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CONSTITUTIONAL LIMITATIONS ON COUNTY INDEBTEDNESS IN KENTUCKY

GEORGE PEAK*

Despite apparently clear and unambiguous language in the Constitution setting bounds to the power of a county to incur debts, county officials have been confused from time to time in determining the particular limitation which applied. At one time a county could not fund its obligations; a period during which funding was permissible later occurred, and now it appears likely that funding once more will be outlawed. At one time a county could incur obligations up to the amount which would be raised by the maximum tax levy, whether or not it was actually levied; no longer is this the case. At one time a county could not levy taxes above the amount set forth in sections 157 and 157a of the Constitution; as applied to certain voted debts this is no longer true. An inquiry into the debt limitations of Kentucky counties, therefore, must concern itself primarily with judicial interpretations of the relevant provisions of the Constitution.

GENERAL OBLIGATIONS

Indebtedness incurred under the authority of sections 157 and 158 of the Constitution of Kentucky is to be considered as distinct from road and bridge bond indebtedness incurred under the authority of section 157a. The pertinent provisions of these "general obligation" sections are as follows:

"... No county . . . shall be authorized or permitted to become indebted, in any manner or for any purpose, to an amount exceeding in any year, the income and revenues provided for such year, without the assent of two-thirds of the voters thereof, voting at an election to be held for that purpose; and any indebtedness contracted in violation of this section shall be void. Nor shall such contract be enforceable by the person with whom made; nor shall such municipality ever be authorized to assume the same." (Constitution of Kentucky, section 157.)

"The respective . . . counties . . . shall not be authorized or permitted to incur indebtedness to an amount, including existing indebtedness, in the aggregate exceeding . . . two per centum (2%) on the value of the taxable property therein, to be estimated by the assessment previous to the incurring of the indebtedness: Provided, any . . . county . . . may contract an indebtedness in excess of such limitations when the same has been authorized under laws in force prior to the

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adoption of this Constitution . . . unless, in case of emergency, the public health or safety should so require. Nothing herein shall prevent the issue of renewal bonds, or bonds to fund the floating indebtedness of any . . . county . . ." (Constitution of Kentucky, section 153.)

Nature of the indebtedness.—The indebtedness referred to in section 157 is of a contractual nature and does not include compulsory obligations cast on a county by law,¹ which will be considered separately. One fiscal court cannot, by contract, create an indebtedness (*i.e.*, assume obligations, whether or not paid currently) in excess of the income and revenue provided for the year which would be a binding obligation on the fiscal court in the next year.² Thus if the income and revenue provided for the year were \$50,000, contractual expenditures would be limited to \$50,000.

Limitation measured by income.—The meaning of "the income and revenues provided for the year" has caused both the counties and the courts considerable difficulty. The initial interpretation of the phrase was made in *City of Providence v. Providence Electric Co.*³ The doctrine laid down was that a municipality might incur indebtedness not to exceed the amount which would have been raised by the maximum tax levy permitted, whether or not it was actually levied. The phrases "provided for the year" and "maximum permissible levy" were in effect declared to be close kinsmen. Thus if a county's actual levy were \$40,000 but its maximum permissible levy were \$50,000, the latter and not the former figure was its expenditure limitation.

However, the Court had not said its last word. In *Hocken-smith v. County Board of Education of Franklin Co.*⁴ Judge Thomas in writing the Court's opinion observed:

"It is not our purpose at this time to draw into question the soundness of that interpretation when first made . . . notwithstanding this Court in rendering such opinions since 1906 made no mention of, or reference to, section 4281u-4 of our present statutes . . . the provisions of which limit the expenditures of subordinate governmental agencies having power to levy and collect taxes to the amount 'actually levied and collected for that year' . . ."

Again in *Hill v. City of Covington*⁵ Judge Thomas wrote the

¹ Hopkins County, etc. v. St. Bernard Coal Company, etc., 114 Ky. 153 (1902).

² Bradford v. Fiscal Court of Bracken County, et al., 159 Ky. 544 (1914).

³ 122 Ky. 237 (1906).

⁴ 240 Ky. 76 (1931).

⁵ 264 Ky. 618 (1936).

opinion upholding a bond issue under the Providence case doctrine. He then took the unusual step of disagreeing with his opinion, stating thus his grounds for disagreement:

"The writer disagrees with the interpretations, *supra*, of the inserted provisions of sections 157 and 158 referred to, and has done so throughout his tenure of service as a member of this court. Others have agreed with him and some of them do so yet, but a majority of the members of the court (and in this case every one but the writer) are of the opinion that a correct application of the *stare decisis* doctrine prevents a reconsideration of those interpretations and that they, as a part of the sections so interpreted, should continue until and unless corrected by amendments duly adopted.

"It is not considered amiss for the writer to briefly state his reasons for disagreeing with the interpretations referred to. They are (a) that according to his conception each of them is in direct conflict with the language employed by the members of the constitutional convention in framing the two involved sections, and (b) that if the language was less plain, the interpretations thwart and destroy the undoubted purpose and intention of the Constitution makers, which was to erect a curb against extravagant and unlimited expenditures of the public revenue of such subordinate taxing agencies and to fix a limit beyond which such expenditures, and the creation of indebtedness would not be tolerated . . ."

Finally,⁶ on December 22, 1938, the Court reversed this factitious accounting doctrine in *Payne, et al. v. City of Covington*.⁷ The opinion said, in part:

"The interpretation heretofore given, beginning with the City of Providence case, is in direct conflict with such clear intent and purpose, and instead of requiring the observation of the intended 'pay-as-you-go' course, it opened wide the door for such political units to accumulate each year an indebtedness equal to the amount that could have been met by the levying and collection of ad valorem taxes up to the maximum limit prescribed in the first part of section 157, without levying any rate at all for that purpose. To our minds there could scarcely be a more erroneous interpretation, since it permitted that to be done which the Constitution had clearly intended to prevent and no interpretation could have been more destructive of such intent than the one adopted and followed since the rendition of the City of Providence case."

The Court further declared that the doctrine announced in the Providence case was mere dictum and therefore should not have constituted a precedent.

It should be pointed out, however, that the new doctrine is prospective in effect only and in no case retroactive. In the Payne case the circuit court had validated a funding bond issue, and the Court of Appeals, although it announced the prospective doctrine, sustained the decision of the lower court. In other

⁶ Or so it seems at the present time.

⁷ 276 Ky. 380 (1938). Judge Thomas was still a member of the Court, although he did not write the opinion.

words, the validity of any indebtedness incurred before December 22, 1938, will depend on the Providence case doctrine, but the validity of any indebtedness incurred after December 16, 1938, will depend upon the doctrine announced in the Payne case.

Exception to income limitation.—Indebtedness in excess of the income and revenues for the year may be created with the assent of “two-thirds of the voters, voting at an election to be held for that purpose.” The ambiguous language quoted has been interpreted to mean “two-thirds of those voting on the question.”⁸

Limitation measured by assessed valuation.—The second important debt limitation is measured by assessed valuation. Counties may not incur general obligation indebtedness in excess of 2 per cent of their taxable property unless, in case of emergency, the public health or safety should so require.⁹ This limitation operates both on indebtedness created without a vote of the people and on indebtedness authorized by the requisite majority of the voters.¹⁰ It is an absolute limitation beyond which even the people cannot go. The exceptions to this limitation are obligations created as a result of emergencies involving public health and safety. Whether or not an emergency exists is a question for the courts to decide.¹¹ The only cases in which the alleged emergency has measured up to the Court’s standard are those involving the construction of water works systems where existing plants had failed. Circumstances not creating emergen-

⁸ Overall v. City of Madisonville, 125 Ky. 684 (1907).

⁹ Constitution, section 158. In County Debt Commission, et al. v. Morgan County, et al., and County Debt Commission, et al. v. Ballard County, et al., decided jointly on June 23, 1939, it was held that 2 per cent was not a grant of power to a county but rather a legislative limitation. The County Debt Act of 1938, section 938q-4, Baldwin’s 1938 Supplement to Carroll’s Kentucky Statutes, 1936 Edition, provided that approval of a State Local Finance Officer must be obtained before a county could incur an indebtedness of more than one-half of one per cent of its taxable property. In upholding the constitutionality of the Act, the Court said that section 158 of the Constitution could not be construed as preventing the legislature from fixing a limit lower than 2 per cent. See also, Clere v. Board of Education of City of Ashland, 211 Ky. 130 (1925). However, see Board of Education of Winchester v. City of Winchester, 120 Ky. 591 (1905) and City of Winchester v. Nelson, et al., 175 Ky. 63 (1917), which held that the legislature might not change constitutional limitations.

¹⁰ Nelson County Fiscal Court, et al. v. McCrocklin, 175 Ky. 199 (1917).

¹¹ Buckner v. Board of Education of Owensboro City School District, 236 Ky. 763 (1930).

cies have been the construction of a new courthouse,¹² the construction of a light plant,¹³ the construction of a new water works plant,¹⁴ and the replacement of a school building destroyed by fire.¹⁵ That the line of demarcation between what is to be termed an emergency and what is not is extremely thin may be illustrated by Chief Justice Clay's dissenting opinion in the Millersburg case,¹⁶ in which Judge Logan concurred. In part it reads:

"In determining whether or not an emergency exists we should not be guided by the standards of pioneer days but should look at the question through the eyes of modern science and give some heed to the voice of those who have made the question of public health a lifetime study. The only way to protect the public health is to take preventative measures. An emergency is simply a pressing necessity, and it will not do to say that no emergency exists until after an epidemic has actually occurred. On the contrary, we should hold that a case of pressing necessity is presented whenever the surrounding conditions are such as to jeopardize the public health.

"Here a large number of persons live in a small area. Only cesspools and tanks are used for the disposal of sewerage. In some instances these cesspools and tanks are being used by many persons. Because of the contour of the land the flowage and seepage are through the city of Millersburg. In the opinion of the sanitary experts this condition is a constant menace to the health of the people. For these reasons, I am inclined to the view that there exists under the Constitution an emergency entitling the city to issue bonds in excess of the debt limit . . . and therefore cannot agree with the majority opinion."

Tax rates to pay indebtedness.—The maximum tax rate for counties authorized by section 157 of the Constitution is 50c per \$100. In deciding the question of whether this maximum applies to indebtedness created under the authority of an election, the Court went through a reversal cycle similar to that terminated in the Payne case, *supra*. It first said in *Town of Bardwell v. Harlin and Others*,¹⁷ after duly quoting the framing fathers of the Constitution, that the maximum rate allowed was the 50c authorized by section 157. The cycle was completed in *City of Winchester v. Nelson et al.*¹⁸ when the Court expressly reversed the Town of Bardwell case with the words:

"We are quite aware that our present construction is not in har-

¹² Franklin Fiscal Court v. Commonwealth, 139 Ky. 307 (1909).

¹³ Samuels, et al. v. City of Clinton, et al., 184 Ky. 97 (1919).

¹⁴ Hurst, et al. v. City of Millersburg, et al., 220 Ky. 108 (1927).

¹⁵ Nelson v. Board of Education of City of Williamsburg, 213 Ky. 714 (1926).

¹⁶ *Supra* footnote 14.

¹⁷ 118 Ky. 232 (1904).

¹⁸ 175 Ky. 63 (1917).

mony with the construction heretofore placed upon the tax rate provision of section 157 . . . but we are convinced that our present construction is right."

The effect of this reversal was to permit a tax rate in excess of 50c per \$100 to retire indebtedness created by a two-thirds majority of those voting at an election for that purpose.

Authority to fund debts incurred without vote.—The following appears in section 158 of the Constitution:

"Nothing herein shall prevent the issue of renewal bonds, or bonds to fund the floating indebtedness of any . . . county . . ."

In *McCrocklin v. Nelson County Fiscal Court, et al.*¹⁹ the authority of a county to issue bonds to fund a valid floating indebtedness incurred without a vote of the people was denied. Without expressly overruling the McCrocklin case, the Court validated bonds to fund such indebtedness in *Vaughan v. City of Corbin, et al.*²⁰ Notwithstanding vigorous dissents,²¹ the Vaughan case doctrine was followed until the recent *Payne, et al. v. City of Covington.*²² Although the Payne case does not expressly overrule the Vaughan doctrine, there is a strong implication that the doctrine of the dissenters will be followed hereafter: *i.e.*, that the provision of section 158 of the Constitution authorizing funding bonds applies only to indebtedness incurred prior to the adoption of the Constitution and to indebtedness authorized by a vote of the people.

Non-contractual indebtedness.—A county must pay its necessary governmental expenses even though such claims exceed the revenue for the year.²³ Yet "necessary governmental expense" has never been completely defined by the Court. It has said that the following fall within the meaning of the phrase: sheriff's posse expense, salaries and fees of county officers, maintenance of public buildings and institutions, fire hose, election expense, dieting of prisoners and pauper expense. Items falling

¹⁹ 174 Ky. 308 (1917).

²⁰ 217 Ky. 521 (1927).

²¹ See *City of Frankfort v. Fuss*, 235 Ky. 151 (1930); *Elliott v. Fiscal Court of Pike County, et al.*, 237 Ky. 797 (1931); *Hall, et al. v. Fiscal Court of Fleming Co.*, 239 Ky. 425 (1931); *Hill v. City of Covington*, 264 Ky. 618 (1936).

²² *Supra*, footnote 7.

²³ *Hopkins County v. St. Bernard Coal Co.*, 114 Ky. 153 (1902); *Breathitt County v. Cockrell*, 250 Ky. 743 (1933); *Adair County Farm Bureau v. Fiscal Court of Adair County*, 263 Ky. 23 (1936); *Ballard v. Adair County*, 268 Ky. 347 (1937).

outside the "necessary" category are road and bridge expense and farm agent salaries.

A county cannot, however, spend the greater part of its revenues for non-essential purposes earlier in the year and then go into debt for its necessary functions. Such action would constitute failure "to exercise due regard for the county's finances" as required by various budgetary statutes.²⁴ Presumably such claims for the necessary expenses would be valid, and the county could recover the illegal expenditures for non-essential services either from the payee or from the members of the fiscal court approving the disbursements.²⁵

Debts incurred for essential services must be carried forward into succeeding years and paid without exceeding the maximum tax rate allowed by section 157 of the Constitution.²⁶ Should a situation ever arise (and it is not inconceivable) wherein a county spent only for essential services and yet incurred obligations which it could not pay, the Court would perhaps be faced with a dilemma requiring another precedent.

Devices to avoid limitation.—In order to escape the limitations upon debt incurrence imposed by sections 157 and 158 of the Constitution, a complicated and ingenious device, commonly called "the holding company plan," has been resorted to in some counties.²⁷ This plan has been used to construct school buildings, courthouses and hospitals. A non-profit corporation is organized by citizens of the county, and its bonds in a given amount are issued and sold. With the proceeds from the sale of the bonds, the corporation enters into a contract with the county to buy the real estate on which the building is to be constructed. In consideration for a sale price in excess of the value of the real estate, the county agrees to construct the building and to enter into a one year lease at a rental which will cover maintenance plus bond amortization; in consideration for accepting real estate less valuable than its cash, the corporation receives title to the

²⁴ Ballard v. Adair County, *supra*.

²⁵ See *Ibid.*; Williams, et al. v. Board of Education of Paintsville, et al., 274 Ky. 624 (1933).

²⁶ Landrum v. Ingram, County Judge, et al., 274 Ky. 736 (1933).

²⁷ For cases upholding this device see Waller v. Georgetown Board of Education, 209 Ky. 726 (1925); Godsey v. Board of Education of Ludlow, et al., 238 Ky. 17 (1931); Rothchild v. Shelbyville Board of Education, 254 Ky. 467 (1934); Sizemore v. Clay County, et al., 268 Ky. 712 (1937); State Bank & Trust Co. of Richmond v. Madison County, et al., 275 Ky. 501 (1933).

building and agrees to lease the building to the county at the price noted above each year for as many years as are necessary to retire the bonds, at which time it agrees to turn the building over to the county. Thus the county acquires the building without becoming legally obligated in any one year over and above "the income and revenues provided for the year." There is no indication that the Court will outlaw this device, but, in view of its recent re-interpretation of section 157 in the Payne case, the holding company plan might be termed a mere subterfuge to evade the Constitutional limitations.

ROAD AND BRIDGE BOND OBLIGATIONS

The following section (157a) in 1909 was added to the Constitution:

"The credit of the Commonwealth may be given, pledged or loaned to any county of the Commonwealth for public road purposes, and any county may be permitted to incur an indebtedness in any amount fixed by the county, not in excess of five per centum of the value of the taxable property therein, for public road purposes in said county, provided said additional indebtedness is submitted to the voters of the county for their ratification or rejection at a special election held for said purpose; in such manner as may be provided by law and when any such indebtedness is incurred by any county said county may levy, in addition to the tax rate allowed under section 157 of the Constitution of Kentucky, an amount not exceeding twenty cents (20c) on the one hundred dollars (\$100.00) of the assessed valuation of said county for the purpose of paying the interest on said indebtedness and providing a sinking fund for the payment of said indebtedness."

Election required.—Indebtedness for road purposes under section 157a may be created by a simple majority of those voting in an election upon the question as distinguished from the two-thirds majority required under section 157.²⁸ The bonds must be issued within a reasonable time after the election. Reasonableness is determined by the Court on the basis of the particular circumstances involved.²⁹

Limitations on amount.—The Court has said that there are two limits to the amount of road and bridge bonds which a county may issue:

1. The amount must not be in excess of 5 per cent of the assessed valuation at the time the bonds are issued.
2. The amount must not be in excess of that which could be

²⁸ *Gatton v. The Fiscal Court of Daviess County*, 169 Ky. 425 (1916).

²⁹ Eleven years not unreasonable in the case of *Jonson v. Fiscal Court of Muhlenberg County, et al.*, 272 Ky. 8 (1938).

paid in full within thirty years³⁰ from a twenty cent tax levy, based on the assessed valuation at the time of issuance.³¹

Provisions for payment.—A county is not required to appropriate any part of the 50c tax authorized by section 157 of the Constitution to the payment of road and bridge bonds.³² However, it is exceedingly doubtful that the debt can be said to have been discharged simply because the county has paid the proceeds of the special 20c levy for a thirty year period. Should assessed values decline (as has often been the case), the Court would undoubtedly hold the obligation unpaid at the end of thirty years to be still binding.³³ The formidable situation of a county unable to meet interest payments from the proceeds of its 20c levy may present a pretty problem to the Court at some future date.

CONCLUSION

That the Constitution is itself the final authority in limiting county indebtedness, the language employed in *Nelson County Fiscal Court, et al. v. McCrocklin*³⁴ conclusively shows:

“This section [157 of the Constitution; and no doubt it applies with equal force to the other debt sections] lays down certain mandatory rules that fiscal courts, city councils and other taxing authorities must observe. It is so plainly written and so easily understood that there is no room for two opinions about its meaning.”

³⁰The legislature has fixed 30 years as the maximum period over which maturities may be spread. Section 4307, Carroll's Kentucky Statutes, 1936 Ed.

³¹See *Bird v. Asher*, 170 Ky. 726 (1916); *Smith v. Livingston*, 195 Ky. 382 (1922); *Gillis, et al. v. Anderson, et al.*, 256 Ky. 472 (1934).

³²*Bird v. Asher*, supra.

³³See *E. T. Lewis Co. v. City of Winchester*, 140 Ky. 244 (1910).

³⁴175 Ky. 199 (1917).

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