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CONSTITUTIONAL LAW - IMPAIRING THE OBLIGATION OF CONTRACTS - REFUNDING BONDS

John F. Hall
University of Michigan Law School

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CONSTITUTIONAL LAW — IMPAIRING THE OBLIGATION OF CONTRACTS — REFUNDING BONDS — In 1938, Mississippi authorized the issuance of state highway bonds in the aggregate of $60,000,000.[1] Interest was payable semi-annually and the bonds were to mature serially semiannually, and to the extent necessary to make these payments the revenues from gasoline taxes were pledged. The act further provided that the state covenanted that so long as any of the bonds were outstanding and unpaid, it would not authorize "any other obligations or securities payable from gasoline tax revenues" unless such revenues should increase in such an amount that one-third of the proceeds would be sufficient to meet the principal and interest obligations on the bonds. In 1940, the act of 1938 was amended so as to allow the state bond commission to issue bonds for the sole purpose of refunding the bonds which matured in 1941.[2] The refunding bonds were to have the same characteristics, be payable from the same revenues and secured by the same covenants as were the original bonds. Plaintiff, who was owner of a bond issued under the act of 1938 and maturing in 1949, filed a petition to enjoin the issuance of the refunding bonds, alleging that since one-third of the gasoline tax revenues would not be sufficient to meet principal and interest payments on the bonds, the obligation of the contract embodied in the act of 1938 will be impaired. *Held*, the amendatory act of 1940 providing for the issuance of refunding bonds is constitutional. *Bank of Morton v. State Bond Commission*, (Miss. 1941) 199 So. 507.

Contracts between a state, or any of its political subdivisions, and private persons are within the protection of the contracts clause of the federal Constitution.[3] It is also clear that when a person loans money to the state on a pledge of property by a legislative act, a contract arises, and the lien of the bond-holder cannot be divested by a subsequent legislative act.[4] It is frequently said that the state may alter the remedy by which the contract is enforced provided the obligation of the contract itself is not thereby impaired,[5] and whether it is only the remedy which has been changed is a question to be decided on the facts of each particular case.[6] In the instant case, the issuance of refunding bonds

[1] Miss. Laws (1938), c. 130.

[2] Miss. Laws (1940), c. 109.

[3] Fletcher v. Peck, 6 Cranch (10 U. S.) 87 (1810); Piqua Branch of State Bank of Ohio v. Knoop, 16 How. (57 U. S.) 369 (1853); and see, Kauper, "What is a 'Contract' Under the Contracts Clause of the Federal Constitution?" 31 MICH. L. REV. 187 (1932).

[4] Trustees of Wabash & Erie Canal Co. v. Beers, 2 Black (67 U. S.) 448 (1862); Gibbs v. Green, 54 Miss. 592 (1877); Von Hoffman v. City of Quincy, 4 Wall. (71 U. S.) 535 (1866); Hubbell v. Leonard, (D. C. Ark. 1934) 6 F. Supp. 145; and see cases collected in 85 A. L. R. 244 (1933); 97 A. L. R. 911 (1935).

[5] Home Building & Loan Assn. v. Blaisdell, 290 U. S. 398, 54 S. Ct. 231 (1933); see also, 1 COOLEY, CONSTITUTIONAL LIMITATIONS, 8th ed., 587 (1927); ROTTSCHAEFER, CONSTITUTIONAL LAW 566 (1939).

[6] The court said in Von Hoffman v. City of Quincy, 4 Wall. (71 U. S.) 535 at 553-554 (1866): "No attempt has been made to fix definitely the line between alterations of the remedy, which are to be deemed legitimate, and those which, under the form of modifying the remedy, impair substantial rights. Every case must be determined upon its own circumstances."

would not be an impairment of the obligation of the contract unless the terms of the contract expressly so provide, because it has been held that the power to issue bonds in the first instance includes the power, by necessary implication, to refund those bonds.[7] It is the general rule that refunding bonds do not increase the aggregate indebtedness, but merely change the form of an already existing debt.[8] If, then, the substantive rights of the plaintiff have been altered, it is because the refunding issue in fact impairs the security created by the contract. It is often said that the constitutional prohibition against impairment of contracts has no reference to degree but that the obligation must not be impaired to any extent.[9] Thus, the courts hold invalid a subsequent statute which reduces the amount of the tax pledged to pay the obligation [10] or diverts the fund pledged [11] so that the bondholders would be deprived of payment. But when it appears that there are sufficient funds to meet all payments on principal and interest, the courts are reluctant to find invalid any subsequent legislative act which may alter the pledged security. Thus, it is said by some courts that if the legislation leaves the creditors with *no adequate means* of payment, it impairs the obligation of the contract.[12] Others say that the impairment must be "substantial." [13] Any surplus of a pledged fund not needed to meet the principal

[7] Talkington v. Turnbow, 190 Ark. 1138, 83 S. W. (2d) 71 (1935).

[8] Poughkeepsie v. Quintard, 136 N. Y. 275, 32 N. E. 764 (1892). *Contra*, Doon Township v. Cummings, 142 U. S. 366, 12 S. Ct. 220 (1892). In the latter case, the distinction is made between the sale and exchange of refunding bonds, but the courts have generally abandoned the doctrine. See cases collected in 97 A. L. R. 442 (1935). Some courts have even held that the sale of refunding bonds at an interest rate above that of the original issue was not a new debt. Robertson v. Tillman, 39 S. C. 298, 17 S. E. 678 (1893).

[9] Planters' Bank of Mississippi v. Sharp, 6 How. (47 U. S.) 301 at 327 (1848); Von Hoffman v. City of Quincy, 4 Wall. (71 U. S.) 535 at 552 (1866).

[10] State ex rel. Judd v. Cooney, 97 Mont. 75, 32 P. (2d) 851 (1934); Von Hoffman v. City of Quincy, 4 Wall. (71 U. S.) 535 (1866); People ex rel. McCauley v. Brooks, 16 Cal. 11 (1860).

[11] Hubbell v. Leonard, (D. C. Ark. 1934) 6 F. Supp. 145; Moore v. Otis, (C. C. A. 8th, 1921) 275 F. 747; Islais Co. v. Matheson, 3 Cal. (2d) 657, 45 P. (2d) 326 (1935); and if the tax is collected but not applied to discharge the bonds, the public is not relieved of the tax, Louisiana ex rel. Hubert v. City of New Orleans, 215 U. S. 170, 30 S. Ct. 40 (1909); and see Fazende v. City of Houston, (C. C. Tex. 1888) 34 F. 95; Western Saving Fund Society of Philadelphia v. Philadelphia, 7 Casey (31 Pa. St.) 175 (1858); McGee v. Mathis, 4 Wall. (71 U. S.) 143 (1866); Gibbs v. Green, 54 Miss. 592 (1877); State ex rel. Judd v. Cooney, 97 Mont. 75, 32 P. (2d) 851 (1934); Eidemiller v. City of Tacoma, 14 Wash. 376, 44 P. 877 (1896).

[12] In re Opinion of the Justices, 297 Mass. 577, 9 N. E. (2d) 186 (1937); Louisiana ex rel. Hubert v. City of New Orleans, 215 U. S. 170 at 178, 30 S. Ct. 40 (1909); Mobile v. Watson, 116 U. S. 289 at 305, 6 S. Ct. 398 (1885).

[13] Thompson v. Auditor General, 261 Mich. 624 at 640, 247 N. W. 360 (1933); In re Gordon, (C. C. A. 2d, 1937) 90 F. (2d) 583 at 586: "It is generally said that an impairment of a creditor's rights must be substantial in order to come within the constitutional prohibition." And the Massachusetts court said, "It is commonly not a question of the degree of impairment of the contract. If there is any

and interest payments on the bonds may be released from the pledge and is subject to be disposed of according to the legislative will.[14] And where revenues from a municipal utility plant are pledged to pay revenue certificates, a later certificate issue of equal dignity is valid, if it appears that the revenues were ample to meet principal and interest payments on both issues as they mature.[15] Also, where it is stipulated that a designated portion of the funds raised by the tax pledge should form a sinking fund for the payment of bonds, the merger of the debtor city into a larger city does not impair the obligation of the contract represented by the bonds, unless the general credit of the larger city is not a substantial equivalent for the special security contracted for.[16] And where the receipts from an ad valorem tax are pledged for payment of principal and interest, a refunding issue to be secured by a special lien on land does not impair the obligations of the contract, provided some provision is made adequately to secure the payment of the bonds held by persons not assenting to the refunding issue.[17] In the principal case, the refunding bonds are not to mature until after the maturity date of plaintiff's bond, and so if the security of his bond is impaired, it is only to the extent of the interest on the refunding issue. Inasmuch as the revenues appear to be greatly in excess of the amount needed to meet the principal and interest payments on the original bonds and the interest on the refunding issue, it would seem that plaintiff's security is not substantially lessened.

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substantial impairment of the obligation it encounters the prohibition." In re Opinion of the Justices, 297 Mass. 582 at 586, 9 N. E. (2d) 189 (1937). And where the bondholder claimed that the alteration in the remedy reduced the value of his contract right and thus impaired the contract, the Indiana court said, "But, even if the law had the effect of working a small diminution in property value, it would not necessarily be condemned on that account by the constitutional provisions relied upon." Storen v. Sexton, 209 Ind. 589 at 607, 200 N. E. 251 (1936).

[14] Streit v. Lujan, 35 N. M. 672, 6 P. (2d) 205 (1931); Board of Liquidation of New Orleans v. Louisiana, 179 U. S. 622, 21 S. Ct. 263 (1900); Flint v. Duval County, 126 Fla. 18, 170 So. 587 (1936); but see, Graham v. Horton, 6 Kan. 343 (1870); Houston v. Allred, 123 Tex. 334, 71 S. W. (2d) 251 (1934); Trustees of Internal Improvement Fund v. Bailey, 10 Fla. 112 (1862). In the last case it was argued that the amount taken from the fund was so small that it would not harm the plaintiff's security. After deciding that it was not satisfied of this, the court said, "and besides this is not a question of ability, but of principle, for if it be once conceded that the fund may be applied to other purposes than those named in the Act, there will be no limit. . . ." 10 Fla. at 131.

[15] State v. City of Jacksonville, 131 Fla. 163, 179 So. 172 (1938).

[16] Ensley v. Simpson, 166 Ala. 366, 52 So. 61 (1909); and see, Oneida v. Pearson Hardwood Flooring Co., 169 Tenn. 449, 88 S. W. (2d) 998 (1935).

[17] Los Angeles County v. Jones, 6 Cal. (2d) 695, 59 P. (2d) 489 (1936); and in Fort Lauderdale v. State ex rel. Elston Bank & Trust Co., 125 Fla. 89 at 98, 169 So. 584 (1936), the court held: ". . . it was the duty of the bondholders to accept payment of their interest from whatever source tendered, as it is utterly immaterial to a public creditor how he gets his money to discharge his indebtedness so long as he is paid from some source sufficient to discharge what is his due and no default by way of a violation of other specific undertakings incident to the indebtedness is being threatened."