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Michael D. Utevsky

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THE FUTURE OF NONGUARANTEED BOND FINANCING IN NEW YORK

I. INTRODUCTION

New York City narrowly escaped municipal bankruptcy in 1975 when it could not service its debt¹ without help from the state and federal governments.² New York State's Urban Development Corporation (UDC) was in default on short-term notes for several days in February-March 1975, until the state legislature appropriated \$90 million for repayment of principal and interest and for current operating expenses.³ Bond markets were severely shaken by New York's financial crisis. States and municipalities nationwide experienced difficulty in marketing their obligations, regardless of their individual credit ratings.⁴

The crisis was largely due to the seemingly unupportable debt burdens on the state, the city and their various authorities and agencies.⁵ For example, about \$1.7 billion, or 58.6 percent of New York City's real property taxes, was used to service the city's debt in fiscal 1974-75.⁶ Total outstanding debts of the state, including commitments to its agencies, stood at \$12.8 billion, or \$707 per state resident, on March 31, 1975.⁷ More than two-thirds of this amount, or \$8.7 billion, was "nonguaranteed" debt⁸ which had never been submitted to a voter

1. The terms "debt" and "indebtedness" are subject to various definitions depending on the jurisdiction and the context in which they are used. Broadly, the terms refer to an undertaking to pay a specified amount at a future date. For a discussion of different interpretations of the terms in the context of government obligations, see 15 E. McQuillin, *Municipal Corporations* § 41.18 (3d ed. 1970) [hereinafter cited as *McQuillin*].

2. See F. Ferretti, *The Year the Big Apple Went Bust* 327-406 (1976).

3. New York State Moreland Act Commission on the Urban Development Corp. and Other State Financing Agencies, *Restoring Credit and Confidence 201-02* (1976) [hereinafter cited as *Moreland Commission Report*].

4. Revzin, *Other Cities Suffer Pains in Bond Market from New York Woes*, *Wall St. J.*, June 19, 1975, at 1, col. 6.

5. *Moreland Commission Report*, supra note 3, at 9.

6. City of New York, *Official Statement, General Obligation Serial Bonds 28* (July 1, 1976). It should be noted that the city is limited in levying real property taxes for municipal purposes to 2.5% of full market value. N.Y. Const. art. VIII, § 10(f). However, taxes used for debt service are excluded from this limitation. *Id.* § 11(a).

7. State of New York, *Preliminary Official Statement, 7% Tax and Revenue Anticipation Notes*, at F-10 (Aug. 19, 1976) [hereinafter cited as *State Prospectus*].

8. *Id.* The state classifies these nonguaranteed debts as "lease purchase" commitments, which amounted to \$3.6 billion, and "moral obligation" debts, which amounted to \$5.1 billion. *Id.*

In a typical lease-purchase arrangement, the state enters into a long-term agreement to lease a facility from one of its authorities. The state's rental payments generally are sufficient to enable the authority to repay interest and principal on the bonds it issued to finance acquisition and/or construction of the facility. Such lease commitments are considered executory obligations of the state, rather than legal indebtedness within the meaning of constitutional prohibitions. See 1975 N.Y. Comp. Ann. Rep., pt. 1, at 22-23; *State Prospectus*, supra note 7, at 61-62; *McQuillin*, supra note 1, § 41.16; Magnusson, *Lease-Financing by Municipal Corporations as a Way Around Debt Limitations*, 25 *Geo. Wash. L. Rev.* 377 (1957).

referendum⁹ and for which the state disclaimed legal liability.

By late 1976, however, an appearance of normalcy had returned to municipal bond markets¹⁰ and to New York finances. The city had met its first deadlines for repayment of state and federal loans.¹¹ The state's obligations were again being purchased by private investors¹²—there was even a market for the moral obligation bonds of the state's Housing Finance Agency and Municipal Assistance Corporation, albeit at high interest rates.¹³ Although a court decision¹⁴ ordered the city to repay almost \$1 billion of short-term notes, government officials remained hopeful that fiscal solvency would be maintained,¹⁵ possibly with help from the new administration in Washington.¹⁶

Financial collapse had been averted by a series of emergency maneuvers. These included a moratorium on repayment of short-term city notes;¹⁷ creation of a Municipal Assistance Corporation (MAC)¹⁸ with power to issue bonds against which the state pledged the city's sales tax and stock transfer tax;¹⁹ the

Moral obligation debts consist of bonds issued by an authority or agency of the state, on which the state agrees to appropriate annually any money needed to make up deficiencies in the issuer's debt service reserve fund. The state disclaims any legal liability for the bonds, but there is said to be a moral obligation on the part of the legislature to make such appropriations. 1975 N.Y. Comp. Ann. Rep., pt. 1, at 23-24; State Prospectus, *supra* note 7, at 62-63. See notes 109-11 *infra* and accompanying text.

These statistics do not include other authority debts that are unsupported by the moral obligation "makeup" clause. These other debts, however, are sometimes said to carry an implied moral obligation of the state for their repayment in event of default by the issuing authority. See notes 74-80 *infra* and accompanying text.

9. N.Y. Const. art. VII, § 11, requires that debts guaranteed by the state's full faith and credit be approved by a majority of voters at an election.

10. Bonds issued by other states and municipalities were being purchased by investors at increasingly lower interest rates and higher prices. See, e.g., N.Y. Times, Dec. 10, 1976, at D3, col. 1; N.Y. Times, Oct. 15, 1976, at D9, col. 1; N.Y. Times, Oct. 4, 1976, at 33, col. 3; Wall St. J., June 25, 1976, at col. 1.

11. E.g., N.Y. Times, Sept. 15, 1976, at 43, col. 1.

12. E.g., Wall St. J., Aug. 20, 1976, at 16, col. 1.

13. N.Y. Times, Sept. 17, 1976, at 1, col. 6 (tax-exempt Housing Finance Agency bonds paid 8.5% interest); N.Y. Times, Nov. 5, 1976, at A1, col. 3 (tax-exempt MAC bonds paid 10.25% interest).

14. *Flushing Nat'l Bank v. Municipal Assistance Corp.*, 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976). See notes 131-136 *infra* and accompanying text.

15. E.g., New York City Mayor Beame's assertion that "we've met the problem with confidence, in full control of the situation." N.Y. Times, Dec. 28, 1976, at 43, col. 3.

16. See, e.g., President-elect Carter's promise to keep the city from bankruptcy. N.Y. Times, Dec. 29, 1976, at 1, col. 6.

17. Emergency Moratorium Act for the City of New York, ch. 874, [1975 extra. sess.] N.Y. Sess. Laws 22 (McKinney 1976), held unconstitutional, *Flushing Nat'l Bank v. Municipal Assistance Corp.*, 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976) (see notes 131-36 *infra* and accompanying text).

18. Municipal Assistance Corporation Act, ch. 168, [1975] N.Y. Sess. Laws 237 (McKinney), as amended, ch. 169, [1975] N.Y. Sess. Laws 260 (McKinney).

19. Municipal Assistance Corporation Act, ch. 168, § 7, [1975] N.Y. Sess. Laws 256 (McKinney), as amended, ch. 169, [1975] N.Y. Sess. Laws 260 (McKinney). This pledge, however, does not create

purchase by state and city pension and workmen's compensation funds of large amounts of obligations of the state, MAC, and several state authorities;²⁰ and a state appropriation of \$750 million to the city and MAC.²¹

At the same time, the legislature began to take steps to limit the amount of debt that could be undertaken in the future. The city's ability to sell bonds to the public was placed under control of the Emergency Financial Control Board.²² Dollar ceilings were placed on the amount of moral obligation debt that could be undertaken by the state's public authorities. Unused moral obligation provisions in legislation governing six authorities and agencies were repealed. A Public Authorities Control Board was created to oversee future authority bond issues and, for some authorities, all new construction projects.²³

Of equal significance were two 1976 decisions of the New York Court of Appeals which, although involving forms of guaranteed debts, demonstrated the court's willingness to invalidate financing practices which strain constitutional debt limitations. In March, 1976, *Wein v. State*²⁴ upheld one of the emergency measures enacted by the state, but attempted to set definite limits on the kinds of financing devices that could be used in the future—to delineate what Chief Judge Breitel called "the brink of valid practice."²⁵ The following November, in *Flushing National Bank v. Municipal Assistance Corp.*,²⁶ the court held unconstitutional the state-enacted moratorium on repayment of full faith and credit city short-term notes.

Whether these efforts of the court and legislature will have any long-term effect, however, is problematic. When the financial crisis of 1975 begins to

any legal obligation on the state legislature to appropriate the tax revenues so pledged into the debt service fund. See Municipal Assistance Corp., Preliminary Official Statement, 1976 Series CC Bonds, at 10-11 (Oct. 29, 1976).

20. Financial Emergency Act for the City of New York, ch. 868, §§ 7-8, [1975 extra. sess.] N.Y. Sess. Laws 1421 (McKinney), as amended, ch. 870, [1975 extra. sess.] N.Y. Sess. Laws 1444 (McKinney); Act of March 12, 1976, ch. 32, [1976] N.Y. Sess. Laws 148 (McKinney), as amended, Act of April 6, 1976, ch. 115, [1976] N.Y. Sess. Laws 325 (McKinney); Act of June 10, 1976, ch. 342 [1976] N.Y. Sess. Laws 906 (McKinney). Based on its findings of a public emergency, the legislature passed these acts to aid financial recovery. Under normal economic circumstances, as one commentator has observed, "purchase of tax-exempt securities by a tax-exempt organization is irrational." J. Maxwell, *Financing State and Local Governments* 205-06 n.22 (rev. ed. 1969).

21. Financial Emergency Act for the City of New York, ch. 868, §§ 22-23, [1975 extra. sess.] N.Y. Sess. Laws 1438 (McKinney), as amended, ch. 870, [1975 extra. sess.] N.Y. Sess. Laws 1444 (McKinney), held constitutional, *Wein v. State*, 39 N.Y.2d 136, 347 N.E.2d 586, 383 N.Y.S.2d 225 (1976) (see notes 122-30 *infra* and accompanying text).

22. Emergency Financial Act for the City of New York, ch. 868, § 2, [1975 extra. sess.] N.Y. Sess. Laws 1409 (McKinney).

23. Acts of March 15, 1976, chs. 38-39, [1976] N.Y. Sess. Laws 158 (McKinney). Creation of such a board was one of the major recommendations of the Moreland Commission Report, *supra* note 3, at 20-36. Similar recommendations were made by the state comptroller, 1975 N.Y. Comp. Ann. Rep., pt. 1, at 40-43.

24. 39 N.Y.2d 136, 347 N.E.2d 586, 383 N.Y.S.2d 225 (1976). See notes 122-30 *infra* and accompanying text.

25. *Id.* at 142, 347 N.E.2d at 588, 383 N.Y.S.2d at 227.

26. 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

recede in the memories of New York's legislators, they will once again become aware of their constituents' needs for low-cost housing, mass transportation, new hospitals and schools, pollution control and electric power facilities, and other projects of public benefit. The temptation to finance these projects through debt will be strong; and the procedure of a public referendum for approval of full faith and credit debts of the state will seem cumbersome and risky.²⁷ Conditions will be ripe for new issues of nonguaranteed bonds, and for the invention of new devices to circumvent constitutional debt limitations.

If this situation arises, how will the legislature react? Moreover, if the legislature renews the practice of financing public works with nonguaranteed debt devices, and if this practice is challenged in court, how might the court of appeals respond? Finally, if the court invalidates such debt financing devices, what practical effect might such a decision have on public financing in New York? These are the key questions that this Comment proposes to explore.

First, the development of general obligation and nonguaranteed debt financing in New York will be reviewed, including the events that led to enactment of constitutional limitations, subsequent legislative evasions of the provisions, and judicial interpretations of the legislative actions.²⁸ The next section will examine the interplay between courts and legislatures in several minority jurisdictions, where strict judicial construction of constitutional limitations has repeatedly been overridden by legislative action.²⁹ Finally, an attempt will be made to indicate, on the basis of this investigation, whether existing constitutional debt provisions are likely to be maintained successfully by judicial enforcement in the face of legislative attempts at avoidance.³⁰

II. NEW YORK'S EXPERIENCE

A. *Origins of Constitutional Debt Limitations—And Ways Around Them*

The New York Constitution appears to place severe restrictions on the power of the state and its local governmental units to incur financial liabilities. The state cannot give or loan its money or credit in aid of any private corporation or undertaking,³¹ nor extend its credit to a public corporation.³² Nor can the state contract a debt without approval by a majority of the legislature and by a majority of voters at a general election.³³ Money raised by such a procedure can be used only for the purposes specified by the legislature, and must be repaid within 40 years.³⁴ A sinking fund must be maintained with yearly appropriations adequate to pay interest and principal on state debts and the monies must be

27. In the November 1976 general election, for example, it was estimated that voters nationwide approved only \$1.5 billion of a proposed \$3 billion of new bond issues. *N. Y. Times*, Nov. 4, 1976, at 63, col. 5.

28. See section II *infra*.

29. See section III *infra*.

30. See section IV *infra*.

31. *N. Y. Const.* art. VII, § 8.

32. *Id.*

33. *Id.* § 11.

34. *Id.* § 12.

segregated from all other funds.³⁵ The state may, however, without a referendum, contract debts in anticipation of taxes, revenues and bond sales,³⁶ as well as to meet certain grave dangers to public safety.³⁷

Local governmental units face similar restrictions. "No county, city, town, village or school district shall give or loan any money or property [or credit] to or in aid of any individual, or private corporation or association . . ." subject to certain enumerated exceptions.³⁸ All debts contracted by such political subdivisions must be for a municipal purpose, repayable within 40 years, and guaranteed by a pledge of the subdivision's faith and credit.³⁹ Subdivisions cannot contract debt in excess of a specified percentage of the value of taxable real estate within their boundaries.⁴⁰

Forty-four states have enacted constitutional limitations on borrowing power similar to some or all of New York's provisions;⁴¹ two require greater-than-majority votes of the legislature, and all others require either a referendum or a constitutional amendment before the state can contract most forms of indebtedness.⁴² Most of these debt limitations were developed in the middle to late 19th century, when many states found themselves overburdened with debts they had incurred to help finance canal and railroad construction. The panic of 1837 resulted in several defaults by states on canal bonds.⁴³ Although not among the defaulting states, New York at that time was pushed to "the very brink of default on its bonds."⁴⁴ During the latter half of the 19th century, several states and municipalities also defaulted on bonds issued for railroad construction.⁴⁵

Rhode Island in 1842 and New Jersey in 1844 were the first states to try to erect

35. *Id.* §§ 15-16.

36. *Id.* § 9.

37. The enumerated crises are: "to repel invasion, suppress insurrection, or defend the state in war, or to suppress forest fires . . ." *Id.* § 10.

38. *Id.* art. VIII, § 1.

39. *Id.* § 2.

40. *Id.* § 4. Percentages range from 5% for school districts and 7% for villages to 10% for New York City and Nassau County. *Id.*

Additionally, both the state and its subdivisions are prohibited from becoming liable for the obligations of public corporations. Upon legislative authorization, however, they may take over the corporations' properties and pay their debts. *Id.* art. X, § 5.

41. Wagner, *Optimality in Local Debt Limitation*, 23 *Nat'l Tax J.* 297, 297 (1970).

42. Morris, *Evading Debt Limitations with Public Building Authorities: The Costly Subversion of State Constitutions*, 68 *Yale L.J.* 234, 240-41 & n.15 (1958). See also A.J. Heins, *Constitutional Restrictions Against State Debt* 29 (1963) [hereinafter cited as Heins].

43. Mississippi, Florida, Arkansas and Indiana defaulted in 1841. Illinois, Michigan, Maryland, Pennsylvania and Louisiana defaulted in 1842. Heins, *supra* note 42, at 7.

44. Moreland Commission Report, *supra* note 3, at 57. See also *Newell v. People*, 7 *N.Y.* 9, 85 (1852).

45. Typically, a state or municipality would exchange its bonds for stock in a railroad company. The railroad would sell the government bonds to finance its construction projects. The company would later become bankrupt, leaving the state or municipality with bonded indebtedness and practically worthless railroad stock. See Willatt, *Constitutional Restrictions on Use of Public Money and Public Credit*, 38 *Texas B.J.* 413, 414-16 (1975).

constitutional barriers against the unchecked growth of state debt.⁴⁶ New York enacted its first such debt provisions in 1846 and gradually added to them at later constitutional conventions.⁴⁷ Similar provisions were adopted in most states by 1890.⁴⁸

Despite such restrictions, New York and many other states developed ways to borrow money without referendum or constitutional amendment to finance a variety of projects considered of social benefit.⁴⁹ These devices are variously called revenue bonds, improvement bonds, and special fund, or limited obligation bonds. Interest payments on all these obligations are exempt from federal⁵⁰ and state⁵¹ taxes. As opposed to the general obligation bond, on which bondholders have recourse to the issuing government's general revenues and full taxing powers,⁵² all these devices are nonguaranteed: the issuing state or municipality expressly disclaims any legal liability.⁵³ Revenue bonds are, typically, payable only from the revenues of the particular project they were issued to finance.⁵⁴ Improvement bonds are issued by special districts (such as water or sewer districts), and are payable from assessments on property benefited by improvements in that district.⁵⁵ Special fund, or limited obligation bonds are payable from a special fund for debt service which the issuer agrees to maintain. Sometimes, a specific tax is pledged to that fund, although the state or municipality usually states that no liability is to attach to the government's general revenues.⁵⁶ In certain instances, the state or municipality may contribute to repayment of any of these bonds by leasing the facility that was built with the bond proceeds.⁵⁷ All such arrangements have been held by a majority of

46. Heins, *supra* note 42, at 8.

47. See Quirk & Wein, *A Short Constitutional History of Entities Commonly Known as Authorities*, 56 Cornell L. Rev. 521, 526-52 (1971) [hereinafter cited as Quirk & Wein]. The process of amendment continued in New York through the 1938 constitutional convention, when article X, section 5, was added as an express disavowal of the debts of public authorities. *Id.* at 561-79.

48. See Heins, *supra* note 42, at 93-120.

49. See, e.g., Foley, *Some Recent Developments in the Law Relating to Municipal Financing of Public Works*, 4 Fordham L. Rev. 13, 26-27 & nn.68-70 (1935); Stober & Falk, *Industrial Development Bonds as a Subsidy to Industry*, 22 Nat'l Tax J. 232, 232 (1969).

50. Int. Rev. Code of 1954, § 103.

51. Interest on these bonds may be taxable unless specifically exempted by statute. 16 E. McQuillin, *Municipal Corporations* § 44.49 (3d ed. 1972). However, such exemptions are routinely included in enabling legislation. See, e.g., N.Y. Priv. Hous. Fin. Law § 54 (McKinney 1976); N.Y. Pub. Auth. Law § 1296(8) (McKinney Supp. 1976).

52. See 64 Am. Jur. 2d *Public Securities and Obligations* §§ 13, 417 (1972).

53. E.g., N.Y. Priv. Hous. Fin. Law § 46(8) (McKinney 1976).

54. See McQuillin, *supra* note 1, at §§ 43.34, 43.131; Virtue, *The Public Use of Private Capital: A Discussion of Problems Related to Municipal Bond Financing*, 35 Va. L. Rev. 285, 292-93 (1949).

55. See McQuillin, *supra* note 1, at §§ 43.45, 43.135; 64 Am. Jur. 2d *Public Securities and Obligations* §§ 13, 418 (1972).

56. See McQuillin, *supra* note 1, at § 43.132; 64 Am. Jur. 2d *Public Securities and Obligations* §§ 13, 416-17 (1972); Virtue, *The Public Use of Private Capital: A Discussion of Problems Related to Municipal Bond Financing*, 35 Va. L. Rev. 285, 291-92 (1949).

57. See Bowmar, *The Anachronism Called Debt Limitation*, 52 Iowa L. Rev. 863, 880-84 (1967);

jurisdictions not to create debts or liabilities within the meaning of constitutional prohibitions.⁵⁸

However, there is often said to be a moral obligation on the part of the state or municipality to repay the bonds from general revenues if the pledged refunding source proves insufficient.⁵⁹ This implicit moral obligation, noted as early as 1852,⁶⁰ was made explicit in the so-called "moral obligation bond" developed in 1960. These bonds are issued by a public corporation created by the state; they contain, in addition to an express disclaimer of liability by the state, a "makeup" clause, which provides that the state shall make up any deficits in the reserve fund maintained by the issuing agency for debt service. This clause has usually been held to create a moral, but not a legal, obligation on future legislatures to appropriate money needed by the agency.⁶¹ For purposes of this Comment, all forms of nonguaranteed debt described above will be termed revenue bonds, except those containing a "makeup" clause, which will be called moral obligation bonds.

The obvious advantages of these nonguaranteed financing devices are speed and flexibility. Cumbersome and risky referendums are unnecessary, and a public authority can move rapidly to take advantage of new federal grants and other opportunities.⁶² Constitutional debt ceilings also can be ignored.⁶³ Additionally, when tax-exempt bonds are used to finance industrial development and water pollution control projects, they offer financing to private industry at lower interest rates than could be obtained elsewhere.⁶⁴

Among their disadvantages are the slightly higher interest rates needed to attract the investing public.⁶⁵ Another difficulty is the lack of government control over the amount of debt incurred by authorities and over the uses to which the money is put.⁶⁶ Despite these disadvantages, nonguaranteed bonds have become an increasingly popular method of public financing.⁶⁷

Magnusson, *Lease-Financing by Municipal Corporations as a Way Around Debt Limitations*, 25 *Geo. Wash. L. Rev.* 377 (1957).

58. *Morris, Evading Debt Limitations with Public Building Authorities: The Costly Subversion of State Constitutions*, 68 *Yale L.J.* 234, 240-43 (1958).

59. See B.U. Ratchford, *American State Debts 517-23* (1941) [hereinafter cited as Ratchford].

60. "No one acquainted with the history of the legislation of this state can doubt that money borrowed under the act of 1851, if applied to the completion of the canals, would be repaid on the ground of this moral obligation . . ." *Newell v. People*, 7 *N.Y.* 9, 93 (1852). See also *id.* at 102-03 (Johnson, J., concurring); *id.* at 114-15 (Edmonds, J., concurring).

61. See notes 109-11 *infra* and accompanying text.

62. Ratchford, *supra* note 59, at 512.

63. *Id.* at 516.

64. Willatt, *Constitutional Restrictions on Use of Public Money and Public Credit*, 38 *Texas B.J.* 413, 413-14 (1975). See also Ritter, *Federal Income Tax Treatment of Municipal Obligations: Industrial Development Bonds*, 25 *Tax Law.* 511, 514 (1972).

65. Heins, *supra* note 42, at 36-68. See also Hollman & Primeaux, *An Examination of Debt Ceilings as Barriers to Efficient Debt Management*, 25 *Ala. L. Rev.* 417 (1973).

66. Moreland Commission Report, *supra* note 3, at 4; Ratchford, *supra* note 59, at 515.

67. See table showing growth of nonguaranteed debt as a proportion of total state and local debts in J. Maxwell, *Financing State and Local Governments* 261 (rev. ed. 1969).

B. *The Development of Revenue Bond and Moral Obligation Bond Financing*

i. REVENUE BONDS

One of the first attempts by a state to evade a constitutional debt limitation was made in 1851, when the New York legislature authorized \$9 million of "canal revenue certificates" to finance the enlargement of the Erie Canal, and the construction of the Genesee Valley and Black River canals.⁶⁸ The certificates were payable out of a special fund maintained by surplus revenues from canal operations,⁶⁹ and the state disclaimed any liability on them.⁷⁰

In *Newell v. People*,⁷¹ the court of appeals held the law a violation of an 1846 constitutional provision that authorized further canal construction to be financed only from the prior fiscal year's surplus canal revenues.⁷² This provision had been added by the Constitutional Convention of 1846 as an expression of fiscal caution: debt reduction was given priority over canal construction.⁷³

The court warned that the state's disclaimer of liability would be practically, if not legally, ineffective in event of default, since the state would in all probability honor its moral obligation to holders of the certificates.⁷⁴ Significantly, however, the majority opinion invalidated the act only due to the specific constitutional provision relating to canal construction.⁷⁵ The court did not decide whether the arrangement created a prohibited state debt.

Many years later, in *People v. Westchester County National Bank*,⁷⁶ the court of appeals again noted the policy rationale for the constitutional prohibitions:

[G]reat expenditures may be lightly authorized if payment is postponed. To place the

68. Act of July 10, 1851, ch. 485, [1851] N.Y. Laws 911.

69. *Id.* §§ 3-4.

70. *Id.* § 14.

71. 7 N.Y. 9 (1852).

72. N.Y. Const. art. VII, § 3 (1846) (omitted from N.Y. Const. (1938)).

73. See 7 N.Y. at 85-86.

74. *Id.* at 93. See also *id.* at 102-03 (Johnson, J., concurring); *id.* at 114-15 (Edmonds, J., concurring).

75. *Id.* at 93. Colorado was the first jurisdiction to hold that such bonds, payable only from canal revenues, did not create a constitutionally prohibited debt of the state. In *re Canal Certificates*, 19 Colo. 63, 34 P. 274 (1893). Perhaps the furthest early extension of this reasoning was *State ex rel. Richards v. Moorner*, 152 S.C. 455, 150 S.E. 269 (1929), appeal dismissed sub nom. *Johnson v. State Highway Comm'n*, 281 U.S. 691 (1930), in which a highway bond issue, payable in the first instance from a gasoline tax and guaranteed secondarily by a pledge of the state's faith and credit was held not to create a state debt. See *Ratchford*, *supra* note 59, at 448-54.

76. 231 N.Y. 465, 132 N.E. 241 (1921). The case involved a proposed \$45 million bond issue to pay bonuses to World War I veterans who were residents of New York. The court held that the bonus was a constitutionally prohibited gift to private individuals, rather than the performance of a moral obligation, on the grounds that the veterans were servants of the federal government, not of the state, and that their war victory was only of incidental benefit to the state. *Id.* at 479-81, 132 N.E. at 246-47.

burden upon our children is easy Conscious of this human weakness, to guard against public bankruptcy the people thought it wise to limit the legislative power.⁷⁷

Soon thereafter, the court held in *Williamsburgh Savings Bank v. State*⁷⁸ that the state did, in fact, have both a moral obligation to repay water commission bonds on which it had disclaimed any legal liability, and the power to honor this obligation. The court found that the state's involvement in the financing arrangement had induced sufficient reliance on the part of the bondholders to create a moral obligation of the state.⁷⁹ However, the court noted that the legislature had great discretion in deciding whether to honor its moral obligation.⁸⁰

These early decisions appear to have had little effect in deterring New York from using nonguaranteed bonds with increasing frequency. Issuance of such bonds was spurred by the development of public authorities as mechanisms for public works finance.⁸¹ The Port of New York Authority, formed in 1921, is considered the first modern public authority.⁸² It was created initially to solve jurisdictional problems of a port operating in two states (New York and New Jersey), but the advantages of such a corporate entity for nonguaranteed public works finance soon became manifest.⁸³

77. *Id.* at 474-75, 132 N.E. at 244.

78. 243 N.Y. 231, 153 N.E. 58 (1926). The act creating the commission, with power to issue bonds and to take private lands for its use, had been held constitutional in *State Water Supply Comm'n v. Curtis*, 192 N.Y. 319, 85 N.E. 148 (1908). Although the *Curtis* decision dealt primarily with the commission's power to initiate condemnation proceedings, it noted that the act "nowhere assumes to pledge the credit of the state or any political subdivision thereof." *Id.* at 328, 85 N.E. at 151.

79. 243 N.Y. at 245-47, 153 N.E. at 63. The state's involvement was said to consist of initiation and approval of the plan, and representation by a state agency of the future value of lands to be improved. *Id.*

80. *Id.* at 244-45, 153 N.E. at 62-63. For other examples of the court's reluctance to upset a legislative decision to honor a moral obligation, see *Lehigh Valley R.R. v. Canal Bd.*, 204 N.Y. 471, 97 N.E. 964 (1912); *Town of Guilford v. Board of Supervisors*, 13 N.Y. 143 (1855). *Contra*, *People v. Westchester County Nat'l Bank*, 231 N.Y. 465, 132 N.E. 241 (1921) (see note 76 *supra*).

81. A public authority is a corporation, authorized for a public purpose by the state legislature, generally with power to take private land and to issue bonds to finance its projects. E.g., N.Y. Pub. Auth. Law §§ 1450-69 (McKinney 1970). See Bowmar, *The Anachronism Called Debt Limitation*, 52 Iowa L. Rev. 863, 884-85 (1967).

82. Council of State Governments, *State Public Authorities* 6 (1970); Morris, *Evading Debt Limitations with Public Building Authorities: The Costly Subversion of State Constitutions*, 68 Yale L.J. 234, 235 (1958). However, the first decision to uphold the bond issue of an organization similar to an authority is said to be *Kennebec Water Dist. v. City of Waterville*, 96 Me. 234, 52 A. 774 (1902).

83. Council of State Governments, *State Public Authorities* 6-9 (1970); Edelstein, *The Authority Plan—Tool of Modern Government*, 28 Cornell L.Q. 177, 178 & n.6 (1943). During the depression of the 1930's, the federal Public Works Administration (PWA) helped states draft legislation to help stimulate construction projects. The bonds issued by the authorities were purchased with federal funds by the PWA and the Reconstruction Finance Corporation. See Council of State Governments, *supra* at 9; J. Maxwell, *Financing State and Local Governments* 199 (rev. ed. 1969). The number of states that authorized local governments to issue nonguaranteed bonds rose from 15 in 1931 to 40 in 1936. J. Maxwell, *supra* at 199. New York itself had 33 authorities by 1938, including ten in the New York City metropolitan area. Edelstein, *supra* at 177.

In 1935, *Robertson v. Zimmermann*⁸⁴ confirmed that public authorities could issue nonguaranteed bonds which did not fall within constitutional debt restrictions. The court of appeals held that bonds issued by the Buffalo Sewer Authority were debts of neither the city nor the state, and thus did not inflate the city's debt beyond the prescribed percentage of assessed valuation of real estate.⁸⁵ Because the Buffalo Sewer Authority, like all other early public authorities, was expected to be "self-liquidating"—that is, to repay its bonded debts from surplus revenues without the aid of outside funds—the legislative disclaimer of state or municipal liability for the bonds was held sufficient to make constitutional debt limitations irrelevant.⁸⁶ Moreover, the court noted that the authority was necessary to the public health and welfare.⁸⁷

In the last 25 years, however, the mechanism of public authority debt has been used increasingly to finance projects that are not self-liquidating. While disclaiming any legal liability, and making no commitment of its general funds, the state or municipality agrees to help repay the debt from a specific revenue source if the project's funds are insufficient. This pledge is usually considered legally binding to the extent of that particular revenue source.⁸⁸ *Comereski v. City of Elmira*⁸⁹ upheld such an arrangement, whereby the Elmira Parking Authority was created to build and operate parking lots,⁹⁰ and the city of Elmira contracted to cover any deficits with up to \$25,000 of revenues from its on-street parking meters.⁹¹ The arrangement was held not to create a debt of the state or municipality,⁹² but rather was found a constitutionally permissible gift of money to a public corporation.⁹³ The court noted that such financing arrangements had become common and essential to the needs of modern municipalities.⁹⁴ Thus, the

84. 268 N.Y. 52, 196 N.E. 740 (1935).

85. *Id.* at 62-63, 196 N.E. at 743-44.

86. *Id.* at 63, 196 N.E. at 744. See also Edelstein, *The Authority Plan—Tool of Modern Government*, 28 Cornell L.Q. 177, 178 (1943).

87. 268 N.Y. at 65, 196 N.E. at 745.

88. See note 56 *supra* and accompanying text.

89. 308 N.Y. 248, 125 N.E.2d 241 (1955).

90. N.Y. Pub. Auth. Law §§ 1450-69 (McKinney 1970).

91. 308 N.Y. at 250-51, 125 N.E.2d at 241-42. The reasons for this unusual arrangement were not explained in the record. *Id.* at 251, 125 N.E.2d at 242.

92. 308 N.Y. at 253-54, 125 N.E.2d at 243-44. A strong dissent found the arrangement created both a debt of the city and an extension of credit. *Id.* at 255, 125 N.E.2d at 244 (Fuld, J., dissenting).

State courts are divided on the question of whether bonds secured by a specified government revenue source, such as a gasoline tax, but not by the government's full taxing power, constitute debts or obligations within the meaning of constitutional debt limitations. See recent discussions in *Secretary of Transp. v. Mancuso*, 278 Md. 81, 359 A.2d 79 (1976); *State ex rel. Ward v. Anderson*, 158 Mont. 279, 491 P.2d 868 (1971). See also Annot., 100 A.L.R. 900 (1936).

93. *Id.* at 252, 125 N.E.2d at 242, citing *Union Free School Dist. v. Town of Rye*, 280 N.Y. 469, 474, 21 N.E.2d 681, 683 (1939), which distinguished gifts or loans of money or property to a public corporation (permissible), from gifts or loans of credit to a public corporation (prohibited). Any gift or loan of money or credit to a private corporation or individual is also prohibited.

94. "We should not strain ourselves to find illegality in such programs. The problems of a modern city can never be solved unless arrangements like these . . . are upheld, unless they are patently illegal." 308 N.Y. at 254, 125 N.E.2d at 244 (citation omitted).

public necessity justification was extended from sewage treatment to parking lots; and judicial approval of a nonguaranteed financing device was extended from a self-sufficient authority to a partially subsidized one.

The reasoning of *Comereski* was ultimately extended to validate an authority with no revenue sources of its own.⁹⁵ In May, 1974, early in the city's financial crisis, the state legislature had created a New York City Stabilization Reserve Corporation (SRC),⁹⁶ which was authorized to sell bonds for the benefit of the city. Although neither the state nor the city was liable for the debt,⁹⁷ the act provided that the city would appropriate money annually to service the SRC debt.⁹⁸ If the city failed to appropriate sufficient funds, the state comptroller would make up the deficit from the "first monies available . . . to the city from the stock transfer tax fund"⁹⁹ and secondarily from other state aid due to the city.¹⁰⁰

In *Wein v. City of New York*,¹⁰¹ a 4-3 decision, the court of appeals relied on *Comereski* to find this arrangement constitutional. Appropriations by the city and state were held permissible gifts to a public corporation, rather than legal obligations of either government.¹⁰²

The SRC, however, unlike the Elmira Parking Authority, operated no parking lots. In fact, as the court noted, "the SRC has no visible means of financial support except for what it can derive from the city, State or Federal governments."¹⁰³ While the majority brushed aside this distinction,¹⁰⁴ the minority distinguished *Comereski* precisely on this ground: "[T]he parking authority . . . had an ostensible purpose. It was not a mere financing device and conduit for evasion of article VIII."¹⁰⁵ The dissent took notice of New York's dire need for funds during its financial crisis, but observed that "judicial condonation of constitutional evasion only prolongs the agony of the cities by postponing . . . a sensible reappraisal . . . of constitutional limits upon local finance."¹⁰⁶

95. *Wein v. City of New York*, 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975).

96. N.Y. Pub. Auth. Law §§ 2530-50 (McKinney Supp. 1975). Included was a legislative finding that "the city of New York is faced with a grave and unprecedented fiscal crisis which threatens the city's ability to provide essential services and thereby endangers the welfare of all the inhabitants . . ." *Id.* § 2533.

97. *Id.* § 2542.

98. *Id.* § 2537(c).

99. *Id.* § 2540(b).

100. *Id.* § 2540(c).

101. 36 N.Y.2d at 618-19, 331 N.E.2d at 518-19, 370 N.Y.S.2d at 556-57. The court found no violation of constitutional limits on amounts of permissible indebtedness that could be incurred; nor did it find a contracting of debt by a municipality without a pledge of its faith and credit; nor a gift or loan of money or credit to a private corporation; nor a gift or loan of credit to a public corporation. *Id.*

102. 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975).

103. *Id.* at 617, 331 N.E.2d at 517, 370 N.Y.S.2d at 555.

104. *Id.*

105. *Id.* at 623, 331 N.E.2d at 522, 370 N.Y.S.2d at 561 (Jasen, J., dissenting).

106. *Id.* at 622, 331 N.E.2d at 521, 370 N.Y.S.2d at 559 (Jasen, J., dissenting).

ii. MORAL OBLIGATION BONDS

By the time the dissent in *Wein v. City of New York* issued this call for a reappraisal of constitutional debt limits,¹⁰⁷ the field of nonguaranteed public finance had undergone 12 years of uninterrupted and unprecedented growth.¹⁰⁸ Much of this growth can be attributed to moral obligation bonds.¹⁰⁹ As noted above,¹¹⁰ their distinguishing feature is a "makeup" clause, which provides that any deficit in the reserve fund set up by the public corporation to repay its debt will be covered by state appropriations.¹¹¹ Thus, the moral obligation implicit in revenue bonds was converted to an express, although not a legally binding, promise. New York's courts have not yet squarely addressed the meaning of the makeup clause.¹¹² However, several jurisdictions have held that it imposes merely a moral obligation on future legislatures, and does not create a legal debt or obligation within the meaning of constitutional prohibitions.¹¹³

The moral obligation bond was first used in the New York State Housing Finance Agency Act of 1960,¹¹⁴ after the state had experienced difficulty in securing voter approval of guaranteed bond issues to finance low-income ("Mitchell-Lama") housing.¹¹⁵ In retrospect, it appears that the moral obligation

107. *Id.*

108. See 1975 N.Y. Comp. Ann. Rep., pt. 1, at 22-24.

109. Invention of this device is generally credited to John Mitchell, later attorney general of the United States. Moreland Commission Report, *supra* note 3, at 109-10; Reilly & Schulman, *The State Urban Development Corporation: New York's Innovation*, 1 *Urban Law* 129, 135 (1969).

110. See text accompanying note 61 *supra*.

111. E.g., N.Y. Priv. Hous. Fin. Law § 47(1)(d) (McKinney 1976): "The chairman of the agency shall annually . . . make and deliver to the governor . . . his certificate stating the amount, if any, required to restore the capital reserve fund to the amount [necessary to service the next year's debt payments] and the amount so stated, if any, shall be apportioned and paid to the agency during the then current state fiscal year." See Griffith, "Moral Obligation" Bonds: Illusion or Security? 8 *Urban Law* 54, 57-62 (1976).

112. However, the makeup clause was discussed in *Wein v. City of New York*, 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975); *Matter of Smith v. Levitt*, 37 App. Div. 2d 418, 326 N.Y.S.2d 335 (3d Dep't 1971), *aff'd mem.*, 30 N.Y.2d 934, 287 N.E.2d 380, 335 N.Y.S.2d 687 (1972). See notes 180-83 *infra* and accompanying text.

113. *Maine State Housing Auth. v. Depositors Trust Co.*, 278 A.2d 699 (Me. 1971); *Massachusetts Housing Fin. Agency v. New England Merchants Nat'l Bank*, 356 Mass. 202, 249 N.E.2d 599 (1969); *In re Advisory Opinion on P.A. No. 346 of 1966*, 380 Mich. 554, 158 N.W.2d 416 (1969); *Martin v. North Carolina Housing Corp.*, 277 N.C. 29, 175 S.E.2d 665 (1970); *Johnson v. Pennsylvania Housing Fin. Agency*, 453 Pa. 329, 309 A.2d 528 (1973); *In re Advisory Opinion to the Governor*, 113 R.I. 586, 324 A.2d 641 (1974); *State ex rel. West Virginia Housing Dev. Fund v. Waterhouse*, 212 S.E.2d 724 (W.Va. 1974); *State ex rel. Warren v. Nusbaum*, 59 Wis. 2d 391, 208 N.W.2d 780 (1973).

But see *Quirk & Wein*, *supra* note 47, at 591 ("It requires a peculiar mind to draw a distinction between a direct guarantee of the bonds and a guarantee of a fund out of which the bonds will be paid.")

114. Act of April 18, 1960, ch. 671, [1960] N.Y. Laws 1945, codified as N.Y. Priv. Hous. Fin. Law §§ 40-61 (McKinney 1976).

115. *Quirk & Wein*, *supra* note 47, at 585-87.

clause was the subject of a misunderstanding between the New York State government, on the one hand, and the investment community on the other. The legislature and the governor believed that all projects funded by the bonds would be self-supporting, and that no appropriations by the state would ever be necessary.¹¹⁶ The investment community believed the state had committed itself as a guarantor of the bonds; therefore, investors purchased them without regard to the financial feasibility of individual building projects.¹¹⁷

Moreover, no court test of the validity of the legislation was forthcoming. Perhaps earlier decisions such as *Comereski*¹¹⁸ discouraged such a challenge. Another inhibiting factor was that taxpayer standing to sue the state on constitutional issues was severely restricted until 1975.¹¹⁹

Recently, however, the legislation's practical effect—if not its precise legal effect—has been made clear: in event of default by the issuing agency, the state will repay the debt in order to protect its own credit rating.¹²⁰

C. "The Brink of Valid Practice"

Against the background of controversy over the nature of moral obligation bonds and public awareness of the huge debt burden facing the state, the court of appeals recently rendered two decisions in which it attempted to restrict certain financing arrangements. In *Flushing National Bank v. Municipal Assistance Corp.*,¹²¹ the court struck down one attempt to circumvent the faith and credit requirement. In *Wein v. State*,¹²² it indicated its willingness to invalidate other financing devices which contravene constitutional debt limitations.

Wein v. State was an action by a taxpayer¹²³ challenging the constitutionality of state appropriations of \$250 million to New York City and \$500 million to

116. Moreland Commission Report, *supra* note 3, at 4-5. "The perception of the bankers and investors proved as a practical matter to be more valid than that held in Albany. For now if the State is to preserve its credit, it must recognize the outstanding moral obligation bonds as in fact State debt and stand behind these bonds." *Id.* at 5.

117. *Id.*

118. See notes 89-94 *supra* and accompanying text.

119. Taxpayers were granted standing in situations where denial of standing would prevent judicial consideration of a law. *Boryszewski v. Brydges*, 37 N.Y.2d 361, 334 N.E.2d 579, 372 N.Y.S.2d 623 (1975), overruling *St. Clair v. Yonkers Raceway, Inc.*, 13 N.Y.2d 72, 192 N.E.2d 15, 242 N.Y.S.2d 43 (1963), cert. denied, 375 U.S. 970 (1964). One month after this decision, the legislature enacted a provision allowing citizen taxpayers to maintain actions against state officials for illegal or unconstitutional use of state funds or property, but excepted challenges to bond and note issues. Act of Aug. 9, 1975, ch. 827, [1975] N.Y. Sess. Laws 1307 (McKinney), codified as N.Y. State Fin. Law §§ 123-123j (McKinney Supp. 1976). The question whether this law has any limiting effect on *Boryszewski* has not yet been addressed by the courts. For a discussion of earlier difficulties in challenging public finance legislation, see Quirk, *Standing to Sue in New York*, 47 St. John's L. Rev. 429, 433-38 (1973).

120. See note 116 *supra*. See also Griffith, "Moral Obligation" Bonds: Illusion or Security? 8 Urban Law. 54 (1976).

121. 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

122. 39 N.Y.2d 136, 347 N.E.2d 586, 383 N.Y.S.2d 225 (1976).

123. Taxpayer-plaintiff Leon E. Wein, a law professor at Brooklyn Law School, was also

MAC. Repayment was secured by one-year city and MAC notes, and by an assignment of all city mortgages. Secondary security was provided by state aid funds pledged to the city.¹²⁴ The appropriations were funded by the sale of short-term revenue-anticipation notes by the state.¹²⁵ The court found the appropriations were constitutionally permissible gifts or loans of money to a municipality and a public corporation, and not impermissible extensions of credit.¹²⁶ However, after a discussion of the history and purposes of constitutional debt limitations, the court stated that in order to prevent the imposition of a debt burden on future generations, the state notes would be valid only if issued "authentically in anticipation of actually committed taxes or other revenues."¹²⁷ Thus, there must be a balanced state budget out of which the notes would be retired. Any "rollover" of the notes would be constitutionally impermissible.¹²⁸ The court therefore found the device legal "so long as the fiscal prospects are tenable."¹²⁹

In a warning that presaged the *Flushing National Bank* decision, Chief Judge Breitel stated for the majority that

the ingenuity of man can devise at least a verbalistic escape from [constitutional] limitations But there must be a point, a determinable point, at which an otherwise plausible manipulation may and will be recognized and declared to be the doing indirectly of that which is forbidden to be done directly¹³⁰

In *Flushing National Bank*, Chief Judge Breitel, again writing the majority opinion, held that the state could not constitutionally allow a moratorium on repayment of a local government's faith and credit obligations.¹³¹ Because New

co-plaintiff in *Wein v. City of New York*, 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975) (see notes 95-106 supra and accompanying text), and co-author of *Quirk & Wein*, supra note 47. See Adams, *New York's Financial Gadfly*, Wall St. J., May 4, 1976, at 22, col. 4

124. Financial Emergency Act for the City of New York, ch. 868, §§ 22-23, [1975 extra. sess.] N.Y. Sess. Laws 1438 (McKinney), as amended, ch. 870, [1975 extra. sess.] N.Y. Sess. Laws 1457 (McKinney).

125. 39 N.Y.2d at 141, 347 N.E.2d at 587, 383 N.Y.S.2d at 227.

126. *Id.* at 140, 347 N.E.2d at 587, 383 N.Y.S.2d at 226. Although the state notes sold to fund the appropriation represented an extension of credit, the issuance and sale of these notes were separate transactions from the gift of the sale proceeds to the city. Moreover, such short-term borrowing in anticipation of revenues is permitted by article VII, section 9, of the state constitution. *Id.*

127. *Id.* at 147, 347 N.E.2d at 591, 383 N.Y.S.2d at 230, relying on *People v. Westchester County Nat'l Bank*, 231 N.Y. 465, 474-75, 132 N.E. 241, 244 (1921).

128. 39 N.Y.2d at 149-51, 347 N.E.2d at 593-94, 383 N.Y.S.2d at 232-33

129. *Id.* at 151, 347 N.E.2d at 594, 383 N.Y.S.2d at 233. According to *State Prospectus*, supra note 7, at 5, "[t]he implication of [*Wein v. State*] appears to be that if a court were to hold that there was a tenable basis for the certificates . . . , the Notes would be valid even if the ultimate result for the 1976-77 fiscal year is a deficit; if, on the other hand, a court were to hold that there was no tenable basis for such certificates, some or all of the 1976-77 Notes . . . would be held to be invalid. In such event, the result is not certain but some or all of the principal of, and interest on, some or all of the 1976-77 Notes . . . might be non-recoverable."

130. 39 N.Y.2d at 149, 347 N.E.2d at 593, 383 N.Y.S.2d at 232.

131. 40 N.Y.2d 731, 732-33, 358 N.E.2d 848, 850, 390 N.Y.S.2d 22, 24 (1976).

York's constitution requires that a municipality pledge its faith and credit for the repayment of debts,¹³² "the city is constitutionally obliged to pay and to use in good faith its revenue powers to produce funds to pay the principal of the notes when due."¹³³ The majority held that the state cannot evade this requirement through the mechanism of a moratorium.¹³⁴ Moreover, the fiscal emergency was held insufficient justification for the suspension of the faith and credit provision,¹³⁵ although the fiscal situation did constrain the court from granting immediate injunctive relief.¹³⁶

In summary, although early decisions by the New York courts showed a reluctance to approve revenue bond issues, they evinced a greater reluctance to upset legislative interpretations of constitutional provisions. Thus, the state gradually developed revenue bond financing devices, while the courts warned of their dangers. By 1935, the court was ready to accept a public authority—one that was self-supporting and performed a public purpose—as an essential part of society. The court later approved a succession of financing devices, each more sophisticated than the last, until 1976, when events created a renewed public and judicial awareness of the dangers of debt financing. *Wein v. State* and *Flushing National Bank*, while they deal with guaranteed bonds and notes, reflect this awareness. In these two decisions the New York Court of Appeals demonstrated its willingness to limit the use of new and more elaborate financing methods.

III. PROCESS OF JUDICIAL CONSTRUCTION AND LEGISLATIVE AMENDMENT IN MINORITY JURISDICTIONS

Despite the New York Court of Appeals' two recent rulings on the constitutionality of debt financing devices,¹³⁷ it remains uncertain whether courts can provide an effective mechanism for restricting such practices in the future. In examining this question, it is instructive to review the experience of those jurisdictions in which courts have invalidated as unconstitutional certain forms of guaranteed and, especially, nonguaranteed debt financing.

Although the majority of jurisdictions have repeatedly approved such practices, the courts of several states have attempted to limit their use through narrow interpretations of constitutional debt limitations. Such decisions have been based chiefly on two grounds: (1) that the proposed arrangement creates a debt, liability or extension of credit, within the meaning of constitutional

132. N.Y. Const. art. VIII, § 2.

133. 40 N.Y.2d at 736, 358 N.E.2d at 852, 390 N.Y.S.2d at 26.

134. Id. at 732-33, 358 N.E.2d at 850, 390 N.Y.S.2d at 24. The court declined to reach the question of whether the moratorium violated the impairment of contracts clause of the U.S. Constitution, art. I, § 10. Id. at 740, 358 N.E.2d at 854, 390 N.Y.S.2d at 28. The impairment clause was held not to bar a mortgage moratorium enacted by Minnesota during the depression of the 1930's. *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934). See discussion of this clause in *Flushing Nat'l Bank*, 40 N.Y.2d at 749-57, 358 N.E.2d at 860-65, 390 N.Y.S.2d at 34-40 (Cooke, J., dissenting).

135. 40 N.Y.2d at 740-41, 358 N.E.2d at 855, 390 N.Y.S.2d at 29.

136. Id. at 741, 358 N.E.2d at 855, 390 N.Y.S.2d at 29.

137. See section II(C) *supra*.

proscriptions; or (2) that the arrangement primarily aids a private individual or enterprise, rather than the public.

Significantly, however, these decisions have been negated in most instances by a pattern of legislative redrafting or constitutional amendment which has eventually resulted in issuance of the bonds for the desired projects. Thus, the courts have succeeded only in slowing the implementation of financing devices, or in altering their character slightly—not in preventing their ultimate use.

A. *Minority Interpretations of Debts, Liabilities and Credit*

i. REVENUE BONDS

The great majority of jurisdictions have held that revenue bonds, payable solely from the revenues of a specified project or agency, and for which the state or municipality disclaims any legal obligation, do not create state or municipal debts, liabilities or loans of credit, within the meaning of constitutional prohibitions.¹³⁸ A minority of states have held to the contrary.

In *State ex rel. Saxbe v. Brand*,¹³⁹ the Ohio Supreme Court held that revenue bonds constituted gifts or loans of credit by the state to private borrowers.¹⁴⁰ Although the revenue bonds did not create a state "debt," the court reasoned that the money raised through their sale was state money. Thus, loans of the funds constituted loans of the state's money and credit.¹⁴¹

One year later, the state adopted a constitutional amendment permitting the use of revenue bonds to provide guaranteed loans to private borrowers for industrial development and pollution control.¹⁴² The court then upheld the validity of the amendment and of a statute passed under it.¹⁴³

The Nebraska Supreme Court, in *State ex rel. Beck v. City of York*,¹⁴⁴ considered a law¹⁴⁵ under which a municipality proposed to issue revenue bonds to finance the purchase of a slaughterhouse which would be leased back to a private company for a rental sufficient to service the debt. This arrangement was held invalid as a prohibited extension of credit to a private

138. See cases cited in McQuillin, *supra* note 1, § 43.34; Annot., 146 A.L.R. 328 (1943); 50 Wash. L. Rev. 440, 448 n.29 (1975).

139. 176 Ohio St. 44, 197 N.E.2d 328 (1964).

140. *Id.* at 46-48, 197 N.E.2d at 330-31, relying on dictionary definitions of "credit." Ohio Const. art. VIII, § 4 provides: "The credit of the State shall not, in any manner, be given or loaned to, or in aid of, any individual association or corporation whatever"

141. 176 Ohio St. at 51-52, 197 N.E.2d at 333.

142. Ohio Const. art. VIII, § 13 (Supp. 1975).

143. *State ex rel. Burton v. Greater Portsmouth Growth Corp.*, 7 Ohio St. 2d 34, 218 N.E.2d 446 (1966). "This amendment has a single purpose, to allow the state and governmental subdivisions to give financial assistance to private industry . . . in order to create new employment within this state." *Id.* at 36-37, 218 N.E.2d at 449. See also *State ex rel. Eichenberger v. Neff*, 42 Ohio App. 2d 69, 77-79, 330 N.E.2d 454, 460 (1974) ("Acts passed pursuant to Article VIII, Section 13, are specifically not subject to the requirements and limitations of other sections of Article VIII . . .").

144. 164 Neb. 223, 82 N.W.2d 269 (1957).

145. Law of May 1, 1953, ch. 40, §§ 1-13, [1953] Neb. Laws 133 (repealed 1961).

corporation.¹⁴⁶ The court reasoned that although liability on the bonds was limited to revenues from the facility, the fact that the municipal bonds provided an advantage to the company over private financing arrangements meant that the city's credit was being extended.¹⁴⁷

Three years later, the voters approved a constitutional amendment which permitted municipalities "to acquire, own, develop, and lease real and personal property suitable for use by manufacturing or industrial enterprises and to issue revenue bonds for the purpose of defraying the cost . . ."¹⁴⁸ The legislature then passed an act authorizing municipal funding of an industrial development project in language closely following that of the amendment.¹⁴⁹ The court reluctantly upheld the law¹⁵⁰ as being, for the most part,¹⁵¹ within the scope of the amendment.

Idaho, formerly one of the most restrictive minority jurisdictions, has, through a process of constitutional amendment and judicial re-interpretation, changed its approach considerably since the often-cited case of *Feil v. City of Coeur d'Alene*.¹⁵² In *Feil*, the Idaho Supreme Court considered an agreement by the city of Coeur d'Alene to purchase a waterworks system from a private company in exchange for bonds that the company would then sell to investors. The city promised to service the debt out of a special fund maintained by revenues from its operation of the waterworks.¹⁵³ The court held that the revenue bonds created a "liability" of the city, in violation of the Idaho constitution,¹⁵⁴ through the city's pledge to operate the water system in such a

146. 164 Neb. at 226-27, 82 N.W.2d at 271-72. Neb. Const. art. XIII, § 3, provides that "[t]he credit of the state shall never be given or loaned in aid of any individual, association, or corporation . . ." The Beck court reasoned that a prohibition against the state would also apply to the state's political subdivisions. 164 Neb. at 225, 82 N.W.2d at 271. Thus, in many instances, distinctions between actions by a state and actions by a municipality are not relevant.

147. 164 Neb. at 226-27, 82 N.W.2d at 271-72. The court also found that the arrangement was for a private purpose, and only of incidental benefit to the community. *Id.* at 228-29, 82 N.W.2d at 272-73. See discussion of the public purpose doctrine in section III(B) *infra*.

148. Neb. Const. art. XIII, § 2.

149. Neb. Rev. Stat. §§ 18-1614 to -1623 (1974).

150. *State ex rel. Meyer v. County of Lancaster*, 173 Neb. 195, 113 N.W.2d 63 (1962). "While we may still feel the financing of private enterprises with public funds is foreign to the fundamental concept of our constitutional system, . . . the constitutional prohibition has been removed by amendment and it is now a part of our fundamental law." *Id.* at 206, 113 N.W.2d at 70.

However, in *Chase v. County of Douglas*, 195 Neb. 838, 850, 241 N.W.2d 334, 341 (1976), the court held that the 1960 amendment expressed the "full measure" of exceptions to the general constitutional debt prohibitions. It held that a law authorizing use of general municipal revenues (as opposed to proceeds from revenue bonds) to purchase property for industrial development was an invalid extension of credit to a private interest.

151. § 18-1621 was held unconstitutional in part on the ground that it did "not subject the project to taxation to the same extent as private property, as required by the amendment." 173 Neb. at 206, 113 N.W.2d at 70.

152. 23 Idaho 32, 129 P. 643 (1912).

153. *Id.* at 38, 129 P. at 645.

154. *Id.* at 58-59, 129 P. at 652. The Idaho Const. art. VIII, § 3, provides: "[n]o . . .

manner as to obtain sufficient funds for debt service.¹⁵⁵ A later decision, however, upheld the constitutionality of a municipal redevelopment authority that had power to issue revenue bonds and to condemn land.¹⁵⁶ The mechanism of a public authority was found sufficient to insulate the city from liability.¹⁵⁷ Additionally, the *Feil* court's interpretation of municipal liabilities has been narrowed by a series of constitutional amendments that permit municipalities to use revenue bonds for enumerated purposes.¹⁵⁸

In another line of decisions, the Idaho Supreme Court held in *State Water Conservation Board v. Enking*¹⁵⁹ that a state authority's revenue bonds created a prohibited liability of the state.¹⁶⁰ However, a 1964 constitutional amendment created a water resource agency with power to issue revenue bonds.¹⁶¹ Following the amendment, the court observed in *Idaho Water Resource Board v. Kramer*¹⁶² that "the precedential value of *Enking* has been totally eroded."¹⁶³ Moreover, the *Kramer* court expressly overruled what remained of *Enking's* interpretation of a liability,¹⁶⁴ holding that the water resource board's revenue bonds did not create "an obligation [the state] is bound in law or justice to perform."¹⁶⁵

A clear pattern emerges from the foregoing cases. Even in those jurisdictions where courts have strictly defined debt, liability or credit, legislatures have acted to protect their development plans by proposing constitutional amendments. Nonguaranteed bonds appear to have become such an essential part of modern public finance that states are unwilling to be deterred from using such devices by adverse court decisions. Since *Robertson v. Zimmermann*¹⁶⁶ upheld the device, the question whether revenue bonds create impermissible debts, liabilities or extensions of credit appears well settled in New York. However, the pattern described above has significance in relation to certain unanswered questions in the state, such as the legality of moral obligation bond legislation.¹⁶⁷

subdivision of the state, shall incur any indebtedness, or liability, in any manner, or for any purpose, . . . without the assent of two-thirds of the qualified electors"

155. 23 Idaho at 52-53, 129 P. at 650.

156. *Boise Redev. Agency v. Yick Kong Corp.*, 94 Idaho 876, 499 P.2d 575 (1972).

157. *Id.* at 884, 499 P.2d at 583.

158. See Idaho Const. art. VIII, § 3 (Supp. 1976).

159. 56 Idaho 722, 58 P.2d 779 (1936), overruled in part, *State Dep't of Parks v. Department of Water Admin.*, 96 Idaho 440, 530 P.2d 924 (1974), overruled, *Idaho Water Resource Bd. v. Kramer*, 97 Idaho 535, 548 P.2d 35 (1976).

160. "Though disclaiming state liability, it is clearly the intention of the act to place the credit of the state, morally and in some degree financially, back of this enterprise" 56 Idaho at 734, 58 P.2d at 783-84 (emphasis omitted).

161. Idaho Const. art. XV, § 7 (Supp. 1976).

162. 97 Idaho 535, 548 P.2d 35 (1976).

163. *Id.* at —, 548 P.2d at 58.

164. *Id.* at —, 548 P.2d at 55.

165. *Id.* at —, 548 P.2d at 56.

166. 268 N.Y. 52, 196 N.E. 740 (1935). There is dictum to the same effect in *State Water Supply Comm'n v. Curtis*, 192 N.Y. 319, 328, 85 N.E. 148, 151 (1908). See note 78 *supra*.

167. See section III(A)(ii) *infra*.

ii. MORAL OBLIGATION BONDS

It is unclear whether the "makeup" clause in moral obligation bonds imposes any greater obligation on the state, in event of default by the issuing agency, than the "moral obligation" imposed by any other nonguaranteed bond.¹⁶⁸ Most of the jurisdictions which have considered the question have held that the makeup clause creates neither a debt nor an obligation of the state, but is "intended only to express to succeeding legislatures an expectation and aspiration that the project might be found worthy of financial assistance, if later needed."¹⁶⁹

In *Gibson v. Smith*,¹⁷⁰ however, an intermediate Oregon court held that the language of the makeup clause in a housing finance act was an attempt to create, indirectly, a state debt, in violation of the state constitution.¹⁷¹ After the ruling, the legislature amended the act to change the clause's language from "[t]he amount so certified . . . shall be appropriated by the Legislative Assembly,"¹⁷² to "[t]he amount so certified . . . may be appropriated by the Legislative Assembly."¹⁷³ The Supreme Court of Oregon upheld the legislation, as amended.¹⁷⁴ It ruled that the clause did not create a legal obligation and that the constitution did not prohibit moral obligations.¹⁷⁵

In *Casey v. South Carolina State Housing Authority*,¹⁷⁶ a form of makeup clause that created a guaranty fund in a mortgage loan act was held by the Supreme Court of South Carolina to pledge the state's "credit to make good any deficit arising because of default"¹⁷⁷ The majority stated that although

168. See Griffith, "Moral Obligation" Bonds: Illusion or Security? 8 Urban Law. 54, 62-66 (1976). Indeed, it was the UDC's default on short-term notes that did not contain a makeup clause which resulted in the New York legislature's appropriation of \$90 million for the agency, and which triggered the crisis of disillusionment over moral obligation bonds. *Id.* at 66. See note 3 *supra* and accompanying text.

169. *State ex rel. Warren v. Nusbaum*, 59 Wis. 2d 391, 429, 208 N.W.2d 780, 803 (1973). See also cases cited in note 113 *supra*.

170. 531 P.2d 724 (Ore. Ct. App. 1975).

171. *Id.* at 727-28. Law of July 1, 1973, ch. 828, § 27(5), [1973] Ore. Laws 2460 provided: "if the amount of money on deposit in the capital reserve account in any year is less than the debt service reserves [needed], the administrator shall certify to the Governor the amount of such deficiency [T]he Governor shall include in his next budget request to the Legislative Assembly the amount certified The amount so certified . . . shall be appropriated by the Legislative Assembly"

Ore. Const. art. XI, § 7, provides that the legislature shall not lend the state's credit, nor create state debts or liabilities of more than \$50,000.

172. See note 171 *supra* (emphasis added).

173. Ore. Rev. Stat. § 456.720(5) (1975) (emphasis added).

174. *Walsh Constr. Co. v. Smith*, 272 Ore. 398, 537 P.2d 542 (1975) (en banc).

175. *Id.* at 404, 537 P.2d at 545. However, the court declined to indicate whether the result would have been the same had the statutory language not been changed. *Id.* at 404-05, 537 P.2d at 545.

176. 264 S.C. 303, 215 S.E.2d 184 (1975).

177. *Id.* at 313, 215 S.E.2d at 187. This clause differed from the typical clause in that it provided that the state treasurer had a "mandatory and obligatory and enforceable" duty to cover deficits by use of the guaranty fund; however, there was no legal obligation on the legislature to make appropriations into the fund. *Id.* at 311-13, 215 S.E.2d at 186-87.

future legislatures had no legal obligation to appropriate money into the guaranty fund, there would be a "compelling desire" to protect the state's credit by covering any deficit that might arise.¹⁷⁸ In this instance, the legislature neither amended the constitution to permit use of a makeup clause, nor redrafted the legislation to retain the substance of the clause in a more acceptable form. Instead, the act was amended to eliminate the Guaranty Fund entirely.¹⁷⁹

In New York, there is a paucity of rulings on the makeup clause. *Matter of Smith v. Levitt*¹⁸⁰ and *Wein v. City of New York*¹⁸¹ both held that the express disclaimer of liability in moral obligation legislation was sufficient to put the debt outside constitutional prohibitions. Although neither case devoted extended analysis to the network of the obligations created by the clause, *Wein v. City of New York* held that appropriations under the clause were permissible gifts.¹⁸² *Matter of Smith*, however, noted that UDC bonds "might be classified as contingent liabilities on the part of the State . . ." ¹⁸³ Neither case, however, represented a direct challenge to the state on the nature of moral obligation legislation. Since the two decisions, *Boryszewski v. Brydges*¹⁸⁴ has created a basis for taxpayer standing for such a challenge, and it is possible that one will soon be forthcoming.

B. *The Public Purpose Doctrine*

Municipal bonds issued to aid industrial development or to build water pollution control facilities for private industry are valid only if issued for a "public purpose." Use of a government's taxing power for a purely private purpose has long been held a violation of due process¹⁸⁵ and of state constitutional debt limitations.¹⁸⁶ However, the distinction between private and public purposes has never been clearly delineated.¹⁸⁷

A majority of jurisdictions have held that projects which aid the local economy, increase employment, redevelop blighted neighborhoods or reduce pollution are for valid public purposes, regardless of any incidental benefits that

178. *Id.* at 313, 215 S.E.2d at 188.

179. South Carolina State Housing Act of 1975, S.C. Code Ann. §§ 36-295.31 to .44 (Supp. 1975), held unconstitutional on other grounds, *Reith v. South Carolina State Housing Auth.*, — S.C. —, 225 S.E.2d 847 (1976).

180. 37 App. Div. 2d 418, 326 N.Y.S.2d 335 (3d Dep't 1971), *aff'd mem.*, 30 N.Y.2d 934, 287 N.E.2d 380, 335 N.Y.S.2d 687 (1972).

181. 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975).

182. *Id.* at 618-19, 331 N.E.2d at 518-19, 370 N.Y.S.2d at 556-57.

183. 37 App. Div. 2d at 421, 326 N.Y.S.2d at 338.

184. 37 N.Y.2d 361, 334 N.E.2d 579, 372 N.Y.S.2d 623 (1975). See note 119 *supra*.

185. *Jones v. City of Portland*, 245 U.S. 217 (1917).

186. *E.g.*, *Loan Ass'n v. Topeka*, 87 U.S. (20 Wall.) 655 (1874); *Sharpless v. Mayor of Phila.*, 21 Pa. (9 Harris) 147 (1853).

187. "A slide-rule definition to determine public purpose for all time cannot be formulated; the concept expands with the population, economy, scientific knowledge, and changing conditions." *Mitchell v. North Carolina Indus. Dev. Fin. Auth.*, 273 N.C. 137, 144, 159 S.E.2d 745, 750 (1968). See *McQuillin*, *supra* note 1, §§ 39.19 to 39.27a; Comment, *The "Public Purpose" of Municipal Financing for Industrial Development*, 70 *Yale L.J.* 789 (1961).

may accrue to private industry.¹⁸⁸ Some states, however, have invalidated use of the government's taxing power, or power of eminent domain, for similar projects, on the ground that they are of direct benefit to private interests and of only incidental benefit to the public.¹⁸⁹ The typical legislative response has been the proposal of constitutional amendments which allow use of bonds for specific purposes.¹⁹⁰ The courts appear to have construed such amendments as narrowly as possible, upholding only those financing devices expressly permitted, and adhering in all other situations to their prior interpretations of the intent of the constitutional debt prohibitions.¹⁹¹

The North Carolina Supreme Court, in *Mitchell v. North Carolina Industrial Development Financing Authority*,¹⁹² scrutinized a public authority which had been given the power to purchase industrial sites with proceeds from tax-exempt revenue bonds, and to lease those sites back to private industry.¹⁹³ The majority found that the practical effect of the legislation was to enable the authority to exercise the power of eminent domain to benefit private industry.¹⁹⁴ The court therefore held the scheme violative of the public purpose requirement of the state constitution.¹⁹⁵

In 1971, the state legislature passed a similar bond act for pollution control.¹⁹⁶

188. E.g., *Wayland v. Snapp*, 232 Ark. 57, 334 S.W.2d 633 (1960) (construction of manufacturing facilities); *California Housing Fin. Agency v. Elliott*, 17 Cal. 3d 575, 551 P.2d 1193, 131 Cal. Rptr. 361 (1976) (en banc) (loans to private builders of mixed income housing); *Opinion of the Justices*, 358 A.2d 705 (Del. 1976) (state purchase of stock in a financially troubled bank); *State v. Jacksonville Port Auth.*, 305 So. 2d 166 (Fla. 1974) (construction of a warehouse for a supermarket chain and a laundry for a linen supply company); *State ex rel. Amemiya v. Anderson*, — Hawaii —, 545 P.2d 1175 (1976) (water pollution facility for electric utility company); *State ex inf. Danforth v. State Environmental Improvement Auth.*, 518 S.W.2d 68 (Mo. 1975) (en banc) (pollution control facilities); *Tribe v. Salt Lake City Corp.*, — Utah 2d —, 540 P.2d 499 (1975) (parking facility in area of urban redevelopment); *Wisconsin Solid Waste Recycling Auth. v. Earl*, 70 Wis. 2d 464, 235 N.W.2d 648 (1975) (authority empowered to promote private waste recycling ventures). See also cases cited in *Mitchell v. North Carolina Indus. Dev. Fin. Auth.*, 273 N.C. 137, 148-50, 159 S.E.2d 745, 753-54 (1968); 50 Wash. L. Rev. 440, 448 n.28 (1975).

189. E.g., *Nebraska*, *North Carolina* and *Washington*. See notes 192-209 *infra* and accompanying text and note 147 *supra*.

190. See notes 192-209 *infra* and accompanying text.

191. *Id.*

192. 273 N.C. 137, 159 S.E.2d 745 (1968).

193. N.C. Gen. Stat. §§ 123A-1 et seq. (1974).

194. 273 N.C. at 159, 159 S.E.2d at 760.

195. *Id.* at 159, 159 S.E.2d at 761. The constitution provided: "The power of taxation shall be exercised in a just and equitable manner, for public purposes only, and shall never be surrendered, suspended, or contracted away." N.C. Const. art. V, § 2(1).

The North Carolina court, however, has been liberal in other respects. For example, it held that moral obligation bond legislation to finance low-income housing was for a public purpose and did not pledge the credit of the state. *Martin v. North Carolina Housing Corp.*, 277 N.C. 29, 175 S.E.2d 665 (1970).

196. *Pollution Abatement and Industrial Facilities Financing Act*, ch. 633, [1971] N.C. Sess. Laws 588, codified at N.C. Gen. Stat. §§ 159A-1 to -25 (1972), held unconstitutional, *Stanley v. Department of Conservation & Dev.*, 284 N.C. 15, 199 S.E.2d 641 (1973).

The statute expressly provided that "[n]o Authority shall have any right or power to acquire any property through the exercise of eminent domain."¹⁹⁷ The court found this exercise in draftsmanship unsatisfactory.¹⁹⁸ If such financing arrangements were found to be for a valid public purpose, the court reasoned, subsequent legislatures would be free to repeal the clause prohibiting exercise of eminent domain, and to allow local authorities to take private property for what would then be considered public purposes.¹⁹⁹ In 1975, the legislature approved the same legislation again,²⁰⁰ this time accompanied by a proposed constitutional amendment that would authorize local authorities to issue revenue bonds for industrial development and pollution control projects.²⁰¹ The amendment, which also provided that the power of eminent domain could not be exercised,²⁰² was approved by voters in a 1976 election.²⁰³ How the court will construe the amendment remains to be seen.

Similarly, the Washington Supreme Court held that the use of eminent domain powers by a port district to take private lands for an industrial development project was an unconstitutional use of those powers for a private purpose.²⁰⁴ In a second decision, the court held that expenditures of public money by port districts for "promotional hosting" of shippers and other potential port users was an unconstitutional municipal "gift" to private individuals.²⁰⁵

In response to these decisions, a constitutional amendment was approved in 1966, which provided: "The use of public funds by port districts . . . for industrial development or trade promotion and promotional hosting shall be deemed a public use for a public purpose, and shall not be deemed a gift . . ."²⁰⁶ The Washington court construed this amendment strictly, holding that it permitted only those uses expressly described by the amendment.²⁰⁷ A lease-financing arrangement, whereby two port districts agreed to use bond proceeds to buy and lease-back pollution control facilities to private corpora-

197. *Id.* at [1971] N.C. Sess. Laws 588, 603.

198. *Stanley v. Department of Conservation & Dev.*, 284 N.C. 15, 199 S.E.2d 641 (1973).

199. *Id.* at 36, 199 S.E.2d at 655. See generally 52 N.C.L. Rev. 859 (1974).

200. N.C. Gen. Stat. § 159C-1 to -26 (1976).

201. Law of June 25, 1975, ch. 826, [1975] N.C. Sess. Laws 1165, proposing N.C. Const. art. V, § 8 (subsequently renumbered § 9 (Cum. Supp. 1976)).

202. *Id.* The amendment provides: "Notwithstanding any other provision of this Constitution, the General Assembly may enact general laws to authorize counties to create authorities to issue revenue bonds to finance, but not to refinance, the cost of capital projects consisting of industrial, manufacturing and pollution control facilities for industry . . . and to refund such bonds.

In no event shall such revenue bonds be secured by or payable from any public moneys whatsoever, but . . . only from revenues or property derived from private parties. . . .

The power of eminent domain shall not be exercised to provide any property for any such capital project.' "

203. See Editor's Note, N.C. Gen. Stat. §§ 159C-1 to -26 (1976).

204. *Hogue v. Port of Seattle*, 54 Wash. 2d 799, 341 P.2d 171 (1959) (en banc).

205. *State ex rel. O'Connell v. Port of Seattle*, 65 Wash. 2d 801, 399 P.2d 623 (1965).

206. Wash. Const. amendment 45, adding art. VIII, § 8.

207. *Port of Longview v. Taxpayers of Port of Longview*, 85 Wash. 2d 216, modifying 84 Wash. 2d 475, 527 P.2d 263 (1974) (en banc), as modified, 533 P.2d 128 (1975). For a discussion of the original holding, see 50 Wash. L. Rev. 440 (1975).

tions for rentals sufficient to service the debt on the bonds, was held a loan of money²⁰⁸ that was "not . . . within the scope" of the constitutional amendment.²⁰⁹

In New York, although the public purpose doctrine received consideration in some early cases,²¹⁰ it has drawn scant attention since the advent of modern industrial development financing techniques. A few cases have considered the question as it relates to functions of non-profit public corporations,²¹¹ but not in situations where private businesses would receive substantial benefits. The major reason for the dearth of rulings on this issue is probably that most of New York's bond legislation has not directly benefited private industry, except to the extent that authority building projects provide lucrative contracts for private construction firms. However, New York has several laws similar to the industrial development legislation in other states. Chief among these statutes is the Job Development Authority Act.²¹² The legislation was passed pursuant to a constitutional amendment that permits the state, through a public corporation, to "mak[e] loans to non-profit corporations to finance [industrial development], including the acquisition of real property therefor . . . to improve employment opportunities in any area of the state . . ."²¹³ However, there has been no court test to determine whether the actual operations of the authority²¹⁴ conform to the enabling language of the amendment or whether they would violate the public purpose requirements of other constitutional provisions.

IV. CONCLUSION

Constitutional provisions limiting state and municipal debt have not had their intended effect. They were enacted in response to severe economic pressures experienced by states in the 19th century as a result of the heavy debt burden incurred to help finance canal and railroad expansion. Despite the intent of these constitutional provisions, states continued to favor bonded indebtedness as a means of public works financing and began to develop nonguaranteed financing devices to circumvent black-letter limitations.²¹⁵ Although the devices grew

208. 85 Wash. 2d at 219-22, 527 P.2d at 264-66. The court distinguished these arrangements from "true lease agreement[s]." *Id.* at 223, 527 P.2d at 266-67.

209. *Id.* at 233, 533 P.2d at 130.

210. E.g., *People ex rel. Simon v. Bradley*, 207 N.Y. 592, 612, 101 N.E. 766, 772 (1913); *Lehigh Valley R.R. v. Canal Bd.*, 204 N.Y. 471, 475, 97 N.E. 964, 965 (1912).

211. E.g., *Comereski v. City of Elmira*, 308 N.Y. 248, 254, 125 N.E.2d 241, 244 (1955); *Robertson v. Zimmermann*, 268 N.Y. 52, 64-65, 196 N.E. 740, 745 (1935). See notes 84-94 *supra* and accompanying text.

212. N.Y. Pub. Auth. Law §§ 1800-34 (McKinney 1970), as amended, (Supp. 1975, 1976). See also N.Y. Pub. Auth. Law §§ 1950-69 (McKinney 1970), as amended, (Supp. 1975) (Troy Industrial Development Authority); N.Y. Pub. Auth. Law §§ 2300-38 (McKinney 1970), as amended, (Supp. 1975) (Auburn Industrial Development Authority).

213. N.Y. Const. art. VII, § 8(3).

214. Typically, the authority uses proceeds from bond sales to finance second mortgages to private companies that are building new facilities. Unlike such arrangements in many other states, the bonds are guaranteed by New York State.

215. As one commentator observed: "Debt limitations were adopted as a result of experience; in principle they are not so 'archaic' as the financial methods which brought them into being.

increasingly elaborate, they were consistently upheld by courts in a majority of jurisdictions, including New York.

At the present time, there are no effective legal restraints to prevent a recurrence of this pattern in New York. The seriousness of the state's recent financial crisis will probably instill fiscal caution in the New York legislature for some time to come. Already, new legislation has been passed which places limits on future authority indebtedness;²¹⁶ other measures may follow. But given the ease with which existing constitutional limitations can be circumvented, the advantages of tax-exempt nonguaranteed financing, and the present lack of alternative methods of finance that would provide equivalent advantages, a return by the state to previous financing practices remains a distinct possibility.

Furthermore, the tone of recent New York decisions, and the possibility of further adverse holdings, may not be as significant as the legal and political communities now believe. The experiences of minority jurisdictions where the courts have struck down certain debt financing practices suggest that state courts can have only a minimal effect in retarding or limiting the use of these devices. Legislatures have regarded debt financing as an essential means of achieving growth and development within the state. Where court decisions in some jurisdictions held legislation unconstitutional, the desired financing was achieved through either legislative redrafting or constitutional amendments which carved out specific exceptions to the general prohibitions.²¹⁷ The process of constitutional amendment, as a reflection of the people's will, is preferable to mere legislative redrafting designed to side-step a particular judicial decision. Nevertheless, in view of the inadequate restrictions currently imposed on nonguaranteed financing mechanisms, it is unlikely that public debate can fully apprise the people of the ultimate debt burden such an amendment could create for themselves and future generations.

What appears to be needed is extensive reform of existing constitutional provisions. Ideally, debt limitations should allow the state to secure necessary financing quickly and flexibly, but would admit of strict enforcement, to ensure prudent debt management. Additionally, the provisions should allow the public a far greater measure of control over state indebtedness.

It is submitted that the following constitutional revisions would be most effective in achieving the above goals: (1) repeal of the referendum requirement for issuance of general obligation debts,²¹⁸ to be replaced by a requirement of a two-thirds vote of the legislature; (2) enactment of a requirement that the state pledge its faith and credit for the repayment of *all* debts of the state *and* of its public corporations;²¹⁹ and (3) enactment of a ceiling on total state indebtedness,

The use of revenue bonds is not an attempt to adjust those limitations to present needs, but rather to render them impotent by avoiding them entirely. Such action is a confession that we are not willing to learn from experience." Ratchford, *supra* note 59, at 513.

216. Acts of March 15, 1976, chs. 38-39, [1976] N.Y. Sess. Laws 158, 181 (McKinney). See note 23 *supra* and accompanying text.

217. See generally section III *supra*.

218. N.Y. Const. art. VII, § 11.

219. This requirement would be similar to the present faith and credit requirement for debts of local government units. *Id.* art. VIII, § 2.

fixed at a percentage of either the market value of all taxable real property in the state, or the total tax revenues received by the state.²²⁰ Existing limitations on local indebtedness should be retained in their present form.

Such measures would result in an end to the use of nonguaranteed debt and the added interest costs it entails. Public authorities could be retained for their original purpose of administrative convenience; but the political reality implicit in authority debts—the state's ultimate liability in event of default—would be legally recognized. Repeal of the referendum requirement would allow the legislature the speed and flexibility necessary for public works financing. Moreover, these proposals could be strictly enforced by the courts, with little detriment to public financing programs.

Perhaps the greatest significance of these proposed revisions is that they would provide the state legislature with full knowledge and control of total state liabilities; this would, in turn, give the public greater influence over political decisions involving further state debt increases. Debt statistics would no longer be fragmented into such categories as guaranteed debts, authority debts and moral obligation debts. Instead, there would be two easily ascertainable amounts: total state debts and total local debts. It is submitted that such a clear accounting system, in addition to direct legislative responsibility for all debts, would result in an increase in public influence over state and local financing policies. A well-informed public that is able to communicate its concerns to elected representatives at the state and local levels would provide a better safeguard against fiscal mismanagement than is now provided by the archaic, easily-evaded referendum requirement.

Government officials and commentators have recommended similar, though often less drastic, reforms.²²¹ It is not within the scope of this Comment to analyze their proposals. Nonetheless, it is submitted that unless radical changes are made in methods of debt financing, New York may well be destined to repeat the patterns of the past.

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220. This debt ceiling would also follow the pattern of limits on local debts. *Id.* § 4.

221. See, e.g., Proposed N.Y. Const. arts. X-XII, in 12 Proceedings of the Constitutional Convention of the State of New York 26-46 (1967); Moreland Commission Report, *supra* note 3, at 56-61; Bowmar, *The Anachronism Called Debt Limitation*, 52 Iowa L. Rev. 863, 896-900 (1967); Hollman & Primeaux, *An Examination of Debt Ceilings as Barriers to Efficient Debt Management*, 25 Ala. L. Rev. 417, 443-44 (1973).