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# THE PATH OF SPECIAL ASSESSMENT BOND LAW IN ILLINOIS: FROM THE ATTIC TO THE COURTROOM

Jonathan B. Gilbert\*

*Numerous Illinois municipalities have faced claims for payment of special assessment bonds which matured as long as fifty years ago. In this Article, the author examines the relationship of the municipality to the bondholder and suggests that the currently confusing status of the law can best be understood by noting the divergence of judicial decisions into considerations of trust law, contracts, and commercial law. He concludes that legislative and judicial attention is needed to eliminate the uncertainty in special assessment bond law.*

Special assessment funding<sup>1</sup> began in Illinois in 1897 with the passage of the Local Improvement Act.<sup>2</sup> At that time, municipalities needed a means to fund basic public improvements to facilitate expansion. This statutory scheme was designed to serve the special interests of small groups of citizens within the community without placing a financial burden on those others who might not benefit from the improvement.

An important event in the history of special assessment financing was the Depression of the 1930's. Unable to pay taxes, many landowners also failed to make payments on the special assessments. Cities and villages attempted to alleviate the burden and "looked the other way" for a number of years. Consequently, the special assessment bonds went into default. Many were put away and forgotten. They resurfaced years later when "committees" pooled defaulted bonds from various sources and attempted mass collections. Some individuals profited by buying up old defaulted bonds for a fraction of face value and then redeeming them for full value from the municipality.

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1. Special assessment bonds are issued for the purpose of financing local improvements such as streets, street lighting, sidewalks, alleys, sewers, and water lines. These improvements in turn increase adjacent property values. For example, the construction of streets and highways, although for the benefit of all users, is expected to increase the values of nearby property. Assessments are made on the properties which will benefit from the improvement, and bonds are payable from the assessments collected.

2. ILL. REV. STAT. ch. 24, § 9 (1975) [hereinafter referred to as the Act].

In the past fifteen years, city and village treasurers have repeatedly faced demands for payment on the defaulted bonds, some of which date back fifty years. When a settlement could not be reached, suit was filed for an accounting.<sup>3</sup> A claim was generally made for substantial penalty interest.<sup>4</sup> The age of many bonds and their accompanying accounting records, added to the relative complexity of the law in this area, have made plaintiffs' positions more advantageous at every phase of litigation. Many judges and defense lawyers are somewhat confused by assessment bond actions, thereby making recovery all the easier, even in cases which should have resulted in a denial of the relief sought.<sup>5</sup>

Because the procedure under the Local Improvement Act is complex, some discussion is appropriate. The thrust of this Article, however, is to examine the relationship of the municipality to the bondholder engaged in litigation. The complexities of the situation have created a difficulty in interpretation which can be understood by noting the divergence of judicial opinions into three areas: trust law, contracts and commercial law. The trust analysis appears to be the most helpful and logical.

#### THE LOCAL IMPROVEMENT ACT

The Local Improvement Act contains five distinct "Divisions," each with a separate function. Division I<sup>6</sup> consists of several general provisions. Ten additional provisions call for an optional "unclaimed rebate

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3. Accounting is a form of action which compels a statement of the debits and credits of an account by order of the court. This action is brought when money claims as to amounts and offsets are in dispute.

4. See ILL. REV. STAT. ch. 24, § 2 (1975). See also *Hoehamer v. Village of Elmwood Park*, 361 Ill. 422, 198 N.E.2d 345 (1935) (6% interest sought on 15 annual installments). While the application of the Interest Act to special assessment bond cases is uniformly accepted, the calculation of the specific interest amount is subject to several views. For three different views as to when the accounting period should begin to run, see *First National Bank and Trust Co. of Racine v. Village of Skokie*, 198 F.2d 1017 (7th Cir. 1952) (interest computed from last date of accounting period to date of district court judgment); *Fidelity Trust Co. v. Village of Stickney*, 129 F.2d 506 (7th Cir. 1942) (interest calculated only on amount actually collected); *Grand Carniolian Slovenian Catholic Union v. Village of Rockdale*, 314 Ill. App. 308, 41 N.E.2d 218 (2d Dist. 1942) (interest calculated from maturity date of bonds to date of accounting).

5. Trial lawyers frequently express the view that legal complexity favors the defendant, but this has not been the case in special assessment litigation. Plaintiffs' counsel could make the municipal defendant out to be a "bad guy" by pointing to isolated incidents of commingling of the special assessment funds collected. They then remind the court that they represent clients such as widows and pensioners. Valid technical defenses, which may not be understood in the first place, are not well received by courts.

6. ILL. REV. STAT. ch. 24, §§ 9-1-1-9-1-14 (1975).

fund,"<sup>7</sup> which has as its purpose the accounting of monies collected but not disbursed to bondholders. These latter sections were not in the original Act<sup>8</sup> and were probably a response to the realization that some bondholders would not diligently pursue their rights. The sections demonstrate the first legislative recognition of what was to become the blossoming problem of attempts to collect on bonds distributed forty or more years ago.

Division II<sup>9</sup> is, in essence, the heart of the original Local Improvement Act passed in 1897. Its one hundred forty-four subparts may be divided roughly into three sections: the first one hundred subparts set out the preliminary mechanical steps for a particular improvement, including hearings both in and out of court; the next eighteen subparts, which deal directly with the work to be performed; and the remaining steps which allow for the issuance of bonds and relate more closely to the concern of this Article.

Division III,<sup>10</sup> passed in 1941, is an abbreviated version of Division II designed to eliminate a number of procedural steps. Although it contains all the salient features of Division II, it provides for less public input and public accountability by the appropriate officials, thus allowing a more expeditious attainment of the desired objective. Division III, however, has not been put to frequent use over the years because it provides insufficient citizen input. While this conclusion may be legally unsound, it is certainly sensible from a political viewpoint.

The last two divisions of the Local Improvement Act are of relatively recent vintage.<sup>11</sup> Division IV<sup>12</sup> allows a municipality to spread the tax burden outside the enacting city if contiguous property is benefited. Division V<sup>13</sup> allows non-home rule municipalities to reimburse subdivision developers for specified public facilities by making collections from homeowners outside the subdivision who will benefit.

7. Section 9-1-5 permits the municipality to set up a special unclaimed rebate fund for undistributed or unclaimed money received from a local assessment. *Id.* § 9-1-5. The decision to set up this fund is entirely discretionary with the municipality.

8. The accounting provisions, sections 9-1-5 through 9-1-14, were added in 1917.

9. ILL. REV. STAT. ch. 24, §§ 9-2-1-9-2-144 (1975).

10. *Id.* §§ 9-3-1-9-3-5.

11. Division IV was enacted in 1963. *Id.* §§ 9-4-1-9-4-3; Division V was added in 1972. *Id.* §§ 9-5-1-9-5-3.

12. Under Division IV, a municipality is permitted to assess property outside the city limits for benefits conferred on the property by local improvements made within the municipality. *Id.* §§ 9-4-1-9-4-3.

13. Under Division V, the municipality is authorized to reimburse a developer for facilities required by local ordinances to be installed in a subdivision where the facilities will also benefit property not in the subdivision. *Id.* §§ 9-5-1-9-5-3.

When an addition to basic municipal facilities is contemplated, contract bids are taken and work is awarded to the lowest bidder.<sup>14</sup> Four sections of the Act are of primary significance in financing the improvement and eventually creating bonds. Section 9-2-48 calls for the payment of the assessment and the division of the payments into installments, usually ten in number.<sup>15</sup> Section 9-2-131<sup>16</sup> provides simply that any improvement made pursuant to the Act may be financed by bonds. This provision allows the option of either paying the first installment collected from property owners directly to the contractor, or issuing the contractor a voucher. Issuance of vouchers historically has been preferred. Section 9-2-131 additionally provides for creation of special assessment bonds pursuant to either Section 9-2-119 or 9-2-127. The first of these is the basic pro-rata scheme contained in the 1897 legislation. The second was added in 1941 and allows for the conversion of vouchers to series bonds.<sup>17</sup>

From a practical perspective, the municipality will proceed under Section 9-2-119 until a majority of voucher holders exercise their option under 9-2-127 and convert the vouchers to bonds, which are more marketable. The fact that the contractor is usually the largest single creditor of the improvement project has an impact on the way the monies derived from installments are distributed. To enhance the appeal of the project to prospective bidders, the great majority of small creditors are often paid from the first installment. The contractor's interest is then spread over the remaining nine installments, thus making him the sole voucher holder in each of these subsequent installments. This places the contractor, or his successor if vouchers are sold, in a position to obtain bonds on demand.

A second practical consideration that emerges from Sections 119 and 127 is the impact on bondholders of prepayment of assessments by property owners. Application of a prepayment to pro rata bonds under Section 9-2-119 involves a division of the sum into equal por-

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14. As noted in ILL. REV. STAT. ch. 24, § 9-2-100 (1975), "[A]ny work or other public improvement [costing more than \$300] to be paid in whole or in part by special assessment or special taxation . . . shall be constructed by contract let to the lowest responsible bidder." The phrase "lowest responsible bidder" refers to a general ability to perform the contract and not merely the lowest bidder financially. See *People v. Omen*, 290 Ill. 59 (1919); *Hallet v. City of Elgin*, 254 Ill. 343 (1912).

15. ILL. REV. STAT. ch. 24, § 9-2-48 (1975). Under this section, for example, special assessments or taxes for building sewers or viaducts may be divided into twenty installments or less.

16. *Id.* § 9-2-131.

17. Section 9-2-127 provides that, upon written request of the holders of all of the outstanding and unpaid vouchers issued in payment of the work, the municipality may issue and deliver bonds to voucher holders in exchange for the vouchers. *Id.* § 9-2-127.

tions for the remaining installments, with each bondholder getting an equal share. Series bonds, in contrast, are paid off in their entirety in numerical order by each installment. Thus, any default by property owners detrimentally affects the holders of bonds with the highest numbers.

An interesting question arises when these two sections are compared. Since Section 9-2-131 makes Sections 119 and 127 mutually exclusive, one might ask where the vouchers referred to in Section 9-2-127 come from. The likely answer is historical in nature. Apparently, during the first years of use of the Act, vouchers were issued to the contractor and nothing further was provided. This option is available to the municipality even today because the provisions of Section 9-2-131 are discretionary. Thus, Section 9-2-127 followed the other Sections as a "clean-up" provision for outstanding vouchers to bring uniformity to the financing of special assessments. Over the years, most contractors have immediately converted these bonds or vouchers into cash by selling them to financial institutions. The contractor often inflates his bidding price appropriately to account for any subsequent discounting of the bonds.

The existence of this voucher or bond mechanism for more than eighty years, and its frequent use even today, has resulted in a proliferation of special assessment bonds. Markets for these instruments have generally been good because of faith in government-issued securities<sup>18</sup> and the special treatment given municipal securities under the federal tax code.<sup>19</sup>

There are also distinct advantages to the issuing municipality, despite the relatively complex statutory scheme. Unlike many other revenue-raising schemes, this one is not subject to direct popular approval.<sup>20</sup> These bonds provide a convenient means of financing local

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18. As will be explained more fully, special assessment bonds do not represent a general obligation on the municipality, but rather are limited to special funds. Nonetheless, the fact that a governmental body generally pays on its obligations has been enough to convince most buyers that the bonds will be satisfied.

19. Under the Internal Revenue Code, Section 103, gross income does not include interest payments on "the obligations of a State, a Territory, or a possession of the United States." I.R.C. § 103.

20. For example, the court in *Bank of Burlington*, interpreting Illinois law, stated that the "decisions of the Supreme Court of Illinois clearly establish that the original local improvement ordinance which authorizes special assessments against property of private owners only, and which authorizes the municipality to issue installment anticipation bonds, is not controlled by the provisions of the Referendum Act of 1909." *Bank of Burlington v. City of Murphysboro*, 96 F.2d 899, 901-02 (7th Cir. 1938). Limited exceptions exist in the statute. Under ILL. REV. STAT. ch. 24, § 9-2-38 (1975), certain municipalities of 15,000 to 500,000 must receive voter approval before exceeding a public benefit tax of 1% of all taxable property. For example, contracts awarded under Section 9-2-19 for the construction of waterwork systems, bridges, or

public improvements while placing the burden of payment on a small number of property owners who benefit from the city's expenditure of their money. This revenue legislation also avoids the voter backlash that sometimes accompanies financial questions placed on the ballot by elected officials. In addition, special assessment bonds are not a general obligation of the municipality<sup>21</sup> and are not subject to the statutory municipal debt limitation.<sup>22</sup> This is true even if the instrument contains express language to the contrary,<sup>23</sup> and is a natural corollary to the proposition that the dollar liability of a city is limited to special assessment funds actually collected.

### THE MUNICIPALITY'S OBLIGATIONS

There are two separate and distinct relationships of importance: (1) the municipality vis-à-vis the property owner against whom the assessment is levied;<sup>24</sup> and (2) the municipality vis-à-vis the bondholder. The two relationships are frequently and incorrectly combined in the same action,<sup>25</sup> an approach that has been specifically

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viaducts are not binding upon the contractor or the municipality until the public benefit tax has been approved by municipal voters. *Id.* §§ 9-2-38 & 9-2-106.

21. Bondholders do not acquire a greater right than the contractor who initially acquired the bond as an acknowledgement of his claim. The bonds evidence the extent of the bondholders' claim against the special trust fund and are not the basis of a claim against the municipality.

22. Section 8-5-1, the debt limitation statute, provides that no municipality with a population of less than 500,000 can become indebted in the aggregate for more than 7½% of the assessed value of the property within its borders. *Id.* § 8-5-1.

23. In *National Protective Legion v. Village of Brookfield*, 228 Ill. App. 311 (1923), the special assessment bonds differed slightly in form from those under the Local Improvement Act because they included an attestation clause which recited "that the good faith and credit of the Village of Crossdale is pledged for prompt fulfillment." *Id.* at 313-14. Despite this language in the bond, the court held that the liability of the village was limited to the amount actually collected under the assessment because the municipality's officers had no power to make the village generally liable under such a recital. *Id.* at 314.

24. Failure to pay special assessments creates a lien on the municipality. ILL. REV. STAT. ch. 24, § 9-2-65 (1975). Bondholders may compel the municipality to use "all lawful means, including foreclosure, to collect the taxes out of which the bondholders are to be paid." *People v. Anderson*, 380 Ill. 158, 165, 43 N.E.2d 997, 1001 (1942). In a foreclosure proceeding, however, the municipality is under no duty to withdraw property from the sale in order to protect the bondholders from insufficient bids, especially if those bondholders had an opportunity to participate in the sale. *Id.* at 165-66, 43 N.E.2d at 1001-02. Under § 9-2-135, the municipality is required to exercise "reasonable diligence" in making collections. ILL. REV. STAT. ch. 24, § 9-2-135 (1975). For a good discussion of the foreclosure remedy, see *Leopold & Freudenthal, The Case of the Special Assessment Bondholder*, 33 CHI. B. REC. 295 (1952).

25. Section 9-2-135 states that no person holding bonds or vouchers shall have a claim against the municipality, even in the event of a failure to collect the assessments. A bondholder, however, does have a claim against the amount collected under the assessment. ILL. REV. STAT. ch. 24, § 9-2-135 (1975).

rejected by Illinois courts.<sup>26</sup> The first relationship is outside the scope of this Article, which is concerned with the municipality-bondholder relationship.

The central authority and control under the Act rests with the Board of Local Improvements,<sup>27</sup> which generally corresponds to the Village Board of Trustees. While each Board has broad discretion, its power is not unchecked. The lack of necessity for prior voter approval in the usual case is adequately compensated for by provisions allowing citizen input into the decision-making process. Voters may not only initiate a request for construction of improvements,<sup>28</sup> but also have the right to do the work themselves<sup>29</sup> and to extend time for payments.<sup>30</sup> Board procedures include a mandatory public hearing on the proposed assessment.<sup>31</sup> The Board must obtain approval of the Circuit Court,<sup>32</sup> which has broad discretion over all facets of the assessment process and the ultimate confirmation of the assessment roll.<sup>33</sup>

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26. Typically, a complaint will contain an allegation that money is owed or a plaintiff will attempt to introduce evidence to the effect that collections should be made by the municipality and the funds passed along to bondholders. A proper remedy to force collections from property owners is by way of a mandamus action against the city. The proper remedy for the bondholder is to ask for an accounting or mandamus to compel payment of funds already collected. See *People v. Anderson*, 380 Ill. 158, 43 N.E.2d 997 (1942); *Village of Lansing v. Sundstrom*, 379 Ill. 121, 39 N.E.2d 987 (1942); *Conway v. City of Chicago*, 237 Ill. 128 (1908).

27. The personnel constituting each board is fixed by ILL. REV. STAT. ch. 24, § 9-2-7 (1975). ILL. REV. STAT. ch. 24, § 9-2-9 (1975) requires that any local improvement ordinance involving special assessments originate in the Board. If any improvement requires the taking of property, the Board must initially pass a resolution describing the nature and cost of the improvement and hold a subsequent public hearing on the proposal. Notice of the hearing must be sent to those persons who pay taxes on the property fronting the proposed improvement. Following the hearing, if the Board favors the proposed improvement, an ordinance is prepared and submitted for approval.

28. Section 9-2-40 provides that a majority of property owners who would be affected by an improvement may petition the local board for an improvement. *Id.* § 9-2-40. The board would then submit information to the local authorities on the nature of the improvement and the cost, together with a recommendation that an ordinance be passed authorizing the improvement. See *People ex rel. Hirsch v. Village of Millstadt*, 254 Ill. App. 39 (4th Dist. 1929).

29. Ten days after notice that a contract for an improvement has been awarded, the property owners affected by the improvement may elect to take the contract themselves. Assumption of the work, however, must be at a price 10% less than that of the awarded contract. ILL. REV. STAT. ch. 24, § 9-2-109 (1975).

30. If 75% of the holders of securities issued in anticipation of special assessment collections petition the municipality for an extension of the time for assessment payment, the city must adopt an ordinance providing for such an extension. *Id.* § 9-2-121. The petition for such an extension must be filed with the court which had original jurisdiction over the assessment. *Id.*

31. *Id.* § 9-2-10.

32. The Act dictates that after an ordinance for a local improvement is passed, a county court of record must levy a special assessment in accordance with the provisions of the ordinance. *Id.* § 9-2-43. The Act also provides for court review of "every assessment proceeding in which the assessment is divided into installments." *Id.* § 9-2-115.

33. *Id.* § 9-2-61.



Any analysis of case law dealing with the municipality-bondholder relationship must note that key changes to the statute were made in 1941.<sup>34</sup> All special assessment bonds issued prior to that date fell under Section 9-2-119. Therefore, the payment of funds collected was required to be on a pro rata basis. Every bondholder in an installment was credited with some interest on any funds collected pursuant to the assessment and a cause of action was provided where errors and malfeasance existed. The creation of the series bond in 1941 eliminated many potential plaintiffs by limiting any interest to a smaller group and further clarifying payment procedures. Most case law almost exclusively deals with the older pro rata bonds and the issues attendant to Section 9-2-119 procedures.

Courts have consistently refused to apply the various amendments to the Local Improvement Act retroactively. Thus, each special assessment bond must be viewed in historical isolation. The decision in *Friedman v. City of Chicago*<sup>35</sup> illustrates the application of the doctrine to pre-1939 bonds.<sup>36</sup> Prior to 1939, the Act provided that bonds could be used by benefiting property owners to pay assessments, but required that such bonds be cancelled in total upon presentation regardless of whether full payment on the bond was made.<sup>37</sup> The 1939 amendment allowed a credit if the bond was larger than the installment. The Supreme Court denied retroactive application, refusing to order the City comptroller to follow the new procedure for pre-1939 bonds. Thus, any bonds predating July 12, 1939, and applied to payment of a special assessment installment to which the bond relates, should have been cancelled.

The impact of this proposition of non-retroactivity on special assessment litigation is potentially enormous. Nine major revisions of the legislative scheme have been undertaken<sup>38</sup> and the effects are

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34. The major legislative development in 1941 was the creation of the series bond. *Id.* § 9-2-127.

35. 374 Ill. 545, 30 N.E.2d 36 (1940).

36. In another case, *City of Jacksonville v. Bankers Life Co.*, 90 F.2d 141 (7th Cir. 1937), the court held that rights of holders of unmatured bonds were measured by the 1897 Act and not by the 1933 amendment, which was not deemed to be retroactive. Courts in Illinois have continued to look at special assessment bonds in terms of the law in effect at the time the bonds were issued.

37. Prior to 1939, in cases in which the amount of the assessment was less than the value of the bond or voucher, the entire balance was nevertheless cancelled when the bond was presented for payment. Under Section 9-2-132, when a municipal officer receives a bond he will issue a receipt for the balance, which will entitle the owner to the same rights he had under the original bond, except as to negotiability. ILL. REV. STAT. ch. 24, § 9-2-132 (1975).

38. Major revisions of the special assessment bond legislation were enacted in 1901, 1917, 1927, 1933, 1939, 1941, 1955, 1961 and 1963.

widespread. Suits involving bonds must be analyzed according to the law in existence at the time the bond was created. For example, bonds introduced in modern litigation could be such that they should have been fully cancelled years before when they were applied to an assessment, but were in fact erroneously returned. The language of some amended sections could become a complete bar to any action by a particular plaintiff.<sup>39</sup> Therefore, the importance of placing each bond in historical perspective cannot be overstated.

The common law development of special assessment bond principles stands upon two cases. *Conway v. City of Chicago*<sup>40</sup> was decided shortly after the passage of the Local Improvement Act. The case is typical of the assessment suits, because it was a claim by a bondholder for monies due after those monies were collected and then improperly commingled with other municipal funds. The case and its succeeding applications established three basic rules: (1) the municipality is liable only for funds actually collected;<sup>41</sup> (2) funds collected from property owners are held in trust for bondholders;<sup>42</sup> and (3) the municipality is liable for interest on funds wrongfully withheld.<sup>43</sup> While the case makes no mention of specific sections of the Local Improvement Act, the general propositions stated in the case are related to subjects specifically addressed in the Act. The *Conway* notion that the aggrieved bondholder can assert a claim only as to specific funds relates directly to Sections 9-2-135 and 9-2-99 of the Act.<sup>44</sup> The trust theory noted in *Conway* had no express statutory support and apparently was derived from a court-created in-

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39. See *City of Jacksonville v. Bankers Life Co.*, 90 F.2d 141 (7th Cir. 1937). In *Jacksonville*, special assessment bonds were issued under the provisions of the 1897 Act, which provided for payment to the holders of the unmatured bonds only after a drawing by lot. The Act, as amended in 1933, called for the payment of assessment money to the holders on a pro rata basis. The court held that the bondholders had no right to compel the city to pay them, even if the city had wrongfully diverted the money, because under the terms of the 1897 Act the bondholders were not assured that they would have been selected for payment. Under this reasoning, the bondholder's remedy was to ask for mandamus to compel the city to make the drawing.

40. 237 Ill. 128 (1908).

41. *Id.* at 135, citing *City of Alton v. Foster*, 207 Ill. 150, 69 N.E. 783 (1904). The court said that a plaintiff could seek mandamus to force collection of the payments. 237 Ill. at 136.

42. *Id.* at 136.

43. *Id.* at 137. The court added that such wrongful action made the city as liable as any private person. *Id.*

44. Except in cases involving federal aid, no contractor agreeing to be paid out of a special tax or assessment fund "has any claim or lien upon the municipality in any event, except from the collection of special assessments or special taxes made or to be made." ILL. REV. STAT. ch. 24, § 9-2-99 (1975). Section 9-2-135 further states that a municipality is not liable to the bondholders "in case of a failure to collect the assessments." *Id.* § 9-2-135.

terpretation. Because the entire legislative framework is "permissive" rather than "restrictive" in nature,<sup>45</sup> the vesting of broad discretionary powers<sup>46</sup> in municipal officials justifies the application of trust fund theories as a policing technique.<sup>47</sup> The third rule, applying penalty interest, reflects the court's interpretation of the Interest Act.<sup>48</sup>

The second case is *Rothschild v. The Village of Calumet Park*.<sup>49</sup> The original complaint in *Rothschild* was similar to that filed in *Conway*, but the central issue before the supreme court was whether money collected in a particular annual installment should be paid to bondholders in chronological order or by a pro-rated method, crediting each outstanding bond with a percentage of the money collected. In language that has been used in subsequent special assessment bond opinions, the court opted for the prorated method. The court stated:

If for any reason the full collection of an installment is not made, the deficiency must fall upon the bondholders, and equity requires that the loss shall be borne ratably by each bondholder. Therefore, when the bonds of any year become due and the collection from the installment of that year is insufficient to pay them, the bondholders are entitled to the amount collected, and it is the duty of the trustee—the municipality—to pay upon each bond issued against the installment its share, *pro rata*, of that amount.<sup>50</sup>

The court further established that each installment is independent of every other installment, except that a surplus raised in one installment could be applied to others. Particularly significant to bond litigation was the court's imposition of minimal prerequisites on the complaining bondholder to the presentation of his case.<sup>51</sup>

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45. By failing to prohibit various types of bond actions by the city, the statute has in effect given municipalities broad powers to create special assessment bonds.

46. For example, Section 9-1-5 gives complete discretion to the municipality in deciding whether to set up an unclaimed rebate fund. ILL. REV. STAT. ch. 24, § 9-1-5 (1975).

47. The "trust fund" concept is used in several contexts. For example, if a city has an unclaimed rebate fund and has complied with the statutory time and notice provisions, it may petition the court for the transfer of that money in trust to the treasurer of the city. *Id.* at §§ 9-1-5-9-1-14.

48. Assessment bonds do not provide for interest payments after maturity. The liability of the municipality is not based on an undertaking to pay interest. Instead, additional interest on matured bonds is allowed when money is wrongfully obtained or wrongfully withheld. *Rothschild v. Village of Calumet Park*, 350 Ill. 330, 183 N.E. 337 (1932).

49. *Id.*

50. *Id.* at 339, 183 N.E. at 341. See also Section 9-2-52, which authorizes the corporate authorities of the municipalities to direct the treasurer or other officer so designated to select by lot what series bonds will be paid or to make a pro rata payment on all unpaid bonds in the series. ILL. REV. STAT. ch. 24, § 9-2-52 (1975).

51. *Conway v. City of Chicago*, 237 Ill. 128, 136 (1908). The plaintiff was required essentially to show only the collection of funds by the city and a failure to pay. No specific proof of

## THE TRUST APPROACH

While both *Conway* and *Rothschild* set out a number of other crucial considerations,<sup>52</sup> the described cases set out the fundamental assessment concepts. Substantial judicial energy has been spent as a result of the view in both cases that the municipality is a trustee. A number of consequences result from this conclusion. Under a trust interpretation, money that is collected may not be diverted to any other purpose,<sup>53</sup> and it is not a proper defense to allege that the funds are no longer in the treasury.<sup>54</sup> The court does not care where the money was diverted, but simply that it was expended.<sup>55</sup> While diversion of funds<sup>56</sup> is clearly impermissible, it has been held that, with a proper accounting, a temporary loan out of bond funds to

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wrongdoing was required. Subsequent decisions have imposed the additional requirement of ownership of the bonds in question.

52 For example, *Rothschild* stated that the courts will not presume that any wrongdoing will continue and thus will not seek to direct future actions of city officials. *Conway* contained extensive discussion on the subject of interest payments. The *Conway* court pointed out that the liability of a municipality for payment of interest arises not out of the bond "contract" but out of the unlawful withholding of the funds actually collected. 237 Ill. at 137. Therefore, the applicable interest rate is one fixed by statute, not the specified contract rate. In addition, interest was said to be recoverable from the time the bondholder is entitled to demand payment of his bonds, not from the time the municipality unlawfully diverted the funds. *Id.* at 138.

53. In *Siefker v. City of Chicago Heights*, 297 Ill. App. 113, 17 N.E.2d 368 (1st Dist. 1938), the City of Chicago Heights paid out more than it had collected under one installment of bonds, thereby paying off and cancelling the second series of bonds. The resulting collection of money was reduced by the amount of the overdraft of the previous installment. The court, however, found that the diversion of funds from one installment to pay off an overdraft on a previous installment was a wrongful action and thus affected the rights of the plaintiff, who was a holder of the first bond. The holder was entitled to the money collected under the present installment. 297 Ill. App. at 117-18, 17 N.E.2d at 370. In *Conway*, the court found that the city had no right to transfer special assessment trust funds to other city funds and then indiscriminately draw on those funds for city payrolls. The court did indicate, however, that some appropriation of assessment funds could be possible. 237 Ill. at 136.

54. In *People ex rel. Anderson v. Village of Bradley*, 367 Ill. 301, 11 N.E.2d 415 (1937), the village contended that the bondholders had a claim only against funds collected under the special assessment. The trustees argued that, since those funds were unlawfully diverted a number of years previously, the effect of a judgment in favor of the bondholders would be for all current taxpayers of the village to pay off the bonds, even though they had no original liability. The court did not accept this argument and stated that "[t]o permit the Village to say it no longer has the money, or is unable to pay, would be to place municipalities in a position to defeat the lawful claims of contractors." *Id.* at 307, 11 N.E.2d at 419.

55. *Allbee v. City of Aurora*, 306 Ill. App. 457, 28 N.E.2d 742 (2d Dist. 1940) (records showed money collected, but no evidence was presented of where money placed or for what purpose it was used). See also *Alexander Lumber Co. v. City of Farmer City*, 272 Ill. 264, 111 N.E. 1012 (1916) (illegal expenditure of special assessment monies obligated the city to pay contractors out of the general revenue funds).

56. Diversion refers to turning funds permanently away from their defined purpose and appropriating them to a use other than that for which they were specifically allocated.

other city funds is not prohibited.<sup>57</sup> Perhaps the most difficult problem for the city attorney to address is that any ambiguities as to the bonds are resolved against the trustee, namely the municipality.<sup>58</sup> The problems inherent in rebutting such a presumption with fifty-year-old records are evident.<sup>59</sup>

Recovery on a bond usually involves a request for an equitable accounting,<sup>60</sup> although other theories have been accepted. Some plaintiffs have sought injunctive relief or mandamus<sup>61</sup> and one even relied on *assumpsit*, which the court accepted and then converted to an action in equity.<sup>62</sup> Equitable estoppel will be raised against a municipality that seeks to allege some irregularity in the bond issue.<sup>63</sup> In the same context, the city will have difficulty divorcing

57. The prerequisite conditions in order to borrow temporarily the special funds are that the bond funds must be idle and used for the benefit of a fund having a stated and sufficient income to repay the sum borrowed. The loan must be made with the intention that the funds will be repaid. *Gates v. Sweitzer*, 347 Ill. 353, 359, 179 N.E. 837, 840 (1932).

58. Since a municipality is the trustee of the funds collected as special assessments, all a plaintiff must show to establish a *prima facie* case against a municipality is ownership of the bond, maturity of the bond, collections made by the city, demand for payment, and no payment. The burden is on the municipality to explain what collections were made and what was done with those funds. The result is that all doubts are resolved against the municipality. *First National Bank & Trust Co. v. Village of Skokie*, 190 F.2d 791 (7th Cir. 1951).

59. Because the city's record keeping is usually the root of any ambiguities as to the bonds, the only other source of evidence will usually be the available correspondence, which is probably inadmissible. One possible source of information for ascertaining the status and value of the bonds would be the business records of a bank, accounting firm, or similar outside institution whose activities paralleled those of the city at a particular time.

60. One of the equitable duties of trustees and other fiduciaries is to stand ready to account to the beneficiary. Therefore, equity will compel an accounting where a duty to account exists.

61. *See Chicago Bd. of Educ. v. Norfolk & Western Ry. Co.*, 88 F.2d 462 (7th Cir. 1937) (court entered a mandatory injunction directing the payment of collected taxes to the satisfaction of the bondholders and forbidding payment of the warrants under any system other than a *pro rata* distribution). *Bransfield & Sons, Inc. v. City of Chicago*, 342 Ill. App. 206, 96 N.E.2d 386 (1st Dist. 1950) (disallowing a mandamus action directing the city to pay into one special assessment warrant almost all the money in the fund because several other bonds were still outstanding); *See also ILL. REV. STAT.* ch. 24, § 9-2-135 (1975).

62. *Cook v. City of Stanton*, 295 Ill. App. 111, 14 N.E.2d 696 (3d Dist. 1959). As stated by the court:

The action is in form *ex contractu*, but the alleged contract being merely fictitious, the right to recover does not depend upon any principles of privity of contract between the plaintiff and the defendant and no privity is necessary. The right to recover is governed by the principles of equity, although the action is at law.

295 Ill. App. at 121, 14 N.E.2d at 700.

63. Equitable estoppel arises if a municipality by its acts or representations, or by its silence when there is a duty to speak, induces a bondholder to believe, for example, that it has not repudiated the bond. If a bondholder reasonably relies and acts on such a belief to his prejudice, the municipality must bear the loss resulting from such a misrepresentation. The bondholder accomplishes this objective by raising an equitable estoppel defense which precludes the municipality from alleging or denying certain facts as a result of previous allegations, denial, conduct or admission.

its actions from those of a wayward city official who detrimentally affects bond funds.<sup>64</sup> Such a separation, however, is not impossible.<sup>65</sup>

A closely related concept is that liability is limited to funds actually collected. A problem arises when the factual situation suggests that actions or a failure to act by an official prevents collection of the assessment installments. It would seem unfair to bondholders in such circumstances to determine their rights to recover on the bonds solely on the basis of whether or not the money is actually in the treasury. In addition, the city, in its role as trustee, should not be prevented from pursuing its former employee for any misappropriated funds.<sup>66</sup>

The application of trust doctrine to this area frequently has led to the defense of laches.<sup>67</sup> Repudiation, which amounts to public renunciation and steps to terminate, is a prerequisite to such an action,<sup>68</sup> and is often difficult to prove. Two recent special assessment bond cases from the Illinois Appellate Court illustrate the problem. In *Kay v. Village of Palatine*,<sup>69</sup> the village admitted wrongdoing in satisfying the bonds and rested its arguments on the delay in bringing

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64. See *Viehweg v. City of Mount Olive*, 298 Ill. App. 412, 19 N.E.2d 211 (3d Dist. 1939). In *Viehweg*, the city collector had received payments from the special assessments, accumulated a large amount of the funds, and diverted them to his own use. Consequently, the city was held liable for the money collected, even though the collector had diverted the funds without the city's knowledge or approval and the money had never been paid into the city treasury. 298 Ill. App. at 415-16, 19 N.E.2d at 213.

65. For example, a city can separate itself from the actions of its officers when a bondholder buys special assessment bonds at a considerable discount. The holder contacts the property owners who are subject to the assessment and agrees with them that if they pay the assessment directly to the holder they can receive receipts showing payment-in-full. The bondholder subsequently presents the bills for the special assessments to the city collector, who marks the bills as paid-in-full. The city collector then delivers to the city treasurer a sufficient amount of bonds belonging to the bondholder to equal the full amount of the assessments covered by the bills for which he noted full payment. Under this method, no money comes into the hands of any city official. Even though there may be wrongdoing on the part of the city officials, the city cannot be held liable because the trust fund theory will not apply where no funds were actually collected. See *Fidelity Trust Co. v. Village of Stickney*, 129 F.2d 506 (7th Cir. 1942).

66. In *Village of Brookfield v. Pentis*, 101 F.2d 516 (7th Cir. 1939), a municipality brought suit against its treasurer for misappropriation of monies and for failure to account for collections of special assessments. The court denied the defendant's motion to dismiss, noting that a public servant who profits secretly from a trust fund can be held liable because a public servant cannot profit at the expense of those whom he serves. *Id.* at 523.

67. Laches is a substantial delay in asserting a right which causes prejudice to the opposing side. The delay will operate to bar recovery. Laches does not, however, arise solely from a mere delay or lapse of time. The party against whom a laches defense is to be invoked must have been aware of his substantive rights and must have failed to assert them.

68. Repudiation is the rejection or disclaimer by the municipality of its duty or obligation to pay on the bonds.

69. 126 Ill. App.2d 308, 261 N.E.2d 823 (1st Dist. 1970).

the cause of action (laches).<sup>70</sup> The appellate court failed to recognize the defendant's claim that plaintiff represented "professional" bondholders who "should have known"<sup>71</sup> that the village had failed to make regular payments in the past, and thereby repudiated. According to the *Palatine* court, special proof of actual knowledge was required to bar recovery.

The question of what qualitatively constitutes repudiation, however, was left primarily to another case, *Kay v. Village of Mundelein*.<sup>72</sup> The court stated that the repudiation must be "plain, strong and unequivocal . . ." <sup>73</sup> and that any renunciation must be clearly communicated to the beneficiary. The court added what is unquestionably the most difficult barrier to use of the laches defense, namely that "the trustee's continued or subsequent recognition or acknowledgement of the trust is regarded as strongly indicating that he had not repudiated it."<sup>74</sup> This defense realistically is difficult to assert, and has been successfully argued in only one case.<sup>75</sup>

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70. The Village of Palatine admitted that it failed to distribute to bondholders the required amounts collected from the special assessments. 126 Ill. App.2d at 11-12, 261 N.E.2d at 824-25. The court did not accept a laches defense and found that there was no hardship imposed on the city which would justify such a defense. As noted by the court, the village's "obligation to respond in damages . . . is no more of a hardship than any other obligation to respond in damages." *Id.* at 315, 261 N.E.2d at 826.

71. Defendant argued that, as professionals, the plaintiff's "failure to discover the Village's breach of trust was the result of their failure to exercise due diligence." *Id.* at 315, 261 N.E.2d at 826. The court, however, found no merit to this contention.

72. 36 Ill. App.3d 433, 344 N.E.2d 29 (2d Dist. 1975). In this case, owners of special assessment bonds brought an action against the municipality seeking an accounting and damages with respect to funds received by the village from special assessments. Defendants filed a motion for summary judgment, requesting that the court find the action was barred by the five year statute of limitations. The court stated that to cause the statute of limitations to start running during the existence of the trust, there must be some act of repudiation of the trust by the trustee. *Id.* at 437, 344 N.E.2d at 32. The issue in this case was whether the village's statement that no further payment would be made on the bonds constituted a repudiation. The court refused to grant summary judgment in favor of the defendants, holding that the repudiation issue was one of fact to be determined at the trial. Repudiation has occurred when the trustee has disavowed the trust or acted with hostility towards the funds and when such an act has been made known to the trust beneficiary. *Id.*

73. *Id.* at 438, 344 N.E.2d at 33.

74. *Id.*, citing *Huffman v. Gould*, 327 Ill. App. 428, 64 N.E.2d 773 (2d Dist. 1945).

75. *Whitaker v. City of Carbondale*, 55 F. Supp. 72 (E.D. Ill. 1944). In *Whitaker*, many installments were not paid on assessment bonds that matured between 1910 and 1920. The plaintiff brought a mandamus action in 1916 to force the city to collect the assessments. The city pleaded constitutional limitations and no liability. *Id.* at 73. The plaintiff dismissed the suit without trial in 1923 on grounds that another suit would be brought in federal court. No such suit was brought. Further unsuccessful attempts were made to collect on the bonds, even under a compromised settlement. The city consistently maintained that it was under no legal liability to the bondholders. Without modifying this position, the city agreed to submit to the voters the question of whether the city had a moral obligation to pay the claims. Plaintiff agreed that if the proposition failed the city would do nothing further about the payment. The voters did not

Once the municipality's liability is established, a subsequent consideration is the amount of money to be accounted for to the beneficiary-bondholder. *Conway* established that the municipality is liable only for those special assessments which it has actually collected. The exceptions to this rule are the application of penalty interest<sup>76</sup> to amounts due and to that percentage of assessments attributable to the general public assumed to have been collected.<sup>77</sup> The rule has been refined such that a bondholder may look only to a specific installment collected where his bonds are so limited. This refinement would be applicable unless a surplus exists elsewhere<sup>78</sup> or amounts were actually collected when special assessment liens were sold at a discount.<sup>79</sup>

Once a judgment is entered against the municipality, the court cannot properly attempt to dictate how the money award is to be collected and paid.<sup>80</sup> This last rule is consistent with a number of opinions which state that the court should not assume that any past wrongdoing by the trustee-village will continue in the future and, therefore, that some form of affirmative direction is necessary.<sup>81</sup>

#### THE COMMERCIAL LAW APPROACH

As early as 1902, the Illinois Supreme Court opened the door to application of concepts of commercial law to special assessment

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approve the plan. Plaintiff's attorney advised that a suit be brought, but the plaintiff refused to authorize a suit. No suit was brought to enforce payment until fourteen years later, after numerous witnesses had died and records were destroyed. The court found that the city had repudiated all its obligations to plaintiff and at no time receded from the position that it was without liability to plaintiff. The laches defense, therefore, was upheld by the court.

76. See note 48 *supra*.

77. *Prange v. City of Marion*, 319 Ill. App. 136, 48 N.E.2d 980 (4th Dist. 1943); *Grand Carniolian Slovenian Catholic Union v. Village of Rockdale*, 314 Ill. App. 308, 41 N.E.2d 218 (2d Dist. 1942). See also ILL. REV. STAT. ch. 24, § 9-2-45 (1975).

78. *People ex rel. Wilmette State Bank v. Village of Wilmette*, 294 Ill. App. 362, 13 N.E.2d 990 (1st Dist. 1938). A surplus might be created, for example, when a bond is cancelled before it is fully paid. In *Wilmette*, the court held that while the act authorized payment of bonds against one installment from the surplus on another installment, holders of bonds did have the right to insist that no other bonds be issued against installments from which their bonds are payable. *Id.* at 373-74, 13 N.E.2d at 995.

79. Discount is the difference between the price received and the amount of the debt. Under Sections 9-2-69 and 9-2-71, costs and fees are permitted and are the first funds taken off the top of the selling price of the assessment bond. ILL. REV. STAT. ch. 24, §§ 9-2-69, 9-2-71 (1975).

80. In *Knell v. Village of Rockdale*, 314 Ill. App. 304, 41 N.E.2d 216 (1st Dist. 1942), the appellate court reversed an order which attempted to direct the future conduct of the village officers regarding the appropriation of money and the levying of taxes for payments to assessment bondholders. The court reasoned that it was impermissible to judicially anticipate the failure or refusal of the city officials to perform their duties. *Id.* at 306, 41 N.E.2d at 217.

81. See, e.g., *Fidelity Trust Co. v. Village of Stickney*, 129 F.2d 506 (7th Cir. 1942); *Grand Carniolian Slovenian Catholic Union v. Village of Rockdale*, 314 Ill. App. 308, 41 N.E.2d 218 (2d Dist. 1942); *Knell v. Village of Rockdale*, 314 Ill. App. 304, 41 N.E.2d 216 (2d Dist. 1942).



bonds. In *National Bank of LaCrosse v. Peterson*,<sup>82</sup> the Illinois Supreme Court allowed enforcement of a mechanic's lien against bonds owned by a second purchaser and originally issued to the contractor toward whom the liens were directed. The court noted that "these bonds or vouchers were not negotiable, and had no effect to invest the appellant with any right superior to the contractor to whom they were issued."<sup>83</sup> The importance of this pronouncement was underscored by the court's statement shortly after *Peterson* that the non-negotiability of special assessment bonds was "no longer an open question. . . ."<sup>84</sup> In the meantime, the court had also decided that this status made it impossible for a thief to pass clear title to an innocent purchaser.<sup>85</sup> The effect of these cases and their affirmations was to apply "caveat emptor" to an area of law which should generally protect the buyer. Many of these cases appeared to involve situations in which the court felt compelled to create or sustain a defense, thus blocking recovery by imposing a barrier to "curing" title defects in the form of non-negotiability.<sup>86</sup>

The Illinois Appellate Court's decision in *Galt v. City of Chicago*<sup>87</sup> appears to be the most recent direct application of these commercial

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82. 200 Ill. 215 (1902); See also *Morrison v. Austin State Bank*, 213 Ill. 472 (1905). In *Morrison*, a partner converted to his own use certain warrants issued to the partnership by the City of Cicero. A receiver was appointed on behalf of the partnership and the city was notified not to pay out on those warrants. The Austin State Bank, however, received the warrants as a bona fide purchaser with no knowledge of the conversion. When the warrants were presented for payment, payment was refused by the municipality. The court held that the warrants were not negotiable. Therefore, the bank had no claim against the city because it did not have good title. The court found that municipal warrants, while negotiable in form, were not negotiable in fact so that no commercial paper principles could apply. *Id.* at 486.

83. 200 Ill. at 218. The court also pointed out in *Northern Trust Co. v. Village of Wilmette*, 220 Ill. 417 (1906), that where bonds are payable out of a particular fund, such instruments are not negotiable because they do not carry the general credit of the municipality and are only contingent upon the sufficiency of the fund. Therefore, the defenses available to a bona fide purchaser are limited to the ones available to the original payee. *Id.* at 426-27.

84. *Northern Trust Co. v. Village of Wilmette*, 220 Ill. 417, 426 (1906). In this case, assessment bonds were issued for special improvements to the contractor, who subsequently assigned them to appellant. When the improvements were not completed in accordance with the requirements in the agreement, the Village of Wilmette refused to pay on the bonds. Suit was brought and the court found that appellants occupied the same position as the contractor. Therefore, because the contractor's work was inferior, the city had no obligation to pay the bondholders. If the bonds had been negotiable, the city's defense to the charge of nonpayment would not have been allowed.

85. *Morrison v. Austin State Bank*, 213 Ill. 472 (1905). The court stated that the non-negotiability of bonds should serve to warn the innocent purchaser that his title may not be good. *Id.* at 486.

86. See note 85 and accompanying text *supra*.

87. 315 Ill. App. 91, 42 N.E.2d 115 (1st Dist. 1942). This case was cited once subsequently in order to distinguish it from the factual pattern in *Prange v. City of Marion*, 319 Ill. App. 136, 48 N.E.2d 980, 996 (4th Dist. 1943).

law principles.<sup>88</sup> The case, however, probably raised more questions than it settled. In *Galt*, the plaintiff-bondholders claimed that the city had collected money and paid off bonds in chronological order, in violation of *Rothschild*.<sup>89</sup> The bonds at one time had been owned by banks, which were at times the beneficiaries of the complained-of overpayments. Those overpayments involved more money than that to which the plaintiffs were entitled. Noting that the plaintiffs were not "innocent purchasers for value," the court concluded that they could not recover against the city because proper inquiries were not made to ascertain the history and value of the bonds.<sup>90</sup> *Galt* imposes affirmative requirements upon the bondholder to make reasonable inquiries.<sup>91</sup> It is uncertain how far a court would go in following *Galt* in view of the fiduciary obligations of the municipality and the foregoing trust analysis. While the basic analysis in *Galt* is sound, it would be realistic to anticipate it being limited to its facts. This is precisely what was done in *Prange v. City of Marion*.<sup>92</sup>

The *Prange* case contains an analysis of the competing interests raised by a trust or a commercial law approach. On one hand, the trust concept favors the bondholder by imposing affirmative duties upon the trustee-municipality. On the other hand, the notion of non-negotiability as applied in commercial law imposes burdens upon the individual purchaser. *Prange* resolved the problem by finding laches on the part of the municipality-defendant,<sup>93</sup> and by barring the

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88. The defendant in *Kay v. Village of Palatine*, 126 Ill. App.2d, 308, 261 N.E.2d 823 (1st Dist. 1970) tried to argue that the plaintiff was precluded from recovery on her assessment bonds because of her deceased husband's knowledge of the village's defaults. The court reasoned that such an assertion might be valid if supported by evidence. This reference to the sophistication of the plaintiff in the area of special assessment bonds was an attempt to establish prior knowledge as a sufficient prerequisite under the doctrine of laches. However, the discussion at the end of the opinion, with no cases cited, sounds much like the analysis contained in the commercial law cases.

89. 315 Ill. App. at 93-94, 42 N.E.2d at 116. *Rothschild* established that the municipality is a trustee and must distribute the amounts collected from assessments on a pro rata basis. 350 Ill. at 339, 183 N.E. at 341.

90. 315 Ill. App. at 98, 42 N.E.2d at 118. The court stated that the city had the right to use the same defense against the bondholder that it could have used against any bank seeking to be paid on the bonds. *Id.*

91. *Id.* The court found that the plaintiffs "could without difficulty have inquired of the city comptroller or other proper official as to the collections made and how the funds had been disbursed, and ascertained whether overpayments had been made on the bonds about to be purchased." *Id.* The plaintiffs did make several inquiries, which the court found to have little or no probative value. The plaintiffs checked the face amount still due on the bonds, made an inspection of the real estate secured by special assessments, and checked the validity of the bonds. *Id.* at 94-95, 42 N.E.2d at 117.

92. 319 Ill. App. 136, 48 N.E.2d 980 (1st Dist. 1943).

93. *Id.* at 161, 48 N.E.2d at 991. The court was concerned that investors would not buy bonds if a "buried, forgotten and cancelled defense could defeat payment of such a municipal

defense in *Galt*, an analysis which ignores the fact that the city had no control over the bonds when it was sued.

This entire line of cases ignores the fact that special assessment bonds are "bearer bonds," and that the municipality generally makes payments to the holder without question. Possession, therefore, equals title. The failure of these courts to attempt any resolution of this title controversy indicates a strong desire to create defenses for cities that pay on the bonds. A de facto distinction has arisen between the right to payment and the right to sue. Making bonds "bearer bonds" obviously eliminates a practical problem for the municipal treasurer, who has no duty to question each bond claimant as to the history of his possession of the instrument and the means by which he gained control of the documents.

#### THE CONTRACT APPROACH

The third approach to special assessment bond law applies the contracts doctrine. This is perhaps the most ambiguous area because of contradictions in the case law. Some opinions discuss and apparently decide the issues squarely within the law of contracts.<sup>94</sup> Others ignore the express language printed on the bonds in favor of other competing principles.<sup>95</sup> Some reconciliation of the two could be accomplished by recognition of the view, for example, that contract language can be subordinated to some contradictory notion such as "public policy." Thus, these cases are really "contract cases," but conflict in their results because of external considerations. The ambiguity is not resolved by cases like *Cook v. City of Staunton*,<sup>96</sup> in which the court recognized the existence of a contractual relationship between a bondholder and the municipality, then described the contract as "fictitious."<sup>97</sup> The ultimate decision was based on principles of equity. There is some support in the cases for the conclusion that a contract theory will be adopted when cases clearly fall within specific statutory provisions or a clearly worded agreement, but that once outside such a situation the court will opt for principles of equity.

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bond." *Id.* The city was not allowed to collect assessment and interest payments against an innocent purchaser for value.

94. For example, in *Hardin v. City of Chicago*, 348 Ill. App. 289, 108 N.E.2d 822 (1st Dist. 1952), the court found that the bidder for a special improvement had entered into a contract with the city. The contract did not provide for interest, but only for a specified payment. Therefore, penalty interest was denied by the court on the basis that the contractor was bound to the specific terms of the contract. *Id.* at 294-95, 108 N.E.2d at 824.

95. See note 23 *supra*.

96. 295 Ill. App. 111, 14 N.E.2d 696 (3d Dist. 1938).

97. *Id.* at 121, 14 N.E.2d at 700.

## RELATED CONSIDERATIONS

The creation of committees to effect collection on special assessment bonds has resulted in the initiation of proceedings in a number of instances by persons suing in a representative capacity.<sup>98</sup> Standing to sue is crucial not only because of the frequency of use of a facade by bondholders in bringing accounting actions, but also because of the concern of defense counsel that their municipal clients face the real parties in interest. The authority or lack of authority by plaintiff's counsel to represent the descendant of a bondholder-depositor in a "committee" or trust raises serious questions about the binding effect of any judgment involving the bonds of the municipality.<sup>99</sup> Certainly, the possibility exists that specific provisions of a committee or trust agreement affect the plaintiff's status. Express contractual restrictions on the method for initiating litigation, or restrictions on the tenure of the agreement itself would certainly have a direct bearing on any bondholder's standing to sue.

Another pertinent consideration is the requirement that the plaintiff plead and prove ownership. This necessity first appeared expressly in *Fidelity Trust Co. v. Village of Stickney*,<sup>100</sup> a Seventh Circuit Court of Appeals decision interpreting Illinois law. The ownership requirement has since appeared only twice.<sup>101</sup> *Fidelity* distilled the ownership prerequisite from Illinois cases which did not discuss own-

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98. See, e.g., *Kay v. Mundelein*, 36 Ill. App.3d 433, 344 N.E.2d 29 (2d Dist. 1976). *Kay v. Palatine*, 126 Ill. App.2d 308, 261 N.E.2d 823 (1st Dist. 1970); The two cases involved the same plaintiff. In many of the assessment bond cases, the named plaintiff may only be in possession of the bonds, and may be a party to the litigation for convenience purposes only. The actual owners are usually small in number but may hold a significant percentage of a particular issue of bonds. Legal action involving bonds of a particular class will be resolved on a never ending piecemeal basis as far as the city is concerned. Because of collateral estoppel, those unrepresented parties could still benefit from payment to the original parties holding the bonds.

99. The situation contemplated here is one in which counsel, representing a nominal plaintiff, brings suit pursuant to an old agreement to enforce collection. A current owner, who has received the bonds through assignment or inheritance, has probably never seen either the designated attorney nor the document. He could later claim plaintiff's counsel did not properly represent him, and he is therefore not bound by the judgment. The consequences are demonstrated in cases such as *Gray v. First National Bank*, 388 Ill. 124, 57 N.E.2d 363 (1944). Where evidence exists that plaintiff's counsel is acting without authority, a motion to dismiss is appropriate. See *Bell v. Farwell*, 189 Ill. 414 (1901). The decision in *Kroehler v. Green*, 37 Ill. App.3d 255, 185 N.E.2d 369 (1st Dist. 1962) represents precedent for application of these concepts to attorneys who claim to represent unidentified "groups."

100. 129 F.2d 506 (7th Cir. 1942). The court noted that the plaintiff proved its case when it showed ownership of the bonds, maturity of the bonds, collection of the funds, a demand for payment and no payment. *Id.* at 511.

101. *First National Bank & Trust of Racine v. Village of Skokie*, 190 F.2d 791 (7th Cir. 1951); *Sampson v. Village of Stickney*, 30 Ill. App.2d 13, 173 N.E.2d 557 (1st Dist. 1961), *rev'd on other grounds*, 24 Ill.2d 134, 180 N.E.2d 457 (1962).

ership, except by reference, in the facts.<sup>102</sup> It is, therefore, an isolated case.

The ownership problem is amplified by the fact that many reviewing courts have interchanged the terms "bond owner" and "bondholder" loosely, without attaching any significance to the distinction enunciated in *Fidelity*. At least one Illinois Appellate Court has approved the capacity of a "committee" to enforce bond owner rights,<sup>103</sup> but the same court incorporated a statement that the committee had included allegations of written authority to proceed from the owners. Thus, the case is not inconsistent with *Fidelity*.

The issue is further clouded by the fact that special assessment bonds are "bearer bonds."<sup>104</sup> This qualification was duly noted in *Reconstruction Finance Corporation v. Calumet City*,<sup>105</sup> which rejected the city's claim that plaintiff's complaint was defective because it did not show "how and when"<sup>106</sup> ownership was acquired. The court noted that the bonds "pass by delivery."<sup>107</sup> The rationale used to analyze this issue supports the conclusion that ownership is not a requirement. A reasonable reading of the case, however, suggests that this language is "overkill" and that the court was concerned with the history of ownership. The plaintiff, however, was the owner of the bonds.<sup>108</sup>

Notwithstanding the lack of express state court support for *Fidelity*, requirement of some showing of ownership is sound. The defendant must be able to face the real parties in interest with assurances that the litigation will conclusively adjudicate all the issues in the case. In addition, this requirement forces the nominal plaintiff who claims to sue in a representative capacity to competently perform his job and keep all bond owners abreast of his activities. In following this

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102. The *Fidelity* opinion cited *Allbee v. City of Aurora*, 306 Ill. App. 457, 28 N.E.2d 742 (2d Dist. 1940), and *Rothschild v. Village of Calumet Park*, 350 Ill. 330, 183 N.E. 337 (1932), in support of the ownership view. The court also cited *People ex rel. Anderson v. Village of Bradley*, 367 Ill. 301, 11 N.E.2d 415 (1937), which, oddly enough, was not a special assessment case and specifically excluded a consideration of bondholder rights.

103. *People ex rel. Decker v. City of Park Ridge*, 275 Ill. App. 97 (1st Dist. 1934).

104. The holder of bearer bonds need not show clear title before seeking payment on bonds from the municipality.

105. 324 Ill. App. 73, 57 N.E.2d 290 (1st Dist. 1944).

106. *Id.* at 80, 57 N.E.2d at 293. The court said the "how and when" was a required showing under the Illinois Civil Practice Act. *Id.*

107. *Id.* The court noted that the city was simply required to make payments on bonds once they were presented.

108. The defendant's answer listed the names of parties to whom payments were made and showed the court that Reconstruction Finance Co. was the owner of the bonds. *Id.*

analysis, the courts should give express recognition to the distinction between standing to collect from the municipality and standing to sue. The former incorporates the practical considerations of day-to-day operations of a city or village, while the latter encompasses the basic requirements of sound trust analysis. Some consistency between the two exists in the observation that, while the city may owe a duty to pay as trustee, it is not obligated to protect the bondholder from third parties.

Actually, the ownership language in *Fidelity* was only part of a statement detailing the necessary elements of a prima facie case, which included "maturity, collections made by the village, demand for payment and no payment."<sup>109</sup> Despite the relative simplicity and longstanding recognition of this ownership test,<sup>110</sup> much judicial energy has been spent detailing and analyzing irrelevant considerations.<sup>111</sup> Most of these can be categorized as sympathy pleas, with the municipality cast as villain. This is unfortunate, because more critical aspects, like applicable accounting methods, are in need of attention.<sup>112</sup>

#### CONCLUSION

The easiest and perhaps most logical explanation for the convergence of trust, contract and commercial law into considerations of special assessment bonds would be that judges decide on equitable grounds who should win the case, then apply the theory which produces that result. The law regarding special assessments unfortunately is not guided by "neutral principles." Those cases which have allowed bondholder recovery tend to stress the city's role as trustee, while those which have supported the municipalities seem to put forth a commercial law or contract theory. The confusion in case law has no doubt led to a high frequency of settlements, which explains the dearth of appellate opinions.

The strongest theory is the notion of trusteeship, which is the most logical approach to the problem. It makes no sense to discuss concepts of contract or "holder in due course" with respect to old bonds

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109. 129 F.2d at 511.

110. See, e.g., *Conway v. City of Chicago*, 237 Ill. 129 (1908).

111. See, e.g., *Norwalk & Western Ry. Co. v. Chicago Bd. of Educ.*, 14 F. Supp. 475 (N.D. Ill. 1936).

112. Decisions like *How & Co. v. City of Chicago*, 306 Ill. App. 571, 29 N.E.2d 388 (1st Dist. 1940), *aff'd*, 384 Ill. 232, 51 N.E.2d 120 (1943) are rare. The court focused on proper accounting methods, but even in that case failed to give a comprehensive analysis of special assessment accounting. For example, some accountants create cash intake from bond applications not properly cancelled.

which have not been widely traded. Dragging up the history of these instruments is not only unfair to all parties, it is practically impossible. At the same time, some modification of the trust analysis could be appropriate. Any ultimate approach must reconcile two sometimes competing interests: the interest of the municipality in maintaining certainty in its financial affairs; and the interest of the bondholder in protecting his investment.

The salient feature of special assessment litigation is the ability of a plaintiff to sue on very old bonds. Bonds found in cedar chests in the attic are the nemesis of city financial officers. Litigation to collect on forty year old bonds represents a threat to principles of sound fiscal management. An obvious solution is to lay the groundwork for a laches defense by engaging in acts of repudiation.<sup>113</sup> Maintenance of a good market for future issues, however, and the very real sense of moral obligation applied by municipalities to bond owners speak strongly against such defenses. Any widespread notice of repudiation would amount to an invitation to litigate. Cities might engage in selective repudiation of older issues of bonds, but in the process might offend investors in current securities.

The solution is the elimination of repudiation as a prerequisite to a defense of laches. Those individuals who hold bonds far past their maturity date should, as a practical matter, be on notice of the city's probable intention not to pay on those bonds. Failure to seek collection for long periods of time should bar recovery, irrespective of the city's actions. Unreasonable delay should be available as a defense unless the municipality engages in some active deception. The bond owner's interest is adequately protected in court by his ability to seek mandamus or an accounting in a timely action.

It is also absolutely essential that Illinois courts adopt the requirement that ownership of the instruments in question be demonstrated. While this ignores the fact that payments are made to the holder, it takes cognizance of other more important considerations. The age of these bonds and the formation of committees to facilitate collection make it quite easy for bonds to fall into the hands of professional plaintiffs who are unknown to the bond owner. Bonds deposited with a "trustee" committee decades ago may be sued upon by that committee years later without an accounting to the owners. Courts should not hesitate to question the origin of a cause of action.

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113. The municipality could clearly indicate its intention not to pay on bonds delivered for payment a significant period of time after maturity.

Such a consideration is for the protection of both the defendant city and those whom the plaintiff claims to represent.

The trial judge should play an active role in remedying the lack of understanding that has prevailed in this area. Judges can make these kinds of inquiries of the plaintiff when presented with the appropriate motion. They can also adhere to the basic guidelines which have been detailed as a foundation to recovery.<sup>114</sup> This assumption of responsibility not only simplifies the plaintiff's case, but also eliminates considerations of wrongdoing and deflates oversized claims against the municipality. The scarcity of recent cases suggests that this area of law has received little attention in the last twenty-five years. Confusion over the applicable rules in this area has undoubtedly contributed to decisions by many municipalities to settle bond cases. Recent appeals have been on technical grounds, and have avoided the basic issue of accounting which is generated by the proposition that the city is liable only for that which it collects.

It remains to be seen if the legislature will offer a solution to a potentially growing problem. Some precedent already exists in the statute. Section 9-1-8<sup>115</sup> is, in essence, a statute of limitations with respect to the so-called "unclaimed rebate fund" described in the sections of Division I.<sup>116</sup> This concept could be applied more broadly throughout the Act to give municipalities necessary relief from stale claims. The unclaimed rebate provision has been trimmed from eight to four years as a cut-off date for claims.<sup>117</sup> Any such provision applying across-the-board should be expanded to a longer period of time in fairness to all bondholders.

The biggest problem in remedying the city and bondholder dilemma stems from the fact that these instruments are payable to the bearer. It is literally impossible for a municipality to send out notice of some proposed action on the bond, such as termination of a fund, with any assurance that it will reach the current holder-owner. A requirement printed on the bond that transfers in ownership be recorded with the issuing municipality would insure that a statute of limitations could not work a hardship, since actual notice would then be given.

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114. That foundation was clearly stated in *Fidelity Trust Co. v. Village of Stickney*, 129 F.2d 506 (7th Cir. 1942). It is necessary that the plaintiff show ownership of the bonds, maturity of the bonds, collections made by the village, a demand for payment, and no payment. *Id.* at 511 (citations omitted).

115. ILL. REV. STAT. ch. 24, § 9-1-8 (1975).

116. *Id.* §§ 9-1-1-9-1-4.

117. *Id.* § 9-1-5.



Success in financing local improvements through special assessment bonding may well depend on future streamlining of the reporting and notice procedure. Increased costs in municipal administration mandate elimination of the uncertainty which encourages litigation in this area. The attention of the courts and legislature is warranted and overdue.