentucky counties is represented by this type of bond. Likewise, but few of the early bonds contained any provision respecting negotiability, and maturity dates usually were not arranged to harmonize with county financial convenience. Such considerations make refinancing all the more desirable but extremely difficult.

#### LEGAL PROBLEMS

*Proration of available funds.*—One question to which a clear answer has been given relates to the rights of non-assenting bondholders in refinancing operations. This is exceedingly important, since virtually all outstanding bond issues are non-callable and refunding is necessarily contingent on the voluntary assent of bondholders to the exchange. If a few bondholders who steadfastly refuse to agree to the terms of any refunding plan could defeat refinancing operations, effort to relieve the county debt situation would often be nullified.

The question of prorating available funds between assenting and non-assenting bondholders arose in connection with one of the first refunding issues the local finance officer was called on to approve. McLean County proposed to refinance \$185,000 of road and bridge bonds by exchanging renewal bonds. At the time, \$45,000 of these were in default. The county was without funds to retire the matured bonds or to pay the interest due on the entire issue. A majority of the holders of outstanding bonds were willing to exchange them for refunding bonds, but a few holders of past-due bonds declined to make the exchange and contended they were entitled to payment of principal and interest in full before provisions were made for payment of unmatured bonds.

The refinancing plan worked out by the local finance officer and McLean County provided that should holders tender less than 100 per cent of the outstanding bonds in exchange for renewal bonds, all funds on hand and which would accrue to the county for the purpose of paying principal and interest on voted road and bridge bonds should be prorated between holders of unexchanged and renewal bonds. Two sinking funds were to be maintained. one, for the payment of interest and principal of unexchanged bonds, the other, for the payment of interest and principal of renewal bonds, together with accrued interest on the bonds tendered for exchange and cancellation. Proration was provided for on the following basis (a) From the funds on hand an amount sufficient to pay all interest accrued to the last interest payment date preceding the date of exchange was to be set aside. The interest due on both the unexchanged bonds and those tendered in exchange for renewal bonds was to be allocated to their respective sinking funds for their amortization. (b) The residue of available funds and all road and bridge bond funds which would accrue to the county was to be allocated to the respective sinking funds for amortizing the unexchanged and renewal bonds in the same ratio which the par principal of each, as of the date the exchange was completed, bore to the par principal amount of both.<sup>120</sup>

The Court of Appeals on June 21, 1940, upheld the proration plan because "the principle that equality is equity dictates the approval of the plan which, while deferring payment in full to some, insures, within the limits of human foresight, the ultimate payment in full to all."<sup>121</sup> Subsequently, on August 8, 1940, this same principle was approved by the United States District Court for the Eastern District of Kentucky in the case of *Whitley County v. Farmers and Mechanics Savings Bank*.<sup>122</sup>

Certain features of the proration plan are commendable, but it gives rise to administrative difficulties and discrimination

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<sup>120</sup> *Epley v. County Debt Commission*, 283 Ky. 600, 604, 142 S. W (2d) 116, 118 (1940).

<sup>121</sup> *Id.* at 606, 142 S. W (2d) at 118. See, also, *Maccabees v. City of Ashland*, 270 Ky. 86, 91, 109 S. W (2d) 29, 32 (1940) and the extensive annotations in 90 A. L. R. 717.

<sup>122</sup> Judgment and Order of Distribution in cause No. 1619 in Equity, U. S. Dist. Ct. (E. D. Ky. Aug. 8, 1940.) The proration plan has been used in refinancing road and bridge bonds of Whitley, Bell, and Breckinridge counties and is to be used in others.



among bondholders. Where proration is possible, a small group of bondholders cannot defeat entirely the refinancing of a county's debt, but, where proration must be resorted to, complicated bookkeeping inevitably results. Likewise, two amortization plans may work injustices to some holders, as the original rights of claimants are necessarily modified.

*Voluntary bankruptcy.*—Refinancing is virtually impossible in some counties even though available funds may be prorated, since one particular bondholder owns a large proportion of the outstanding bonds and has steadfastly refused to assent to any refinancing plan which promises to reduce in any manner his pecuniary interests.<sup>123</sup> The Federal Bankruptcy Act offers some inducement to these counties to reorganize their debt structure under its provisions, as compliance by non-assenting holders becomes compulsory if holders of not less than 66 2/3 per cent of the bonds affected voluntarily assent to the refinancing plan. In September, 1940, Perry County—probably the first in America—filed a voluntary petition of bankruptcy in the Federal District Court for the Eastern District of Kentucky, but jurisdiction was denied in the absence of enabling state legislation.<sup>124</sup> The 1942 General Assembly, however, has enacted legislation authorizing any taxing agency or instrumentality entitled to relief under the Bankruptcy Act on approval of the refinancing plan by the local finance officer to petition the federal courts for the composition of its debts.<sup>125</sup> This affords an additional opportunity to a few counties to reorganize their debt structures that heretofore have been effectively denied this privilege.<sup>126</sup>

*Permissible maturity dates.*—Another question which has retarded refunding operations relates to permissible maturities of refunding bonds. Section 157a of the Constitution contains no provisions respecting the length of time for which road and bridge bonds may be issued. The enabling legislation<sup>127</sup> specified that the bonds should mature within 30 years. On the other hand, section 159 of the Constitution provides that county bonds must mature within not more than 40 years. Contradictory in-

<sup>123</sup> Reeves, *op. cit.*, p. 10.

<sup>124</sup> Reeves, *op. cit.*, p. 9; *Floyd County Times*, Prestonsburg, Ky., Sept. 26, 1940.

<sup>125</sup> Acts 1942, Chap. 146, p. 621, Ky. Rev. Stats., Sec. 66.400.

<sup>126</sup> U. S. C. A. Tit. II, sec. 303.

<sup>127</sup> Acts 1914, chap. 80, sec. 21, p. 338; Carroll's Ky. Stats. (1936), sec. 4307; Ky. Rev. Stats., secs. 178.010, 178.170.

terpretations of the constitutional basis underlying the statutory limitation of 30 years have been given. One line of reasoning considers the 40-year constitutional limitation as merely establishing a maximum beyond which the legislature is not free to exercise discretion;<sup>128</sup> another holds the constitutional provision to be mandatory on the legislature and that the general assembly is powerless to limit or otherwise modify its application.<sup>129</sup> In the most recent case involving the competence of the legislature to fix a maximum time limit for the indebtedness of a local taxing district less than the maximum stated in the Constitution, the Court of Appeals held section 4307 of the statutes to be unconstitutional, thus removing the 30-year limitation which allegedly conflicted with the 40-year constitutional limitation.<sup>130</sup>

Prior to the decision in the Estill County case, the Court of Appeals had upheld the constitutionality of the statute limiting the maximum maturity date of voted road and bridge bonds to 30 years.<sup>131</sup> Relying on the former decision the state local finance officer, prior to 1940, refused to approve any road and bridge bond refunding issue where property values at the time the proposed reissue was to be floated would not justify reasonable anticipation that the bonds could be retired in 30 years. The earlier decision delayed refinancing in some counties but made it possible for other counties to refinance voted road and bridge bonds at reduced interest rates. The latter decision will prevent refinancing at reduced interest rates in some counties but will enable other counties with heavy bond obligations to re-

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<sup>128</sup> *Clere v. Board of Education of the City of Ashland*, 211 Ky. 130, 133, 277 S. W. 335, 336 (1925), *County Debt Commission v. Morgan County*, 279 Ky. 476, 481, 130 S. W. (2d) 779, 782 (1939).

<sup>129</sup> *City of Winchester v. Nelson*, 175 Ky. 63, 72, 193 S. W. 1040, 1044 (1917), *Harris v. City of Morganfield*, 201 Ky. 588, 592, 257 S. W. 1032, 1034 (1924), *Fox v. Boyle County*, 245 Ky. 27, 30, 53 S. W. (2d) 192, 194 (1932), *Williams v. City of Raceland*, 245 Ky. 212, 218, 53 S. W. (2d) 370, 373 (1932), *Wheeler v. Board of Commissioners of the City of Hopkinsville*, 245 Ky. 388, 398, 53 S. W. (2d) 740, 744 (1932).

<sup>130</sup> *Estill County v. County Debt Commission*, 286 Ky. 114, 117, 149 S. W. (2d) 735, 737 (1941).

<sup>131</sup> *County Debt Commission v. Morgan County*, 279 Ky. 476, 481, 130 S. W. (2d) 779, 782 (1939). The 30-year time limitation was not directly before the Court; but in deciding another question the Constitution was construed as establishing a limit beyond which the legislature could not go, although a lower limit could be established by legislative action.

finance their debts, as greater indebtedness can be liquidated over a 40-year period than in 30 years.

The Estill County case will also reduce substantially the number of bonds of doubtful validity because of overissue. The Court has consistently held invalid voted road and bridge bonds issued in excess of maximum amounts permitted by section 157a of the Constitution.<sup>132</sup> Since most road and bridge bonds were issued under the 30-year limitation in section 4307 of the statutes, extension of the limitation to 40 years permits a greater amount of bonds to be retired from the proceeds of the 20-cent levy

In a few aggravated situations, even with substantial acceptance of reduced interest rates by bondholders, the 40-year limitation will not permit satisfactory refinancing except insofar as bondholders are willing to accept an arrangement of maturity dates which will again call for refunding a substantial proportion of the bonds at the expiration of the 40-year period. There is currently little hope of an immediate solution in these counties. The state is powerless to abrogate or otherwise alter contractual rights of non-assenting bondholders. The federal government only has jurisdiction of bankruptcy. It may be necessary for a few counties to compose their debts under the Federal Bankruptcy Act, postpone payment over a considerable period of years, or else remain indefinitely in default.

*Negotiability.*—Probably no issue illustrates better the varying and inconsistent decisions of the Court of Appeals than that respecting the negotiability of Kentucky county bonds in general,<sup>133</sup> and road and bridge bonds in particular. The Uniform Negotiable Instruments Act<sup>134</sup> provides that negotiable instruments must contain

“An unconditional promise to pay a sum certain in money. ”

<sup>132</sup>A question arises in this connection which has not been judicially determined. What position would the Court take with respect to bond issues which were within constitutional limitations when they were floated but which, owing to reduced assessments, are currently in excess of such limitations?

<sup>133</sup>Though the negotiability of general fund bonds has never been adjudicated, if road and bridge bonds could be held non-negotiable because resources for their payment were limited to the 20-cent levy, is it not reasonable to assume that general fund bonds might be held non-negotiable because payment is restricted to the 50-cent levy, especially since county general expenditures must also be met from these same funds?

<sup>134</sup>Acts 1904, chap. 102, secs. 1, 3, p. 213; Carroll's Ky. Stats. (1936), secs. 3720b-1, 3720b-3; Ky. Rev. Stats., secs. 356.001, 356.003.

However

"An unqualified order or promise to pay is unconditional within the meaning of the act, though (there is) coupled with it:

"(1) An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount; or

"(2) A statement of the transaction which gives rise to the instrument.

"But an order or promise to pay out of a particular fund is not unconditional."

Practically all Kentucky county road and bridge bonds purport to pledge the "full faith and credit of the county" for their payment. The question then arises as to whether this constitutes an unconditional promise to pay. The answer necessarily turns on the construction given sections 157 and 157a of the Constitution, but the construction of these provisions has not been such as to determine definitely a county's liability. Certain decisions indicate that a county's liability is limited to revenues derived from the special 20-cent levy authorized by section 157a, while others just as assuredly indicate that a county's liability is not so limited.

Beginning in 1915 with *Mitchell v. Knox County Fiscal Court*,<sup>135</sup> counties have been permitted, but not required, to supplement the 20-cent levy with additional general fund levies.<sup>136</sup> Though the Court has continued to hold that a county may not be required to apply any revenue derived from any source other than the special 20-cent levy to the payment of road and bridge bonds, the question has been in each instance not whether liability of the county was limited by the 20-cent levy, but whether the county could incur indebtedness in excess of what the 20-cent levy would amortize. Certain considerations, however, indicate a county's liability is not so restricted.

Indebtedness incurred under section 157a of the Constitution is referred to as "additional indebtedness," and the 20-cent

<sup>135</sup> 165 Ky. 543, 554, 177 S. W. 279, 284 (1915).

<sup>136</sup> See *Bird v. Asher*, 170 Ky. 726, 730, 186 S. W. 663, 665 (1916); *Collier v. Bourbon Fiscal Court*, 188 Ky. 491, 497, 223 S. W. 149, 151 (1920), *Hughes v. Eison*, 190 Ky. 661, 666, 228 S. W. 676, 678 (1921), *Smith v. Livingston County*, 195 Ky. 382, 391, 242 S. W. 612, 617 (1922), *Payne v. Fiscal Court of Carlisle County*, 200 Ky. 41, 43, 252 S. W. 127, 129 (1923), *Knox County v. Newport Culvert Co.*, 248 Ky. 661, 664, 59 S. W. (2d) 558, 559 (1933), *Gillis v. Anderson*, 256 Ky. 472, 481, 76 S. W. (2d) 279, 284 (1934), *Whitley County v. Hermann*, 263 Ky. 440, 444, 92 S. W. (2d) 797, 799 (1936), *Pulaski County v. Ben Hur Life Association*, 286 Ky. 119, 133, 149 S. W. (2d) 738, 747 (1941).

levy is "permitted in addition to" the general taxing power allowed in section 157. The implication here certainly supports the view that road and bridge bonds constitute an additional obligation not separate and distinct from the general indebtedness of the county. In *Burd v. Wilson*<sup>137</sup> it was held that a county could incur a general indebtedness under section 157 in the form of road and bridge bonds not to exceed the 2 per cent limit imposed by section 158. Then, in *Hughes v. Eison*,<sup>138</sup> section 157a was regarded as being in effect a part of section 157 and as enlarging and extending its provisions. Wherein, then, lies the distinction between voted road and bridge bonds issued under the authority of section 157 and those issued under section 157a of the Constitution? Three differences are apparent. (a) One concerns the requisite majority of votes to authorize the respective issues. But this distinction stems from judicial construction and not from either constitutional or statutory provisions. (b) An unlimited tax may be levied to pay the principal and interest of bonds formerly issued under section 157.<sup>139</sup> (c) Subsequent to *Mitchell v. Knox County*<sup>140</sup> in 1915 and prior to *Bird v. Asher*<sup>141</sup> in 1916 road and bridge bonds could be issued under section 157a in amounts not exceeding the 2 per cent assessed value limitation in section 158 without regard to the 20-cent tax rate limitation.<sup>142</sup> Recent decisions of the Court indicate that the validity of bonds purchased on the faith of the *Mitchell v. Knox County* decision will be upheld.<sup>143</sup>

In the absence of something indicating the contrary, courts have held that the power to incur indebtedness implies the power to assume personal liability.<sup>144</sup> "All obligations incurred un-

<sup>137</sup> 171 Ky. 807, 809, 188 S. W. 899, 900 (1916).

<sup>138</sup> 190 Ky. 661, 664, 228 S. W. 676, 677 (1921). See, to the contrary, *Whitley County v. Hermann*, 263 Ky. 440, 444, 92 S. W. (2d) 797, 799 (1936).

<sup>139</sup> *City of Winchester v. Nelson*, 175 Ky. 63, 70, 193 S. W. 1040, 1043 (1917).

<sup>140</sup> 165 Ky. 543, 557, 177 S. W. 279, 285.

<sup>141</sup> 170 Ky. 726, 186 S. W. 663.

<sup>142</sup> Bell County is at present levying an additional 25-cent tax for this purpose and has been upheld in doing so by the Circuit Court of the 26th District.

<sup>143</sup> See, for instance, *Ballard County v. Kentucky County Debt Commission*, 290 Ky. 770, 773, 162 S. W. (2d) 771, 773 (1942).

<sup>144</sup> *Hunter v. City of Louisville*, 208 Ky. 326, 328, 270 S. W. 841, 842 (1925); *Carter County v. Stinton*, 120 U. S. 517, 525, 7 Sup. Ct. 650, 30 Law. Ed. 701, 703 (1887); *Scotland County v. Hill*, 140 U. S. 41, 35 Law. Ed. 351 (1891); 44 C. J. 1231.

der Section 157 of the Constitution to which the indebtedness authorized by Section 157a are (is) added had before its adoption and has (have) since been regarded as general in nature and binding upon the county as a municipal entity”<sup>145</sup> Following this line of reasoning, which is supported by precedent in both Kentucky and federal decisions, the federal court in *Pulaski County v. Eichstaedt*<sup>146</sup> regarded references in bond recitals to the Constitution and statutes to be only an indication of the fund out of which they were to be paid. Thus, when the Court was called on in *Pulaski County v. Ben Hur Life Association*<sup>147</sup> to determine the negotiable character of bonds pledging the full faith and credit of the county for payment, precedents existed for holding section 157a of the Constitution as being a collateral source of payment and not limiting the obligation of the county. When the question first came before the Court of Appeals, the identical bond issue was involved which the federal courts in *Pulaski County v. Eichstaedt* previously had held negotiable. The Court of Appeals, however, declined to follow its own precedents and those set by federal courts and declared the bonds to be non-negotiable.

Because of the tremendous impact of the Pulaski County decision on county refinancing and also because of its probable future implications, it might be well to discuss briefly the reasoning employed and to note some of the social and economic consequences.

*Reasoning of the original Pulaski County decision.*—For bonds to be negotiable the Court in its original opinion reasoned.

“It is the possibility of insufficiency of the fund rather than the probability of sufficiency that determines the question whether the promise itself is contingent and therefore unconditional.”<sup>148</sup>

It seems clear, as was contended in appellees’ brief for re-

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<sup>145</sup> *Pulaski County v. Ben Hur Life Association*, 286 Ky. 119, 135, 149 S. W. (2d) 738, 746 (1941). Contrast this reasoning with the holding of the case that, though payment of road and bridge bonds is limited to a restricted fund, liability extends indefinitely in time; therefore, there exists an unlimited liability.

<sup>146</sup> 110 F. (2d) 79, 80 (E. D. Ky. 1940). Also, see *Commissioner of Cleveland v. Cleveland County Bank*, 157 N. C. 191, 72 S. E. 996 (1911).

<sup>147</sup> 286 Ky. 119, 149 S. W. (2d) 738 (1941).

<sup>148</sup> Reprinted at p. 112 in Appellees’ Petition for Rehearing.

hearing, "it is the presence or absence of liability and not any certainty of payment that makes the paper negotiable."<sup>149</sup>

As to the sufficiency of payment the Court relied heavily on *Bird v. Asher* and had this to say

"Sections 4307, 4307b-1, et seq., Statutes, make it (Sec. 157a of Const.) operative and regulate the counties in relation thereto. The amendment and the statutes establish an independent system or mode for financing road construction and improvement. The indebtedness is not to be included in the aggregate county indebtedness. It may be in addition to the amount otherwise and elsewhere limited by the Constitution. A county cannot be required to use any other revenue although it is permissible for it to do so out of its general revenue derived from the regular fifty cents tax long authorized by Section 157 of the Constitution and Section 1882 of the Statutes."<sup>150</sup>

From this construction of the Constitution and Negotiable Instruments Act the following conclusion was reached.

"The provisions in the bonds that the 'full faith, credit and resources of said county are hereby irrevocably pledged' to secure the payment must be read in connection with the Constitution and statute therein referred to. When it is so read it can only mean that the faith and credit of the county is pledged to the extent of the resources to be derived from and under the provisions of the Constitution and statutes designated as they have been construed by this Court. We think it manifest, therefore, that these bonds are to be deemed payable exclusively out of a special restricted fund, and the promise of payment is contingent upon the sufficiency of money to be raised by the special annual levy."<sup>151</sup>

*The immediate impact of the original decision.*—The immediate repercussions of the Court's original decision, rendered October 8, 1940, were of far-reaching social, political, and economic significance. These reverberations have not yet entirely subsided. Certain issues theretofore unquestioned were brought forcibly to the public's attention and probably await future clarification.

The most immediate effect of the decision was to extend to counties a hope that they would be relieved from payment of approximately three-fourths of a million dollars of road and bridge bonds immediately involved in the Caldwell and Company<sup>152</sup> debacle. Webster County had previously attempted to recover the uncollected portions of its bond proceeds from

<sup>149</sup> *Id.* at p. 69.

<sup>150</sup> *Id.* at p. 114.

<sup>151</sup> *Id.* at p. 116.

<sup>152</sup> A bankrupt banking institution of Nashville, Tennessee, which had marketed the bonds and with whom the proceeds had been left on deposit. Several other counties were defrauded of their bond proceeds similarly deposited.

county officials responsible for the sales to Caldwell and Company;<sup>153</sup> and Breckinridge County, within twenty days after the Pulaski decision, had moved to refuse payment and had employed counsel for its defense.<sup>154</sup> But the adverse effects of the decision were not limited to the bonds of these three counties. Approximately 100 other counties had bonds outstanding amounting to over \$20,000,000. The negotiability of these had never been questioned and the effect of the decision was to destroy an important feature of their marketability. Overnight the asked price for Kentucky county bonds dropped around thirty points with no takers.<sup>155</sup> At the time several counties were in default on their road and bridge bond obligations and several other counties were threatened with default. Refinancing in these counties or the issuance of original road and bridge bonds would have been a virtual impossibility had the original decision of the Court been permitted to stand. Counties are restricted by statute from issuing road and bridge bonds bearing over 5 per cent interest, and sales of bonds below par are forbidden.<sup>156</sup> Under such limitations non-negotiable municipal bonds probably would not have been marketable. The market for general fund bonds also would have been adversely affected as the investing public has tended to associate the Pulaski County situation with all county bonds.<sup>157</sup> This result could have been anticipated. Regardless of whether the Pulaski decision furnished any reasonable basis for doubting the negotiability of general fund bonds, investors simply have failed to differentiate between the two types of bonds, and, in addition, the notorious publicity the case received *created in investment markets the impression that Kentucky regarded debt obligations lightly.*

*Rehearing and reversal.*—The petition for rehearing of the Pulaski County case was promptly granted, and the Court reconsidered its original opinion on January 21, 1941. Appellees ably contended that section 157a should not be considered an

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<sup>153</sup> Webster County v Hall, 275 Ky. 54, 120 S. W. (2d) 756 (1938).

<sup>154</sup> George W. Peak, *Negotiable Non-Negotiables*, (Jan. 1942) 30 Ky L. J. 179.

<sup>155</sup> *Louisville Courier-Journal*, Jan. 15, 1941.

<sup>156</sup> Acts 1914, chap. 80, sec. 21, p. 338; Carroll's Ky. Stats. (1936), sec. 4307; Ky. Rev. Stats., secs. 178.010, 178.170.

<sup>157</sup> This statement is confirmed by correspondence with brokerage and investment institutions.



independent source of payment of road and bridge bond obligations. The Court, however, persisted in holding that the county's liability was restricted to funds derived from the 20-cent levy, but, although restricted in scope, under sections 158 and 159 of the Constitution its liability continued indefinitely into time, hence, the pledge of its full faith and credit contained in the bond recitals constituted an unconditional promise to pay within the meaning of the Negotiable Instruments Act. This reasoning is evident in the conclusion of the Court.

"Since Pulaski County could renew the bonds if not paid at maturity, could use other available resources—at least at its option—and could because of the requirements of Section 159 of the Constitution be mandatorily required to continue the special levy beyond the life of the bonds, we are of opinion that the payment of the bonds cannot be said to be confined to a particular fund, hence that they are negotiable instruments."

Perhaps it would be well to indicate certain social considerations pointed out by the Court. If section 157a is to be construed as being separate and independent of other constitutional provisions, as was done here, there is nothing in the constitutional provision or in section 4307 of the statutes making it operative to indicate whether bonds issued under the authority thereof are to be negotiable in character. In its quest for the legislative intent, the Court remarked as follows.

"It may be observed that the legislature has frequently provided that obligations which would otherwise be clearly payable out of particular funds shall be negotiable instruments."<sup>158</sup>

<sup>158</sup> Specific statutes making bonds of special municipal corporations and quasi-public corporations negotiable, though payable out of particular funds are: Acts 1923, chap. 172, sec. 15, p. 565; Carroll's Ky. Stats. (1936), sec. 4356s-25; Ky. Rev. Stats., sec. 180.070; Acts 1893, chap. 244, sec. 76, p. 1265 as amended by Acts 1926, chap. 115, sec. 67(k), p. 389; Carroll's Ky Stats. (1936), sec. 2839(k), Ky. Rev. Stats., sec. 93.470; Acts 1894, chap. 100, art. IV, sec. 28, p. 234 as amended by Acts 1910, chap. 107, sec. 8, p. 306; Carroll's Ky. Stats. (1936), sec. 3102; Ky. Rev. Stats., sec. 94.470 (2), Acts 1932, chap. 119, sec. 5, p. 116; Carroll's Ky. Stats. (1936), sec. 3480d-5; Ky. Rev. Stats., sec. 96.520; Acts 1940, chap. 120, sec. 8, p. 486; Carroll's Ky. Stats. (1940 Supp.), sec. 2741p-18; Ky. Rev. Stats., sec. 97.160; Acts 1938, chap. 92, sec. 3, p. 441; Carroll's Ky. Stats. (1939 Supp.), sec. 3235i-3; Ky. Rev. Stats., sec. 216.120; Acts 1934, chap. 72, sec. 4, p. 370; Carroll's Ky. Stats. (1936), sec. 4535m-4; Ky. Rev. Stats., sec. 162.350; Acts 1936, 4th ex. sess., chap. 6, sec. 16, p. 25; Carroll's Ky. Stats. (1939 Supp.), sec. 883j-17; Ky. Rev. Stats., sec. 279.130; Acts 1936, chap. 110, sec. 3, p. 340; Carroll's Ky. Stats. (1936), sec. 938g-30; Ky. Rev. Stats., sec. 74.340; Acts 1934, chap. 113, sec. 10, p. 507; Carroll's Ky. Stats. (1936), sec. 2741x-10; Ky. Rev. Stats., sec. 80.230; Acts 1936, 4th ex. sess., chap. 22, sec. 5, p. 166; Carroll's Ky. Stats. (1939 Supp.), sec. 2948c-5; Ky. Rev. Stats., sec. 165.150; Acts 1940, chap. 148, sec. 41, p. 563; Carroll's Ky. Stats. (1940 Supp.), sec. 2062g-41; Ky. Rev. Stats., sec. 220.400.

"Logic, history and custom all have their place in quest for the legislative intent. We have taken cognizance of the fact that a large issue of public bonds cannot be advantageously sold unless they are negotiable. We must weigh the purpose to be accomplished.

One is to dispose of the bonds for the best price. That cannot be done if they do not possess all the qualities of negotiable instruments.

It is said that there are perhaps \$20,000,000 of the bonds now outstanding. It cannot be thought that the legislature intended that so many obligations for such large sums should not have all the qualities, attributes and incidents of negotiable instruments."<sup>159</sup>

*Contractual rights of holders of road and bridge bonds.—*

What the contractual rights of holders of valid road and bridge bonds would be should the 20-cent levy prove inadequate, as is the case in a few counties, has never been decided to the complete satisfaction of the investing public. The question was raised in *Gillis v. Anderson*,<sup>160</sup> but that portion of the lower court's decision was stricken from the record as being irrelevant. In the Pulaski case the implication is that the county is morally obligated but that its legal liability does not extend beyond the 20-cent levy. The moral implication is embodied in the following remark of the Court: "The power to incur an indebtedness in the absence of something indicating the contrary implies the power to assume personal liability." The implied legal limitations on the county's liability were indicated by way of analogy with the opinion in *Commissioners of Cleveland County v. Citizens' National Bank*,<sup>161</sup> when the Court approvingly cited the holding in that case to the effect that "though the taxing power was limited it was general in the sense that it was all the municipality had." In other words, should the special 20-cent levy prove inadequate, the county's liability is not absolved, but the creditor is without immediately enforceable legal remedy.

Reorganization of the debt structure of some counties will be extremely difficult, if not impossible, until the extent of county liability is definitely clarified. Bondholders generally are reluctant to accede to any scaling down of par principal amount of their bonds or to assent to any reductions in interest rates until they have definite assurance that this is necessary as a compromise expedient, and it has been the experience of the

<sup>159</sup> The case of *Hunter v. City of Louisville*, 208 Ky. 326, 270 S. W. 841 (1925) is cited.

<sup>160</sup> 258 Ky. 472, 481, 76 S. W. (2d) 279, 284 (1934).

<sup>161</sup> 157 N. C. 191, 72 S. E. 996 (1911).

local finance officer that some bondholders have steadfastly refused to consider any compromise proposal pending clarification of their rights.<sup>162</sup>

#### ESTOPPEL

*Estoppel in general.*—"Estoppel is founded on morality and justice, and especially concerns conscience and equity"<sup>163</sup> It is predicated on the equitable rule that a person shall not deny the validity of his voluntary act to the prejudice of another,<sup>164</sup> and is so called "because a man's own act or acceptance stoppeth or closeth up his mouth to allege or plead the truth."<sup>165</sup> From its very nature the principle can be invoked only in those instances where equity dictates. No hard and fast rule can be prescribed governing its application, as this is necessarily contingent on the existence of specific facts in each instance.

Under what circumstances—if at all—counties, their officials, or taxpayers may be estopped from denying the validity of bond issues is difficult to ascertain. Bond recitals, though frequently similar, are not necessarily uniform, and identical conditions precedent to their issuance rarely if ever exist. Any decision, then, as to whether bondholders may offer the principle of estoppel in defense must be based on a studied consideration of the facts in each particular case. Nevertheless, because of the current significance of the issue, an examination of its possible application cannot be evaded entirely on account of the difficulties involved. The question recently was before the Court of Appeals in the case of *Morgan County v. Governor of Kentucky*, but no decision was given. It was remanded to the county debt commission on a technicality<sup>166</sup> Subsequently, an agreement has been reached without the estoppel question having been decided. Meanwhile, refundings have been suspended in several counties;<sup>167</sup> and the facility with which refinancing is handled in many other counties ultimately will depend on the position taken by the Court.

<sup>162</sup> Reeves, *op. cit.*, p. 10.

<sup>163</sup> 10 R. C. L. 690.

<sup>164</sup> Lockhart v. Kentland Coal and Coke Co., 182 Ky. 673, 679, 207 S. W. 18, 21 (1918).

<sup>165</sup> 2 Coke upon Littleton, sec. 667.

<sup>166</sup> *Morgan County v. Governor of Kentucky*, 288 Ky. 532, 156 S. W. (2d) 498 (1941).

<sup>167</sup> Reeves, *op. cit.*, p. 13.

There is considerable litigation in other jurisdictions involving the principle of estoppel, but only five Kentucky cases directly involving the principle appear to have been reported. Only one of these was by the Kentucky Court of Appeals, the others were by the Federal District Court for the Eastern District of Kentucky. Evidently, then, the issue is far from being settled.

If estoppel be applicable to Kentucky county bond litigation, it will relate generally, because of the prevailing character of county indebtedness, to either of two propositions. (a) whether the *mode* of performing the conditions precedent was wrong in form or execution, and (b) whether debt limits have been exceeded, in which case the *power* to issue is involved. Of the two, the latter is of much greater practical significance, as the amount of Kentucky county indebtedness of questionable validity because of over-issue exceeds by far that which may be questioned because of procedural irregularities.

*Estoppel in pais.* Apparently, the only decision of the Kentucky Court of Appeals relative to a plea of estoppel in litigation relating to municipal bond issues was in 1883 in *Town of Eminence v. Grasser's Ex'r*<sup>168</sup>. Several instances may be cited where the Court has made remarks which might be construed to suggest either that a county may or may not be estopped from denying the validity of its own acts or those of its officials,<sup>169</sup> but many such remarks may be considered as mere *obiter dicta* or as being so remotely related as to permit of distinction.

In the *Eminence* case the municipality relied on various irregularities in the application for a submission of the proposition to subscribe to the taxpayers, in the advertisement, and time of holding the election, and questioned the capacity of the officers who held it and signed the bonds. The bondholder pleaded the principle of estoppel. He contended that, in addition to the recitals contained in the bonds sued on, the municipality gave

<sup>168</sup> 81 Ky. 52.

<sup>169</sup> Representative instances are cited as follows: *Cook v. Lyon County*, 13 Ky. Opinions 81, 83 (1884), *Long v. McDowell*, 107 Ky. 14, 18, 52 S. W. 812, 813 (1899), *Greene County v. Shortell*, 116 Ky. 108, 75 S. W. 251 (1903), *Gray v. Jackson County Board of Education*, 205 Ky. 277, 280, 265 S. W. 772, 774 (1924), *Burnside Land Co. v. Connelly & Lee*, 218 Ky. 346, 350, 291 S. W. 409, 411 (1926); *Kentucky Utilities Co. v. City of Paris*, 248 Ky. 252, 258, 58 S. W. (2d) 361, 363 (1933); *City of Paducah v. Gillispie*, 273 Ky. 101, 115 S. W. (2d) 574 (1938), *Pulaski County v. Ben Hur Life Association*, 286 Ky. 119, 126, 149 S. W. (2d) 738, 742.

other representations of their validity by levying and collecting taxes, and paying thereby nearly three-fourths of the issue. The acts were held to constitute a basis for estoppel. The Court also refused to permit the city to deny the official character of its own officers who acted as such in the performance of the duties necessary to execute the conditions precedent to the issuance of the bonds.

Whether the *Eminence* case is controlling in Kentucky courts is not known. Should the courts see fit to apply the doctrine there asserted, there is little doubt that Kentucky counties are estopped from questioning the validity of bonds where the mode of performing the conditions precedent was wrong in form or execution. The case also offers persuasive evidence that bonds invalid in their inception may become valid by subsequent ratification.<sup>170</sup>

The writer has been unable to find an opinion of the Kentucky Court of Appeals directly deciding the proposition as to whether or not county officials acting beyond constitutional limitations by making untrue recitals in the face of bonds can estop the county from questioning the validity of bonds because of over-issue.<sup>171</sup> The only decisions in this respect have been in the Federal District Court for the Eastern District of Kentucky. In each of those instances the counties were estopped from pleading invalidity.

The first federal decisions relative to a plea of estoppel, where Kentucky county bonds were the subject of litigation, were in 1909, in *Dietrich v. Bath County, Kentucky*<sup>172</sup> and its companion case, *George A. Eyer and Co. v. Mercer County, Kentucky*.<sup>173</sup> The Bath County case will be discussed to the exclusion of the Mercer County case, because the latter, as a companion case, relied on the reasoning employed in the former. The Bath County case involved the validity of \$21,045.49 of bonds and interest coupons thereon out of an issue of \$23,500, dated July 1, 1900, and issued under section 1857 of Kentucky

<sup>170</sup> To the contrary, however, see *Board of Education of Calloway County v. Talbott*, 261 Ky. 66, 76, 86 S. W. (2d) 1059, 1064-65 (1935), *Whitley County v. Hermann*, 263 Ky. 440, 444, 92 S. W. (2d) 797-799 (1936).

<sup>171</sup> Appellees in their brief of June 7, 1941 in the case of *Morgan County v. Governor of Kentucky* make the same admission.

<sup>172</sup> 292 Fed. 279 (E. D. Ky. 1909).

<sup>173</sup> 292 Fed. 292 (E. D. Ky. 1923).

Statutes, providing for the funding of a county's indebtedness contracted for public buildings, bridges, and turnpikes. The bonds were issued to fund indebtedness created during the fiscal year 1892 for the construction of turnpikes. The funded debt was averred to be invalid because it was in excess of the income and revenues provided for the year and was created in violation of section 157 of the Constitution without having been submitted to a vote of the people. Total revenues for the year amounted to \$20,022.43, and, during the year previous to the creation of the indebtedness that was funded, an indebtedness of \$12,000 had been incurred for current annual expenses. This left a surplus of only \$8,022.43 applicable to other legitimate purposes. In holding that the county was estopped to claim that the funded indebtedness was invalid, Judge Cochran reasoned.

"The Legislature had power to confer on the fiscal court power to fund such indebtedness. Undoubtedly said section should be construed to confer power to fund only such indebtedness as has been legally incurred. But it must also be construed as conferring power on the fiscal court to determine what of its county's indebtedness is legal and to make representation in regard thereto by way of recital in the funding bonds. There is no statute in Kentucky providing for semi-annual or other statements setting forth the amount of the indebtedness of the county, much less the facts upon which its legality may be determined, so that the amount and legality thereof may be readily ascertained by the purchaser of its funding bonds. To determine the amount of the indebtedness and the character thereof, he must search the minutes of the fiscal court, any reports that may have been made to it, and the accounts of the court's treasurer, and to determine its legality he will have to investigate carefully all steps in order to its occurrence. If a purchaser has to go to that much trouble and cannot safely rely on the determination of the fiscal court and its representation made by way of recital in the bonds issued by it, there will be very few funding bonds sold. Hence there can be no question that under this provision the fiscal court of the defendant had power to determine and make representation by way of recital in the bonds in question as to the validity of the indebtedness which they were issued to fund."

In a recent decision, *Woodmen of the World v. Rowan County, Kentucky*<sup>174</sup> Judge Swinford applied the rule stated above and held that counties which have the power to issue bonds also have implied authority to determine the existence of necessary facts as a condition precedent. He distinguished clearly between a complete lack of power to issue bonds under all circumstances and the power to issue them if certain conditions exist.

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<sup>174</sup> 23 F Supp. 903 (E. D. Ky. 1938).

The most recent case in federal courts was *Women's Catholic Order of Foresters v. Carroll County*.<sup>175</sup> In this case it was contended that Carroll County bonds issued in 1928 under authority of sections 157, 158, and 159 of the Constitution and sections 1857, 1858, and 1859 of Kentucky statutes to fund floating indebtedness were in excess of debt limitations. Judge Ford, in answer to this contention, said.

"The defense asserted is in direct contradiction of the recitals made by the Fiscal Court in its resolution authorizing the issuance of the bonds and seeks to repudiate the certificate incorporated in each of them. It does not rest upon the claim of total lack of power in the county, under any and all circumstances, to issue funding bonds of the character here involved, but rests upon claimed lack of power resulting from the absence of precedent facts which conditioned its exercise. The distinction between a defense based upon total lack of power and one based merely upon the absence of precedent facts or conditions upon which the exercise of a conferred power depended, has been so frequently stated that it is no longer open to question in this jurisdiction. At the time these bonds were issued, the Fiscal Court of the County, having jurisdiction to 'regulate and control the fiscal affairs' of the county (Sections 1840 and 4281u-1 to 4281u-4, inclusive, Kentucky Statutes), was clothed with authority and charged with the duty of determining whether there had been a fulfillment of the precedent conditions essential to the lawful exercise of the power conferred by the Statutes and the Constitution."

The Morgan County case, the only case involving the particular issue ever to have been squarely before the Kentucky Court of Appeals, relates to the validity of road and bridge bonds alleged to have been issued in excess of constitutional limitations. Refunding bonds for Morgan County were approved by the state local finance officer on the theory that the county is estopped from denying the validity of the bonds because of recitals in the face thereof alleging in effect the contrary. A protesting taxpayer appealed to the county debt commission and that body overruled the decision of the state local finance officer. The action of the commission was based on an opinion given by Assistant Attorney General A. E. Funk, pursuant to Section 938q-4 of the County Debt Act, to the effect that a taxpayer would not be estopped by any recital in bonds to question the validity thereof.<sup>176</sup> Morgan County is resting its case largely on the principles discussed previously in connection with the decisions where Kentucky counties have been estopped

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<sup>175</sup> 34 F Supp. 140 (E. D. Ky 1940).

<sup>176</sup> See consolidated original and reply briefs of appellants at pp. 2-4.

from pleading invalidity of their bond issues. The contention of the county debt commission briefly is as follows.

"It is the contention of the Attorney General that the \$11,000 of (the Morgan County issue) which exceeded the amount that could have been liquidated in forty years was void *ab initio*; that being void *ab initio*, neither Morgan County nor her fiscal court could by any act, trick, pretense, device or subterfuge pay such said excess bond issue or any part thereof or obligate Morgan County so to do. The reason for this contention is the plain unvarnished fact that under the provisions of sections 157, 157a, and 159 of the State Constitution, neither Morgan County nor its fiscal court had the power to assume its payment after its attempted creation; and not having the power to either create or assume the indebtedness, any act looking to that end, even presuming that a county is a corporation (which it is not) and that the fiscal court are its corporate officers, such an act or acts would come under the well known doctrine of *ultra vires*."<sup>177</sup>

In support of the above contentions advanced by appellees it is of interest to note the following arguments and footnoted cases cited in support thereof (a) It is the inescapable duty of those contracting with or purchasing the obligations of a county to take notice of the law and the authority of the county to contract thereunder.<sup>178</sup> (b) Parties contracting with or purchasing obligations of fiscal courts do so at their peril.<sup>179</sup> (c) The fiscal court has no power when issuing against the county void obligations prohibited by the Constitution, to estop the county, its officers, or taxpayers from resisting the payment of those obligations on constitutional grounds by the fraudulent device of inserting fake statements in the face of those obliga-

<sup>177</sup> Appellees' Brief, pp. 2-3.

<sup>178</sup> U. S. Fidelity & Guaranty Co. v. Commonwealth, 31 R. 1179, 1180, 104 S. W. 1029 (1907), Grinstead v. Monroe County, 156 Ky. 296, 298, 160 S. W. 1041, 1042 (1913) Leslie County v. Keith, 227 Ky. 663, 664, 13 S. W. (2d) 1012, 1013 (1929), Farmer v. Marr, 238 Ky. 417, 426, 38 S. W. (2d) 209, 212 (1931), Fulton County Fiscal Court v. Southern Bell Telephone and Telegraph Co., 285 Ky. 17, 36, 146 S. W. (2d) 15, 25 (1940)

<sup>179</sup> Fulton County Fiscal Court v. Southern Bell Telephone and Telegraph Co., 285 Ky. 17, 36, 146 S. W. (2d) 15, 25 (1940); Farmer v. Marr, 238 Ky. 417, 426, 38 S. W. (2d) 209, 212 (1931); Leslie County v. Keith, 227 Ky. 663, 664, 13 S. W. (2d) 1012, 1013 (1929), Grinstead v. Monroe County, 156 Ky. 296, 298, 160 S. W. 1041, 1042 (1913), Bruner v. Jefferson County Fiscal Court, 239 Ky. 613, 617, 40 S. W. (2d) 271, 273 (1931), Cruck v. Rash, 190 Ky. 820, 825, 229 S. W. 63, 65 (1921), Owen County v. Walker, 141 Ky. 516, 520, 133 S. W. 236, 238 (1911); Jefferson County v. Young, 120 Ky. 456, 462, 86 S. W. 985, 986 (1905), Board of Church Extension M. E. Church South v. Taylor, 152 Ky. 518, 519, 153 S. W. 747, 748 (1913) Pulaski County v. Richardson, 225 Ky. 556, 566, 9 S. W. (2d) 523, 526 (1928).



tions.<sup>180</sup> (d) The holders of a void bond have no right against the county that issued the bond.<sup>181</sup> In addition to these contentions of appellees the Court of Appeals has repeatedly held any debt created in excess of constitutional debt limits is void.

Finally, it should be observed that the bonds in each of the cases referred to where the decision has permitted invoking estoppel were issued prior to legislative enactment in 1934 providing expressly that any county may not be estopped from contesting the legality of any indebtedness which it has created.<sup>182</sup> Apparently, recitals in bonds issued subsequent to 1934 are of little force. The same might be suggested respecting bonds issued since 1932, when the legislature provided for court validation,<sup>183</sup> as judicial approval should dispel any fears relative to statements contained in bond recitals. The truth of such statements having once been judicially determined should in the absence of fraud withstand collateral attack in subsequent proceedings. Prior to this time, however, there is presumptive evidence that counties might be so estopped. The tenor of the Court's decisions appears to have been that municipal indebtedness, in the absence of definite evidence to the contrary, is presumed to be valid, and in all instances the burden of proof is on the party who challenges the validity thereof.<sup>184</sup>

<sup>180</sup> *Sutliff v. Board of County Commissioners*, 147 U. S. 230, 235, 236-237, 37 Law. Ed. 145, 148, 149 (1893), *Waite v. Santa Cruz*, 184 U. S., 302, 319, 46 Law. Ed. 564 (1902), *Dixon Co. v. Field*, 111 U. S. 83, 28 Law. Ed. 360 (1884) *Pulaski County v. Ben Hur Life Association*, 286 Ky. 119, 127, 137, 149 S. W (2d) 738, 742, 747; *Whitley County v. Hermann*, 263 Ky. 440, 444, 92 S. W (2d) 797, 799 (1936) *City of Henderson v. Redman*, 185 Ky. 146, 150, 214 S. W 809, 810 (1919) *In Re Town of Aiton* (No. 6710) 43 Okla. 720, 726, 144 Pac. 184, 187, 188 (1914).

<sup>181</sup> *Downing v. Mason County*, 87 Ky 208, 212, 8 S. W 264, 266 (1899), *Kentucky State Park Commission v Wilder*, 260 Ky. 190, 194, 84 S. W (2d) 38, 40 (1935), *Carr v. Jefferson County*, 275 Ky 685, 687, 122 S. W (2d) 482, 484 (1936)

<sup>182</sup> Acts 1934, chap. 132, p. 544; *Carroll's Ky. Stats.*, sec. 1649c-1; *Ky. Rev. Stats.*, sec. 422.140.

<sup>183</sup> Acts 1932, chap. 22, secs. 1, 2, p. 124; Acts 1936, chap. 21, sec. 1, p. 58; *Carroll's Ky. Stats.*, 186c-6, 186c-7; *Ky. Rev. Stats.*, secs. 66.260-270. *City of Newport v. The Newport National Bank*, 148 Ky. 213, 146 S. W 377 (1912), *McDonald v. City of Lexington*, 253 Ky. 585, 70 S. W (2d) 534 (1934), *Ballard County v. Kentucky County Debt Commission*, 290 Ky. 770, 162 S. W (2d) 771 (1942)

<sup>184</sup> See, for example, *Fox v. Boyle County*, 245 Ky. 27, 31, 53 S. W (2d) 192, 194 (1932), *Rhode v. City of Newport*, 246 Ky 476, 481, 55 S. W (2d) 368, 370 (1932), *Kentucky Utilities Co. v. City of Paris*, 248 Ky. 252, 258, 58 S. W (2d) 361, 363 (1933).

## III. CONCLUSIONS

The constitutional debt limitations of 1890 were designed to prevent Kentucky counties from incurring indebtedness during any year in excess of the income and revenue provided for the year and to limit indebtedness for extraordinary expenditures and capital outlays to 2 per cent of assessed valuation. The latter was extended in 1909 to permit indebtedness up to 5 per cent of assessed value when incurred for road and bridge purposes. Judicial constructions of these provisions, however, have resembled the swing of a pendulum. For several years the progressively increasing laxity in the Court's decisions went a long way toward removing all restraining influences of the Constitution, but the current tendency of the Court apparently is to revert to a stricter interpretation more in accord with the meaning of the original instrument. Taken chronologically the trend of the Court's decisions may be summarized briefly as follows. Initially, non-voted general fund indebtedness was limited to include only voluntary contractual obligations, expenditures for essential governmental purposes were thus effectively excluded from any restraints. Soon thereafter, the restraining influence of the annual income and revenue limitation was practically nullified when it was decided that the amount of indebtedness which a county could lawfully create was to be measured by the maximum permissible tax levy and 100 per cent collections and not by the actual levy with proper allowance for probable delinquencies. For about two decades, then, the Court attempted to follow this basically unsound decision to its logical conclusion. first, by authorizing counties to forward general fund deficits to succeeding years for payment, second, by sanctioning the funding of these accumulated deficits. Meanwhile, many counties through their failure to act in good faith abused the administrative freedom and discretion permitted them and became indiscriminately involved in debt. Culmination of the increasingly liberal interpretations of the Court has been followed by progressively stricter and more limited constructions tending to invalidate the obligations of many counties. As a result, some counties have been forced to resort to such expedients as attempted repudiation, proration of available funds, compromise agreements, and, it may be, to

voluntary bankruptcy, others have escaped legal hurdles through refinancing at reduced interest rates, delayed maturity dates, etc. Apparently, no solution is in sight for a few.

Inconsistencies in the Court's decisions have tended to aggravate the situation. Before any refunding plan can be arranged, a prodigious amount of detailed investigation must be done. Even then, because of the diversity in judicial precedents, refinancing cannot be done with complete assurance that there will be compliance with all legal requirements.

Most judicial controversies have tended to gravitate around certain fundamental constitutional issues. These may be presented as follows: Does the general 50-cent levy measure the extent of county liability for general fund obligations—both voted and non-voted, or is it mandatory upon counties under section 159 of the Constitution to exceed the 50-cent levy, if necessary, to service valid obligations? Are constitutional limitations on county indebtedness self-executing, or may the legislature and local governing bodies impose additional limitations within prescribed limits? Is section 157a to be construed as an extension and an integral part of section 157, or is it to be interpreted as being distinctly separate? Varying constructions of these basic issues have resulted in much litigation which, in turn, has been responsible for many delays and additional expense in refinancing operations and has tended to destroy the confidence of the investing public generally in Kentucky municipal bonds. Likewise, much additional litigation appears inevitable before any measure of harmony can be brought out of the chaotic conditions thus created. In this connection it might be suggested that social and economic implications may be given considerable weight in future decisions, at least current opinions offer persuasive evidence to this effect.

Finally, the policy followed by the state local finance officer of insisting that all doubtful legal questions be resolved by the courts is a controversial issue. This may be the only sane and constructive policy that could have been adopted, but, from the standpoint of getting the job done, the propriety of pressing adjudication of all doubtful issues may be questionable.



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Two of the members of the staff of the College of Law are away, one for the duration, practicing law in Frankfort, Kentucky; the other on leave, at the University of Missouri. Forty-two students were enrolled in the Fall, a decrease of about 40 per cent from the year before. Courses are being alternated and not all the regular normal offerings are being given at one time.

There are a number of openings for graduates of accredited law schools as Special Agents with the Federal Bureau of Investigation. For further information, write to Mr. H. K. Moss, Special Agent in Charge, Federal Bureau of Investigation, 633 Federal Building, Louisville.