

THE LAW OF MUNICIPAL BONDS

Published @ 2017 Trieste Publishing Pty Ltd

ISBN 9780649626342

The Law of Municipal Bonds by John F. Dillon

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Edited by Trieste Publishing Pty Ltd.
Cover @ 2017

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JOHN F. DILLON

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MUNICIPAL BONDS**

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OF
MUNICIPAL BONDS

BY

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ST. LOUIS:
G. I. JONES AND COMPANY.
1876.

THE LAW
OF
MUNICIPAL BONDS.

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PART I. OF THE POWER OF MUNICIPALITIES TO ISSUE NEGOTIABLE SECURITIES.

SECTION I. *Extent of Municipal Indebtedness—Comparative Statement here and in Great Britain and Paris, note.*—It is esti-

mated that the municipal indebtedness in this country has already reached the enormous sum of \$900,000,000, and it is constantly increasing.¹ A large portion of this indebtedness

¹ "The Public," July 27, 1876, page 53, where a list of the debts of sixty-two cities are given, amounting to \$618,205,488. The writer concludes his article with these admonitory observations: It "is high time to know how large a burden of indebtedness has been fastened upon the commerce and industry of the country through municipal government. Perhaps a full knowledge of the magnitude of that burden may awaken the tax-payers to prevent its increase, either by constitutional changes, or by reforms in the methods of local government. According to the latest report of the local government board in Great Britain, the indebtedness created for all purposes not national amounts to £92,000,000, or about \$460,000,000, having increased about \$100,000,000 within three years. In this country, the increase has been over \$360,000,000 in six years, or \$60,000,000 yearly, in only sixty-two cities and the other municipalities of two states. In the whole country, it has probably been nearly \$100,000,000 each year. Our local indebtedness includes \$382,000,000 for states, \$180,000,000 for counties, and probably \$900,000,000 for municipalities; in all \$1,462,000,000. It is a mortgage of about five per cent. upon the entire estimated wealth of the country. The interest exceeds six per cent. yearly. The annual tax upon industry and commerce exceeds \$90,000,000 for interest on local debt alone."

It thus appears that although our taxable property and resources are much less than those of Great Britain, our local debt is at least twice as large.

Recently the city of Paris, having proposed a new loan, the *Economiste Francaise* reviewed the growth of the debt of that city, and it appears that municipal extravagance is not confined to this side of the Atlantic. "The figures show," says the *London Economist*, alluding to the subject, "how the desire, partly to beautify the great city, and partly to give employment to its turbulent population, has led successive *regimes* to add extravagance to extravagance. In the first year of the rule of Napoleon as first consul, the expenditure of Paris was no more than 11,216,000 francs, or \$2,223,200; in the last year of the first empire, the sum had grown to 33,483,000 francs, or \$6,696,600. In fifteen years, that is, the expenditure of the city had trebled. The two invasions of 1814 and 1815 imposed heavy fines and an immense outlay upon Paris, which raised the expenditure for 1815 to the enormous sum of over 78,000,000 francs, or \$15,600,000.

"But in the first year of the Restoration, the outlay was again reduced to 36,000,000 francs (\$7,200,000), or not very much more than the sum spent in 1814. The elder Bourbons and their advisers had a lively recollection of the influence exerted on the Revolution by the disorder into

is evidenced by *negotiable bonds*, which are held by thousands of persons, at home and abroad, as an investment. These bonds have been issued for a great variety of purposes, such as the erecting of public buildings, the making of municipal improvements, and in payment of subscriptions for the stock of railway corporations, or as donations to aid them in the construction of their roads located in or near the municipality or public corporation thus extending its assistance.

SEC. 2. *Effect of power to issue municipal commercial securities for public improvements—Stimulus to extravagance—Abuse of power—Repudiation.*—The power conferred upon municipal and public corporations to issue *commercial securities* for such purposes is of comparatively recent origin, and it has, undeniably, been attended with very serious, and it is perhaps not

which the finances had fallen under Louis XVI, and therefore they practised economy in the administration. Accordingly, we find that in the last complete year of Charles X, 1829, the expenditures had risen only to 48,000,000 francs (\$9,000,000). Instead of trebling, as under the First Napoleon, in a nearly equal period of time under the Restoration the increase was only one third. But with the government of Louis Philippe, we find a somewhat augmented outlay. In 1847 the expenditure had risen to 64,000,000 francs (\$12,800,000), it having been no more than 40,000,000 francs (\$8,000,000) in 1830.

"It was, however, under the second empire that extravagance gained free scope. We all remember the great works carried out by Baron Haussmann, the disregard of all financial rule, and the mystifications practised in the accounts. Even before the rise of Baron Haussmann, however, the expenditure swelled inordinately. In 1852, including the special as well as the general funds, it had grown to 102,000,000 francs (\$20,400,000), or 38,600,000 francs (\$7,600,000) more than in 1847. And in 1869 it had actually reached 346,000,000 francs, or \$69,200,000. Thus, as under the First Napoleon, the expenditure had more than trebled in a single reign. Furthermore, we see that, during the twenty years from the accession of the first consul to the breaking out of the war with Germany, the expenditures of Paris had been multiplied about thirty-one times, from less than £450,000 to nearly £14,000,000 sterling (\$70,000,000). Since the restoration of order, the attention of the government has been given to the enforcement of economy. But the minor debts upon the city have allowed of only a small measure of success being attained. In the present year, the expenditure is estimated at 305,000,000 francs, or \$61,000,000."

As to coupon bonds, see Daniel on Neg. Instr. sec. 1486, *et seq.*

too strong a statement to add, disastrous, consequences, the end of which is not yet. One of these is the stimulus which the long credit commonly provided for effectually supplies, to over-indebtedness. The bonds usually fix a time, twenty or thirty years distant, for payment of the principal. Those who vote the debt, and the councils or bodies which create it and issue the bonds, do so without much hesitation, as the burden is expected to fall principally on *posterity*. A learned justice of the Supreme Court of the United States has very fitly described the effect witnessed as a *mania* for running in debt for public improvements.* It has elsewhere been characterized as an "epidemic insanity" inducing extravagant corporate subscriptions to public works.

In many parts of the country, and particularly in the west, this mania has become general in cities, counties, townships and school districts, and large and burdensome debts have been thoughtlessly created. The writer has known new counties in a western state, not containing over 10,000 inhabitants, vote, for a single railway, bonds to the amount of \$300,000, drawing ten per cent. interest, payable annually, and instances are not infrequent where bonds have been issued greater than the assessed value of all the taxable property at the time, within the municipal or territorial sub-division. No check against the incurring of over-indebtedness is so effectual as the one *that you must pay as you go*, but this is wholly disregarded in the legislation which authorizes bonds payable at a remote period. Another serious consequence of this policy is, that even the *interest* on these bonds often proves to be a heavy burden upon the community, and in many instances the bonds have been issued fraudulently by the public or municipal officers, and no consideration, or none of value, has been, in fact, received therefor. They may, indeed, have the stock of the railway company, but in most cases, under the prevailing mode of constructing railways, the stock is utterly valueless. When the sting of taxation is felt, and when the tax-payer knows that the bonds were fraudulently issued, and even when

*Mr. Justice Davis.

he feels that they were improvidently given, experience shows that repudiation, or attempted repudiation, is the next stage, involving a forfeiture of the public faith pledged for their payment. Occasionally it has been witnessed that the *state*, in all its departments, has actively sympathized with the repudiating municipality, and the public faith has been redeemed only through the coercion of the Supreme Court of the United States. In a few instances, indeed, the *states* have set the example of repudiating their own obligations issued in aid of railways; and it was only last winter, in a case of this kind, that the Supreme Court at Washington felt itself bound to declare "that the faith of the state, [of Minnesota] solemnly pledged, has not been kept; and were she amenable to the tribunals of the country, as private individuals are, no court of justice would withhold its judgment against her."

Examples of this kind are demoralizing, and cannot safely become general or frequent.

SEC. 3. *Scope and nature of this paper*—*The law of Municipal Bonds as developed in the Federal Courts*.—The policy of burdening the future has been sanctioned by the legislature, and the courts have to deal with the legal rights of the municipality on the one hand, and the holders of its obligations on the other. The determination of their legal rights involves enquiries as complicated as they are important. The law on this subject is substantially the growth of the last twenty-five years. The decisions in the various State and Federal courts are very numerous, and on some points conflicting. The writer has treated the subject elsewhere,³ and does not in the present article intend to reproduce what is there said, or refer to it, except where it will serve to illustrate or abridge the present discussion. It is impossible, were it even desirable, to compass within the limits of a single article all the learning, and to refer to all the cases, upon the subject of municipal securities. It will not be attempted. By reason of the greater favor with which the rights of the holders of such securities have been regarded by the Supreme

³ *Municipal Corporations*, chaps. 14, 20.