NOTE

CREDITORS' REMEDIES IN MUNICIPAL DEFAULT

I. INTRODUCTION

Today the nation's cities face a financial crisis which will affect their ability to satisfy the demands of their creditors while at the same time providing an adequate level of services to their inhabitants. Creditors faced with a municipality's refusal to pay its debts and honor the pledge of its full faith and credit will often turn to the courts in an effort to obtain satisfaction. The basic question which will arise in such a case does not concern the legal obligation incurred by the municipality when it borrows funds in the private sector. That obligation is clear—the city must pay its debt. The real issue is what remedies are available to the holder of the municipal obligation when the obligor refuses to pay according to the terms of the bond contract.

These remedies are circumscribed by the pledge of full faith and credit, for which the creditor has bargained, and with whose limitations he must be satisfied. The implications flowing from interpretation of the phrase are broad. The approach taken by the courts in defining the meaning of the pledge and the extent of the remedies made available to private creditors will reflect difficult social and political choices; it will mirror judgments about the separation of powers, and will embody attitudes concerning the sovereignty of governmental entities. Courts

THE FOLLOWING CITATIONS WILL BE USED IN THIS NOTE:


W. Raymond, State and Municipal Bonds (1923) [hereinafter cited as Raymond];

Fordham, Methods of Enforcing Satisfaction of Obligations of Public Corporations, 33 Colum. L. Rev. 28 (1933) [hereinafter cited as Fordham].

1. No reported decision dealing with the default of general obligation bonds has held, in the absence of some special statute, that a creditor is legally entitled to less than 100 percent of the principal amount of the validly issued bonds he holds. Whether courts actually provide a remedy to protect this right is another matter.

2. See State ex rel. Dos Anigos, Inc. v. Lehman, 100 Fla. 1313, 1325, 131 So. 533, 538 (1930) (municipal bonds are a contract between issuer and bondholder); Fordham 28 (problem "intimately concerns the remedies available to the creditor against the governmental debtor in enforcing a claim").

3. See, e.g., Fordham 46, 53 (explaining why courts refuse to appoint receivers to administer affairs of an insolvent municipality); Dimock, Legal Problems of Finan-
must factor these and other considerations into any evaluation of precisely what it is that a creditor has when he owns a bond backed by the full faith and credit of a municipality.

This Note will examine the remedies available to the creditor of a defaulting municipality which has pledged its full faith and credit and will attempt to develop a practical definition of that pledge. It should be noted that this analysis rests on several assumptions. First, it will be assumed that there is no express statutory scheme of remedies available to the municipal creditor. The issue therefore is the nature of judicial action which may be taken to fill the vacuum caused by the absence of legislative action. Second, the availability of state and federal schemes to facilitate a composition of an insolvent municipality's debts will be ignored except insofar as their very existence bears upon the extent of the nonstatutory remedies a court will provide. Finally, although cases dealing with other types of municipal obligations will be mentioned and the principles developed may be relevant to municipal securities in general, this Note is limited to a discussion of full faith and credit as it relates to general obligation bonds.

---

4. Since the transaction is contractual in nature, any state could develop such a scheme limited only by various constitutional considerations. E.g., U.S. CONST. art. II, § 10 ("No State shall . . . pass any . . . law impairing the obligation of contracts . . . ."). See generally Comment, The Role of the Contract Clause in Municipalities' Relations with Creditors, 1976 Duke L.J. 1321.


6. Broadly speaking, a general obligation bond obligates the issuing municipality to pay principal and interest from its general revenues. 15 McQuillin § 43.129. Such bonds should be distinguished from revenue bonds (those expressly payable only from the income generated by a particular municipal enterprise) and improvement bonds (those expressly payable only from special assessments on property benefited by the proceeds of the bonds). Id. §§ 43.34-35.

The chief source of the city's general revenues will usually be taxes. See Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 509 (1942) (principal asset of a municipality is taxing power); Meriwether v. Garrett, 102 U.S. 472, 519 (1880) (creditors must look to taxing power); State ex rel. Dos Anigos, Inc. v. Lehman, 100 Fla. 1313, 1325, 131 So. 533, 538 (1930) (power to tax is the essence of a general obligation bond); 15 McQuillin § 43.130. It is not unusual for a municipality to levy a specific tax designed to raise amounts sufficient to pay accruing interest and principal on a particular bond issue. E.g., May v. Board of Directors, 34 Cal. 2d 125, 128-29, 208 P.2d 661, 663 (1949) (statute requiring municipality to levy an annual tax sufficient to pay accruing principal and interest); 15 McQuillin § 43.133. The municipality might channel such funds or funds from any other source into a sinking fund for the benefit of its bondholders. Id. § 42.131.

However the parties choose to structure the transaction, the holder of a general
II. THE MEANING OF FULL FAITH AND CREDIT

Municipal securities may be backed by various types of pledges or security. This Note will focus upon the pledge of full faith and credit, which should be contrasted with a moral obligation or a revenue obligation. When a municipality pledges its full faith and credit to secure a bond, it "promise[s] both to pay and to use in good faith the city's general revenue powers to produce sufficient funds to pay the principal and interest of the obligation as it becomes due." At the opposite end of the spectrum stands the moral obligation bond, which is backed only by a moral commitment and not by a legally enforceable promise. Between the full faith and credit bond and the moral obligation bond lies the revenue bond, which is secured only by those city revenues that flow from a designated source.

The pledge of full faith and credit may be given either a flexible or a rigid construction, as is well illustrated by the recent opinion of the New York Court of Appeals in Flushing National Bank v. Municipal Assistance Corp. The majority struck down the New York City Emergency Moratorium Act of 1975, a state statute which had been enacted to assist New York City in its financial crisis by imposing a three-year moratorium on actions to enforce the city's short-term obligations. The court found that the requirement of the New York constitution that cities pledge their faith and credit when borrowing, coupled with other constitutional provisions allowing cities to exceed taxing limits in order to pay their debts, amounted to a "constitutional imperative: debt obligations must be paid, even if tax limits be exceeded." The court seemed to view these provisions as strict commands which would not allow "good faith tampering" with a city's obligations, regardless of the financial condition of the city, its efforts to satisfy its obligations, as the concept is used here, may look for payment in the first instance to the general revenues of the municipal debtor.

9. Id. at 735, 358 N.E.2d at 851, 390 N.Y.S.2d at 26; see 15 McQuillin § 43.11.
11. N.Y. Laws 1975, ch. 874, as amended by ch. 875.
12. N.Y. Const. art. VIII, § 2.
13. Id. §§ 2-a-6, 7, 7-a.
creditors, or the great public harm which could result from immediate full payment of the debt then due.¹⁵

Judge Cooke, dissenting, took a somewhat more pragmatic and flexible view of the pledge, focusing on the "good faith" implications of the clause. In his view, the pledge "requires no more than that the city make a good faith effort to use its resources, credit and powers to pay its indebtedness."¹⁶ The dissent found that the record made a "strong showing in this respect, . . . measured in the light of the City's overall financial condition and its overall obligations to its citizens and others."¹⁷

Despite its appealing logic and simplicity, the majority's approach may prove to be unrealistic. The dissent's approach implicitly recognizes the necessity that a municipality continue to carry out its essential functions for the benefit of its inhabitants, even at some expense to its creditors.¹⁸ The majority seemingly leaves no room for this, giving instead a pyrrhic victory to the City's creditors. The financial structure of the City may be irreparably injured as a result of the majority's insistence on literal adherence to the terms of the contract.

The remainder of this Note will deal with the remedies available to the holder of a full faith and credit obligation. The discussion will necessarily assume the flexible view of the pledge taken by the dissent in Flushing National Bank.

III. SOVEREIGN IMMUNITY AS A MUNICIPAL DEFENSE

A municipality might default on its general obligation bonds because it questions the validity of the bonds, because it is politically unpopular to pay, because it cannot raise the money by levying additional taxes, or because additional levies would not result in increased general revenues. Whatever the substantive reason for default, one of the bondholders' weapons in compelling payment will be to invoke

¹⁵. The majority's view may not be as rigid as this discussion suggests. The court expressed concern over the fact that the Act involved a moratorium which barred all remedies for three years. Id. at 738, 358 N.E.2d at 853, 390 N.Y.S.2d at 27. The creditor could thus be deprived of all payment during that time, should the city so choose. Payment was not simply being spread over a longer period of time; it could be totally withheld. The court also indicated displeasure at the inequality of treatment accorded creditors—those managing the city's finances "ha[d] made an expedient selection of the temporary noteholders to bear an extraordinary burden." Id. at 736, 358 N.E.2d at 852, 390 N.Y.S.2d at 26. It is not clear, however, that the outcome would have been different had the burdens been allocated more equitably.

¹⁶. Id. at 747, 358 N.E.2d at 859, 390 N.Y.S.2d at 33 (Cooke, J. dissenting).

¹⁷. Id.

¹⁸. See text accompanying notes 38-40 infra.
judicial assistance. The principle that municipal corporations are immune from suit to compel the payment of money\(^{\text{19}}\) has generally been recognized.\(^{\text{20}}\) A substantial question presently exists as to whether a municipality may assert that immunity as a defense to a suit by a bondholder for breach of the bond contract.

There are no reported cases in which a municipality has asserted sovereign immunity as a defense to a suit involving its bonded obligations. Since sovereign immunity may be waived or modified by statute,\(^{\text{21}}\) this general failure to assert the defense may be explainable in terms of waiver.\(^{\text{22}}\) But even assuming that the common law of a state makes sovereign immunity available to a municipality and that no express statutory waiver exists, it seems likely that most courts would reject any assertion of sovereign immunity as a defense to a suit for default on a municipal bond obligation.

Support for this conclusion can be found in a number of recent cases in several jurisdictions which have typically held that the state and its subdivisions impliedly waive sovereign immunity whenever they enter into a contract authorized by law.\(^{\text{23}}\) If a court is not prepared to abolish the immunity doctrine entirely, it may distinguish contract from tort liability and employ the implied waiver theory only in the contract cases.\(^{\text{24}}\)

---


20. There is, however, a split of authority as to whether sovereign immunity extends to municipal corporations. "The state's immunity from suit usually does not extend to municipal corporations..." 17 McQUILLIN § 49.02. On the other hand, courts have expressed the view that a right of action against a municipal corporation is a matter of legislative favor. Id.

21. Id.

22. See, e.g., IOWA CODE § 613.8-.10 (1971); VA. CODE § 8-752 (1976 Supp.). Why any investor would demand less than the right to sue his obligor to enforce the obligation is not clear.


24. E.g., Williams v. City of N. Las Vegas, 91 Nev. 622, 626, 541 P.2d 652, 655
The result reached in the contract cases is clearly correct as a policy matter. It would be misleading in the extreme to allow a state to breach a contractual pledge simply by asserting that the pledge was never enforceable. Such a denial of contractual obligations by a state or subdivision assumes the aspect of a taking without just compensation. Application of the immunity doctrine forces the aggrieved party to fall back on the nebulous and generally unsatisfactory remedy of petitioning the legislative branch for a redress of his grievance. Moreover, affirmation of the immunity doctrine in contract cases amounts to a judicial attribution of latent bad faith to the state's legislative and executive branches.25

These concerns are equally applicable when the contract is in the form of a general obligation bond calling for the issuing municipality to apply its general revenues to payment of the debt. Certainly the notions of basic fairness, mutuality and good faith which underlie the theory of implied waiver of immunity for breach of contract are every bit as compelling in the municipal securities context. Thus, from a policy standpoint, the doctrine of sovereign immunity should not bar bondholders from enforcing a municipality's general obligation bonds.

This does not mean, however, that the broader concept of sovereignty is irrelevant when defining the nature of a municipal corporation's liability on its general obligation bonds. Elements of municipal sovereignty will frequently intrude to prevent the bondholder from effectively pursuing the variety of remedies that would be available to him in a suit against a private obligor.26 In no case, however, should the doctrine of sovereign immunity prevent the bondholder from reducing his claim to a judgment against the municipal debtor.27


25. The policy arguments against immunity were summarized by the North Carolina Supreme Court in abrogating the doctrine in contract cases in Smith v. State, 289 N.C. 303, 320, 222 S.E.2d 412, 423 (1976):

(1) To deny the party who has performed his obligation under a contract the right to sue the state when it defaults is to take his property without compensation and thus to deny him due process; (2) To hold that the state may arbitrarily avoid its obligation under a contract after having induced the other party to change his position or to expend time and money in the performance of his obligations, or in preparing to perform them, would be judicial sanction of the highest type of governmental tyranny; (3) To attribute to the General Assembly the intent to retain to the state the right, should expediency seem to make it desirable, to breach its obligation at the expense of its citizens imputes to that body "bad faith and shoddiness" foreign to a democratic government; (4) A citizen's petition to the legislature for relief from the state's breach of contract is an unsatisfactory and frequently a totally inadequate remedy for an injured party; and (5) The courts are a proper forum in which claims against the state may be presented and decided upon known principles.

26. See notes 28-48 infra and accompanying text.

27. See, e.g., Defoe v. Town of Rutherfordton, 122 F.2d 342, 343 (4th Cir. 1941)
IV. CONVENTIONAL BONDHOLDERS’ REMEDIES

Execution on Municipal Property

Having reduced his claim to judgment, the bondholder must still find some way to compel payment by the municipality. If the judgment were against a private corporation, the bondholder's remedies would be relatively clear; he could obtain a writ of execution empowering an officer of the court to seize some of the corporation's assets. When the debtor is a municipal corporation, however, the bondholder-judgment creditor’s remedies are radically different in legal theory, in scope, and in practical effect.

In the vast majority of cases, execution upon the debtor's assets will not be available to aid the municipal bondholder who has obtained a judgment. In some states, the legislature has expressly immunized municipal property from execution by statute. Courts in jurisdictions lacking a statute expressly dealing with the problem reach similar results by construing existing remedial statutes narrowly. Execution “against the public property of a municipal corporation is unknown to the common law” and will not lie absent an authorizing statute. Rarely do courts articulate any reason for such a rule beyond repeating the phrase that it is “against public policy” to seize municipal property.

28. This power might be restricted somewhat by statute, or it might be limited by the terms of the bondholder's bond contract. Otherwise the private corporation is very much at the mercy of its creditor. With a bankrupt corporation, of course, the creditor's rights will be limited by the power of the trustee.

29. See generally 17 MCQUILLIN § 49.43; Fordham 29 (“in no jurisdiction is there dissent from the proposition that property of a public corporation presently devoted to a public use and appropriate to that end is free from execution”).


32. Lyon v. City of Elizabeth, 43 N.J.L. 158, 160 (Sup. Ct. 1881). It should be noted that in some jurisdictions execution may issue against a municipal corporation. But its purpose in such jurisdictions is not to authorize seizure and sale of public property. It merely lays the foundation for a mandamus proceeding. Grosso v. City of Patterson, 59 N.J. Super. 412, 157 A.2d 669 (1960).

33. E.g., Delta County Levee Improvement Dist. v. Leonard, 516 S.W.2d 911, 912
However, when articulated and analyzed, the rationale is a persuasive one.

The basic premise of the argument is that states erect municipal corporations for political purposes. Insofar as a municipality owns property it does so only as a means of promoting those political objectives. If a municipality's property were subject to seizure by its judgment creditors, those private individuals would have the power to deprive the municipal corporation of the means necessary to the exercise of its governmental functions. "It would be manifestly contrary to the theory upon which a part of the sovereignty of the state is delegated to local governments to concede to an individual the right thus to arrest their operations."

Immunity from execution is thus derived from the municipal corporation's status as sovereign. It has already been suggested in this Note that invocation of the sovereign immunity doctrine is not appropriate if its effect is to deprive bondholders of access to legal remedies in general. Nevertheless, there may be circumstances in which the principle of sovereignty may properly preclude use of a particular remedy because of that remedy's direct effect upon the governmental unit or because the particular remedy would be mechanically or politically unwieldy in a court's hands. Certainly the seizure of municipal property, as noted above, could have disastrous effects upon the ability of a municipal corporation to provide those services for which it was created. Such considerations go to the essence of the doctrine of sovereign immunity—that no individual with a claim against the sovereign can employ judicial process to satisfy that claim, regardless of the


35. Some courts view public property held by a municipal corporation as held in trust for the public. *See, e.g.*, Meriwether v. Garrett, 102 U.S. 472, 513, 518 (1880).
36. "It would be a startling proposition to hold that a creditor could seize and sell a court-house or a jail, and that the sheriff could be required to put him in possession of it." Lyon v. City of Elizabeth, 43 N.J.L. 158, 163 (Sup. Ct. 1881).
37. *Id.* at 161. That the municipal corporation does not derive its powers from the state government but rather is a so-called home-rule entity in no way weakens the analysis.
38. *See* notes 23-27 *supra* and accompanying text.
40. *See* note 36 *supra* and accompanying text.
claim's intrinsic worth, when the result would be a substantial disruption of government.

It may be inferred from this analysis that, while courts will generally not permit execution on municipal property for the benefit of judgment creditors when this would result in disruption of the local government, the opposite rule should prevail when a municipality owns property the seizure of which would have no appreciable impact on the ability of the unit to perform its functions. Some courts, however, state the rule broadly and apparently would not permit execution on municipal property under any circumstances.\textsuperscript{41} Several courts do roughly approximate the distinction just suggested by differentiating between municipally owned property used for "governmental purposes" and property held by the corporation in its "proprietary" or "private" capacity.\textsuperscript{42} According to some dicta at least, this latter property may be subject to seizure and sale for the benefit of the municipality's judgment creditors.\textsuperscript{43}

Such a governmental-proprietary dichotomy provides a broader immunity than the principles of sovereign immunity discussed above might dictate, since a municipality may use a particular asset in the performance of its governmental functions the seizure of which would not materially disrupt those functions. The distinction suggested above—whether the seizure of a particular municipal asset would have a detrimental effect on the municipality's ability to carry out its essential functions—\textsuperscript{44} is thus more consistent with the purposes of the immunity doctrine, although no case has employed or discussed this narrower rule. Rather, the general approach seems to be to use the governmental-proprietary distinction and to characterize almost all municipal activities as governmental functions.\textsuperscript{45} The effect of such an interpretation is to

\textsuperscript{41} 17 McQuillin § 49.43.

\textsuperscript{42} \textit{Id.}; Vanderpoel v. Borough of Mt. Ephraim, 111 N.J.L. 423, 168 A. 575 (Ct. Err. & App. 1933) ("The fundamental needs of government require that municipalities be free from the seizure of lands and personal property used in the exercise of a governmental function." \textit{Id.} at 424, 168 A. at 575).

\textsuperscript{43} Meriwether v. Garrett, 102 U.S. 472, 518 (1880) (dictum); Shamrock Towing Co. v. City of New York, 20 F.2d 444, 445 (E.D.N.Y. 1927); El Camino Irrigation Dist. v. El Camino Land Corp., 12 Cal. 2d 378, 382, 85 P.2d 123, 125 (1938) (per curiam) (suggesting that municipal corporations own property used in performing some functions which are nongovernmental and which therefore would be subject to seizure). See Raymond 4; Fordham 30; cf. Dession, \textit{Municipal Debt Adjustment and the Supreme Court}, 46 Yale L.J. 199, 202 (1936).

\textsuperscript{44} Of course the more protective rule may be justified on the grounds that if a court errs in such a sensitive area, it is better to err in favor of the sovereign entity and the larger public which it represents.

\textsuperscript{45} See Martin v. City of Asbury Park, 114 N.J.L. 298, 301, 176 A. 172, 173 (Ct. of Err. & App. 1935) (finding requisite "public purpose").
provide for municipal property a blanket immunity against seizure by creditors.\textsuperscript{46} Those creditors who attempt execution on municipal property are limited to an extremely “narrow” and “vaguely defined” concept of a municipality’s “private property.”\textsuperscript{47} As a result, “[t]he cases where anything is collected by levy upon the municipality's property and funds are few and far between.”\textsuperscript{48}

**Execution on Private Property**

Frustrated in his attempt to seize municipal property, a bondholder-judgment creditor might look to the private property of the defaulting municipality's inhabitants for satisfaction. Seizure and sale of such private property by execution should not be barred by any doctrine of sovereign immunity, because such seizures would not disrupt the ability of the governmental unit to function.\textsuperscript{49} Nevertheless, in the absence of a specific statute authorizing seizure of private property to satisfy a defaulted municipal bond,\textsuperscript{50} only the courts in a few New England states have held such property directly liable to seizure.\textsuperscript{51}

While the above rule is well established, courts have not often examined its logic. An early Supreme Court case drew an analogy to the private sector—as a court could not seize the property of a private corporation's shareholders, so it could not seize “the property of citizens for the debt of the corporation in which they reside . . . .”\textsuperscript{52} This comparison presents two problems. First, it is not clear that there is a sufficient similarity between a citizen of a municipality and a sharehold-

\textsuperscript{46} Id. at 302, 176 A. at 174.

\textsuperscript{47} Fordham 29-30. For an early attempt at delineating what constitutes the “private property” of a municipal corporation, see Meriwether v. Garrett, 102 U.S. 472, 518 (1880) (dictum) (suggesting relatively broad concept of “private”).

\textsuperscript{48} Dimock, Legal Problems, supra note 3, at 40.

\textsuperscript{49} Presumably such land after seizure and sale would continue to be subject to the municipal corporation's taxing authority.

\textsuperscript{50} E.g., VT. STAT. ANN. tit. 12, § 2743 (1973) (“When judgment is rendered against a county, town, village, school or fire district, execution shall issue against the goods or chattels of the inhabitants of such county, town, village, school or fire district, and may be levied and collected of the same”).

\textsuperscript{51} See Meriwether v. Garrett, 102 U.S. 472, 519 (1880) (“In no State . . . outside of New England, does the doctrine obtain that the private property of individuals within the limits of a municipal corporation can be reached by its creditors, and subjected to the payment of their demands . . . . Elsewhere the private property of the inhabitants of a municipal body cannot be subject to the payment of its debts, except by way of taxation . . . .”); Barkley v. Levee Comm'rs, 93 U.S. 258, 265 (1876); Lyon v. City of Elizabeth, 43 N.J.L. 158, 160 (Sup. Ct. 1881); 17 MCQUILLIN § 49.48; RAYMOND 3; Dession, supra note 43, at 201.

\textsuperscript{52} Barkley v. Levee Comm'rs, 93 U.S. 258, 265 (1876).
er in a private corporation to warrant the analogy. Second, even assuming a sufficient similarity, the analogy begs the real question.

A creditor of a private corporation could demand as additional security that any or all shareholders of the debtor pledge their personal assets. This is basically a question of the provisions in the bond contract. A premise of this Note is that the municipal corporation's bond contract contains only a pledge of its full faith and credit. The question thus is whether this pledge secures the creditor's loan with the personal assets of the municipality's inhabitants. A few jurisdictions have so interpreted the pledge in the past, but most have concluded that full faith and credit does not give the municipal bondholder access to private property. In these latter jurisdictions prospective investors could presumably demand such access by statute as a precondition to their purchase of municipal bonds. Absent such an explicit agreement, a bondholder does not have access to the inhabitants' property for the simple reason that he has not bargained for it.

53. Of course the corporation could not conclude such a contract without the consent of those shareholders who would be personally liable.

54. It has already been noted that this is essentially a pledge of its general tax revenues. See note 6 supra.

55. E.g., Hill v. City of Boston, 122 Mass. 344, 349-50 (1877); Chase v. Merrimack Bank, 36 Mass. (19 Pick.) 564, 569 (1837); Hawkes v. Inhabitants of the County of Kennebeck, 7 Mass. 461, 463 (1811); see Beardsley v. Smith, 16 Conn. 368, 377-80 (1844).

56. There are sound policy reasons for refusing to subject private property to seizure for the satisfaction of municipal debts in the absence of a statute. First, courts would have difficulty in administering the remedy; e.g., whose property is to be seized when the obligation is a general one? Second, and more importantly, it is clear that the preferred remedy is to force the municipality to levy a tax sufficient to generate the revenue necessary to pay the obligation. See Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 509 (1942); Fordham 44. The tax is likely to be a property tax, although in any case it will fall upon the inhabitants. This, of course, makes private property indirectly liable to the creditors pursuant to the pledge of full faith and credit. If the property owner failed to pay his taxes the municipality would seize his land and sell it. The proceeds would be a part of the general revenues pledged to the bondholders. See Provident Land Corp. v. Zumwalt, 12 Cal. 2d 365, 370-71, 85 P.2d 116, 118 (1938) (per curiam). However, the amount of tax levy which a creditor has the right to demand pursuant to the full faith and credit pledge may be limited by statute or constitutional provision. See Fordham 45. Such provisions operate to prevent oppressive tax rates—in other words, to protect the property owner. The bondholder should be held to have been aware of these limitations and should not be able to impose a greater burden on the inhabitants by directly seizing their property.

Of course, the above argument does not have as much force when a municipal corporation refuses to honor a judgment against it and does not comply in good faith with a court order to levy a particular tax. But the majority rule is that the pledge of full faith and credit does not give a bondholder direct access to private property within a municipality under any circumstances. But cf. RAYMOND 4 (statutory scheme in New Hampshire provides for seizure of private property of any inhabitant when the money is not raised by taxation).
V. MANDAMUS AND THE TAXING POWER

It should be clear from the preceding discussion that a bondholder-creditor derives little direct security from either a debtor-municipality's own tangible assets or the personal assets of its inhabitants. This leaves the taxing power of the municipality as the sole source of revenue to which a bondholder can look when a municipality defaults on its general obligations. The balance of this Note will be devoted to answering many of the questions which arise in connection with this problem. How does a creditor determine the extent of this amorphous asset? How does he employ the judicial process to compel the exercise of this power for his benefit? What affirmative defenses can a defaulting municipality assert to thwart a creditor's attempt to gain control of the taxing power? What is the effect of a municipality's assertion of "insolvency" on the creditor's ability to control the taxing power?

The Taxing Power

To understand the remedy that courts provide to bondholders, it is first necessary to examine the nature of the asset which secures the municipality's creditors. As previously noted, a municipality issuing a general obligation bond pledged its general revenues to the payment of the debt. Realistically, a municipality generates such revenues almost entirely by levying and collecting taxes. It is elementary that the power to levy taxes belongs to the legislature or some equivalent body ultimately responsible to the electorate. Certainly the judiciary does not ordinarily exercise such power. From this basic concept flow many of the limitations on bondholders' ability to compel the exercise of the taxing power for their benefit.

In the first place, courts cannot seize the taxing power by execution either to "distribute" it to creditors or to exercise it on their behalf.

57. Indeed, commentators and courts have long recognized that "[s]ubstantially the only asset of a municipal corporation of any importance to its creditors is its taxing power." Dimock, Legal Problems, supra note 3, at 40; see Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 509 (1942) ("The principal asset of a municipality is its taxing power. . . ."); 17 McQuillin § 49.42 ("Ordinarily the only means that a municipal corporation has for the payment of its liabilities is the power of taxation . . . ."); RAYMOND 183.

58. See note 6 supra.


60. Id. at 518, 519 ("No Federal court . . . has any inherent jurisdiction to lay a tax for any purpose or to enforce a tax already levied, except through the agencies provided by law"); Guardian Savings & Trust Co. v. Road Improvement Dist. No. 7, 267 U.S. 1, 6 (1925); Barkley v. Levee Comm'rs, 93 U.S. 258, 265 (1876).

Absent a specific statute, no court would direct one of its officers to levy and collect a tax of any amount. Clearly this rule is based upon notions of separation of powers and a perception of the limitations of the judicial function. However, in light of the remedy courts do provide to enforce the pledged taxing power—mandamus to levy and collect a tax—it could be plausibly argued that the courts' refusal to deal directly with a municipality's taxing power is merely a formalistic and conceptual application of the doctrine of separation of powers; that to sanction mandamus instead of a more direct remedy elevates form over substance, substituting hollow concepts for practical analysis. The unfortunate result is that the creditor is left with a wooden, easily thwarted remedy. After looking more closely at the remedy of mandamus, this Note will again raise the question whether courts should provide for more direct assistance.

**Mandamus**

Though courts do not directly levy a tax in a municipality's stead, they do provide a remedy which can be roughly equivalent to such action. "The public debtor without property or funds from which a
claim may be satisfied may be subjected to a process which has scant
analogy in the case of the private debtor—mandamus to compel taxa-
tion. This remedy is, within limits, available everywhere in this coun-
try.”8 The crucial question is, of course, under what circumstances a
court will grant the writ.69

Mandamus is “a command, issuing from a court of competent
jurisdiction . . . requiring the performance of a particular duty therein
specified, which duty results from the official station of the party to
whom the writ is directed, or from the operation of law.”70 As this
definition implies, a court can issue the writ to command a specific
action only when the duty to act is one imposed by statute. This means
that a court can grant the writ on behalf of a bondholder only when
there is statutory authority in some organ or official of the municipality
to levy a tax.71 It is also said that the duty sought to be enforced must
be mandatory and non-discretionary.72 In theory, these general limita-
tion on the issuance of mandamus to aid a bondholder-creditor could
substantially restrict the circumstances in which the writ will issue. As
a practical matter, however, neither limitation has proven a serious
obstacle to the enforcement of those rights for which the bondholder has
bargained.

Insofar as the statutory authorization requirement is concerned, it
is clear that there must first exist some direct or implied constitutional
power to tax for the purpose of paying creditors.73 No municipal

8 In Municipalities, 45 Yale L.J. 702, 706 (1936) (mandamus is in effect a method
of executing a judgment against a municipality).

68. Fordham 44. E.g., Meriwether v. Garrett, 102 U.S. 472, 515 (1880); County
609, 612 (1967); May v. Board of Directors, 34 Cal. 2d 125, 129, 208 P.2d 661, 664
(1949); Delta County Levee Improvement Dist. v. Leonard, 516 S.W.2d 911, 913 (Tex.

69. It is assumed that a bondholder already has a valid judgment for the amount
which the municipal corporation owes him.

70. 17 McQuillin § 51.02.

71. “Mandamus will lie only to require the discharge of an official duty on the
part of a person filling an official or quasi-official position.” Id. § 51.12. See also
id., § 49.42.

72. Fordham 34; see 17 McQuillin § 51.43 (duty must be “ministerial”). Issuance
of the writ is also said to depend on the absence of other adequate legal remedies.
Fordham 33. As the previous discussion of alternative remedies has shown, this require-
ment will not often bar a bondholder from obtaining the writ. Cf. Shamrock Towing
Co. v. New York, 20 F.2d 444, 445 (E.D.N.Y. 1927) (court refused to grant mandamus
because creditor failed to execute upon the private property of the municipality).

73. See Fordham 44-45 (power to tax will be implied from the grant of a power
to incur indebtedness).
corporation could exist without such power. The state constitution, however, may impose an absolute limit on the amount of such levies.\textsuperscript{74} According to the theory of mandamus, this would place a ceiling on the size of the tax which a court could direct a municipal corporation to levy.\textsuperscript{75} The bondholder must therefore accommodate himself to any constitutional limitations upon his power to compel a tax for his benefit. Viewed from the perspective of what he has bargained for, however, his right to mandamus is really not limited at all. That is, in a general obligation bond, a municipal corporation promises to pay the debt out of its general revenues. The general revenues are in turn secured by a promise of full faith and credit—essentially a pledge to exercise the taxing power to assure a level of revenue sufficient to pay principal and interest. The extent of the bargained-for taxing power is defined by the constitutional limits. Such limits circumscribe the bondholder's legitimate expectations and therefore his rights; they are not in any sense a limitation inherent in the form of the remedy of mandamus. That the maximum levy will not generate revenues sufficient to meet the municipal debtor's obligation to him is simply an economic risk which the bondholder has taken.\textsuperscript{76}

It is likely that a specific statute will provide the authorization for a municipality to levy a tax in order to pay its bonded indebtedness.\textsuperscript{77} Certainly a bondholder would prefer that the generic statute authorizing

\textsuperscript{74} Id.

\textsuperscript{75} See Note, 38 Mich. L. Rev. 259, 260 (1939). The theory is that the court itself cannot levy a tax for the benefit of a municipality's creditors, as it lacks the power. The court can nevertheless order the proper municipal body to carry out a legal duty which requires no exercise of "discretion." As an obvious prerequisite to the finding of a legal duty, a court must first discern a constitutional authorization, express or implied; the presence of an absolute ceiling would clearly preclude a finding of authorization. See Meriwether v. Garrett, 102 U.S. 472, 531 (1880) (Strong, J., dissenting) (court has power to enforce ministerial act of collecting a tax already levied whereas it would not have power to levy that same tax).

\textsuperscript{76} The bondholder could, of course, attempt to minimize the risk. First, he would not purchase bonds of a municipality that was already exacting a tax close to the constitutional limit. Second, the bondholder would try to insure against the future profitability of the municipal debtor. This is an acute problem for the bondholder given the doctrine that a municipality's current expenses have priority over principal and interest on his bond when general revenues are insufficient to satisfy both. See notes 104-05 infra and accompanying text. Were the debtor a private corporation, the bondholder could protect himself effectively. He would limit the right of the debtor to incur obligations in the future. Various contractual arrangements with the debtor would achieve this goal. However, when the debtor is a municipal corporation, it is by no means clear that a private creditor can so limit its power to incur future obligations. See generally Comment, supra note 4, at 1338-52.

\textsuperscript{77} See, e.g., Fort Lee v. United States ex rel. Barker, 104 F.2d 275, 280-81 (3d Cir. 1939) (New Jersey statute making it duty of municipal corporation to levy tax sufficient to pay judgments against it); May v. Board of Directors, 34 Cal. 2d 125,
municipal corporations to borrow money and to issue bonds state explicitly what powers are vested in the corporation to levy taxes.\(^7\) Such specificity is desirable because of the rule that mandamus will issue only to compel a ministerial as opposed to a discretionary act. The more precise the statutory grant of the taxing power, the less plausible will be the municipality's argument that mandamus is inappropriate because the duty to tax is discretionary.\(^7\) In any event, courts apparently do not strictly construe the concept of legal compulsion in these cases. "If a tax levy is necessary to provide funds courts have experienced no difficulty in finding a clear duty to make the levy even though the power is conferred in permissive terms."\(^8\) In light of the prevalence of precise language in the enabling statutes and this general reluctance of the courts to interpret the requirement strictly, mandamus will not often be refused on the ground that the duty to levy a tax is discretionary.

Thus, neither the rule that mandamus will not issue to compel a tax which would exceed applicable constitutional and statutory limitations nor the rule that mandamus will issue only to compel ministerial (non-discretionary) acts operates in practice to deny the bondholder anything for which he has bargained. This does not mean, however, that mandamus is a satisfactory substitute for execution. In particular, it does not mean that the strained use of mandamus protects the bondholder from dilatory tactics not available when execution is permitted. Two situations illustrate the weakness inherent in the mandamus remedy.

First is the situation in which those officials to whom the writ is directed simply refuse to obey. The court may hold the officials in contempt and perhaps send them to jail.\(^1\) This does not necessarily result in an improvement of the bondholder's plight, however; as the Supreme Court has noted,

128-29, 208 P.2d 661, 663 (1949) (statute imposing duty on governmental unit to levy tax to pay general obligation bonds); State ex rel. Gillespie v. County of Bay, 112 Fla. 687, 725, 151 So. 10, 23 (1933) (statute imposing duty on county officials to levy tax).

78. Such a statute might itself contain a limitation on the amount of tax which the municipality could levy comparable to the constitutional limitations discussed above. See note 74 \textit{supra} and accompanying text.

79. One example of a statute which leaves little discretion in the municipal officials is one that requires them to levy an annual tax upon land which must raise money sufficient to pay both interest and principal becoming due before the close of the year for which the tax is levied. \textit{See May v. Board of Directors}, 34 Cal. 2d 125, 128-29, 208 P.2d 661, 663 (1949). Thus, the statute effectively fixes the nature, amount and timing of the taxes which secure the bond.

80. Fordham 34.

81. 17 \textit{McQuillin} § 49.49 ("Officers of a . . . city may be required to do all acts within their power to cause a municipality to obey a decree against it, and may be punished for a failure to do so").
we have had the spectacle to taxing officials resigning from office in order to frustrate tax levies through mandamus, and officials running on a platform of willingness to go to jail rather than to enforce a tax levy . . . , and evasion of service by tax collectors, thus making important a court's mandate.\textsuperscript{82}

The bondholder is in a similar plight when there is no one to whom the court can direct the writ in the first instance.\textsuperscript{83} Particular offices may be vacant,\textsuperscript{84} or the state might intercede to alter the nature of the municipal obligor.\textsuperscript{85} Unless the bondholder has some way to force the corporation to fill the necessary offices or to prevent the state from abolishing the debtor, he is for all practical purposes without remedy.\textsuperscript{86}

The Effect of Insolvency

From a bondholder's point of view, then, the remedy of mandamus to compel a tax is inefficient at best and valueless at worst.\textsuperscript{87} This is

\begin{itemize}
  \item \textsuperscript{82} Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 511 (1942).
  \item \textsuperscript{83} See Meriwether v. Garrett, 102 U.S. 472, 515 (mandamus requires someone upon whom the court may act).
  \item \textsuperscript{84} See Barkley v. Levee Comm'r's, 93 U.S. 258 (1876).
  \item \textsuperscript{85} See Meriwether v. Garrett, 102 U.S. 472 (1880) (state abolished municipality); Barkley v. Levee Comm'r's, 93 U.S. 258 (1876) (levee district abolished).
  \item \textsuperscript{86} In Barkley v. Levee Comm'r's, 93 U.S. 258 (1876), the state had abolished the municipal obligor. The governmental units which had replaced the obligor did not possess the authority to assess and collect the taxes in question. The Court concluded that mandamus could not issue to aid the bondholder. "The truth is that a party, situated like the present petitioner is forced to rely on the public faith of the legislature to supply him a proper remedy. The ordinary means of legal redress have failed by the lapse of time and operation of unavoidable contingencies."
  \item \textsuperscript{87} See Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 509-10 (1942), quoted at note 66 supra. But see Fordham 54, where the author concludes that "[s]ubject to the limitation that, unless modified by statute, current expenses have a preference in the exploitation of a power to tax for general purposes, the writ affords creditors an usually effective weapon, which often more than compensates for the substantial immunity of the debtor's property from normal processes of execution." This statement is valid only insofar as it rests on the assumption that the municipal corporation will act in good faith; otherwise it is overly optimistic. See, e.g., Water Users Ass'n v. Board of Directors, 34 Cal. App. 3d 131, 109 Cal. Rptr. 592 (1973); May v. Board of Directors, 34 Cal. 2d 125, 208 P.2d 661 (1949); El Camino Irrigation Dist. v. El Camino Land Corp., 12 Cal. 2d 378, 85 P.2d 123 (1938) (per curiam). These cases chronicle the valiant efforts of some persistent bondholders to compel payment of their obligations. In 1949 the California Supreme Court ordered a recalcitrant irrigation district to levy a tax for that purpose. By 1973 these bondholders had yet to collect one cent of principal or interest. Water Users Ass'n v. Board of Directors, 34 Cal. App. 3d 131, 133, 109 Cal. Rptr. 592, 593 (1973).
true regardless of the financial condition of the defaulting municipality. It is not inappropriate, however, to introduce the financial condition of the municipal corporation as a factor in the analysis of a bondholder's remedies. What effect does the debtor corporation's plea of insolvency have upon a court's decision to issue a writ of mandamus? How does a court evaluate the financial condition of the municipal corporation?

Perhaps the first question to be asked is who benefits from a determination that a municipal corporation is insolvent. Obviously a court cannot order a municipal corporation to pay out funds which it does not have and cannot raise. Thus the immediate benefits of a finding of insolvency accrue to the municipality. It may have to pay only a portion of its obligations, or it may even escape having to pay anything. This is not to say that such a finding relieves the debtor of its obligation to pay. In the absence of a statute a court can neither relieve the municipal corporation of its ultimate obligation nor force the bondholders to accept less than the full amount owed.

It is not inconceivable, however, that a bondholder would also benefit from a finding that the municipal corporation is insolvent. If, for example, a judicial determination of insolvency were to trigger some remedy beyond mandamus that would provide to the bondholders or the court some degree of control over the affairs of the debtor, the bondholder might welcome the finding. As a practical matter, how-

88. [I]n cases of factual insolvency as distinguished from outright repudiation, which is to say cases wherein the debtor taxing district cannot as a matter of fact raise or be made to raise funds sufficient to meet its obligations as they mature, there is no magic in mandamus or any other available judicial writ or decree which will enable the creditors as a whole to collect their due. Dession, supra note 43, at 201.

89. E.g., Borough of Fort Lee v. United States ex rel. Barker, 104 F.2d 275, 283 (3d Cir.), appeal dismissed, 308 U.S. 629 (1939); State ex rel. Bottome v. City of St. Petersburg, 126 Fla. 233, 237, 170 So. 730, 731 (1936); State ex rel. Gillespie v. County of Bay, 112 Fla. 687, 725, 151 So. 10, 23 (1933); see East St. Louis v. Amy, 120 U.S. 600, 604 (1887); North Miami v. Meredith, 121 F.2d 279, 282 (5th Cir.), cert. denied, 314 U.S. 674 (1941).


91. E.g., State ex rel. Dos Anigos, Inc. v. Lehman, 100 Fla. 1313, 1323, 131 So. 533, 537 (1930) (There is "no authority supporting the view that poverty may be successfully interposed as a defense to the payment of lawful obligations . . ."); Morris, Mather & Co. v. Port of Astoria, 141 Ore. 251, 261, 15 P.2d 385, 388 (1932) ("Heavy burdens of debt, although they provoke sympathy for those who struggle under them, can never prompt a court to erase from the bond anything which the debtor wrote there").

92. Some sort of equity receivership has often been suggested. See Dimock, Legal Problems, supra note 3, at 43.
ever, courts do not provide any such remedial device, and it is therefore unlikely that bondholders as a group would ever argue for or support a finding that the municipal debtor was insolvent. It is in this tactical

---


94. There may be situations in which certain classes of bondholders would benefit from a finding of insolvency. See Groner v. United States ex rel. Snower, 73 F.2d 126, 130 (8th Cir. 1934); State ex rel. Drainage Dist. No. 8 v. Duncan, 334 Mo. 733, 741-42, 68 S.W.2d 679, 683-84 (1934); Annot., 171 A.L.R. 1033, 1038-39 (1947).

The solvency of a municipal corporation will be at issue in a common law court only as a last resort for the creditor. Given the vagaries of the mandamus remedy, the bondholder will probably have tried to settle his claim with the municipality through negotiation. See Dession, note 43 supra, at 201. In suing a municipality which a court might find to be insolvent, the bondholder risks having the court spread those payments due him over a number of years. This is essentially an involuntary refunding of his bonds. Moreover, if the corporation's financial condition deteriorates further, there is no guarantee that even a lengthened payment schedule will be met. Finally, assuming the municipal corporation is not found to be insolvent and the bondholder receives the benefit of a writ ordering the debtor to pay its entire contractual obligation, the bondholder has no assurance that the debtor will proceed in good faith. Thus, while a suit may be useful to cut through exaggerated claims of poverty and to put pressure upon the responsible municipal officials to achieve a settlement, it is of limited remedial value to the bondholder.

A bondholder might, however, sue an insolvent municipal corporation in order to obtain a preference for his claim against those of other secured creditors. See, e.g., Clough v. Baber, 38 Cal. App. 2d 50, 100 P.2d 519 (1940); State ex rel. Central Auxiliary Corp. v. Rorabeck, 111 Mont. 320, 108 P.2d 601 (1940); Morris, Mather & Co. v. Port of Astoria, 141 Ore. 251, 15 P.2d 385 (1932). Whether the bondholder can secure a preference by winning the race to the courthouse depends to some extent on the type of bond involved, the jurisdiction he is in, and the court's projection of the financial prospects of the debtor. The trend appears to be against granting preferences according to who is the first to sue. See generally Comment, Rights of Public Corporation Bondholders to Fund Insufficient to Meet Due Interest or Principal Payments, 21 Calif. L. Rev. 161 (1933); Annot., 171 A.L.R. 1033 (1947).

The uncertainty of litigation is disadvantageous to the debtor corporation as well. Except for its value as a dilatory tactic and the chance that a court will approve a generous refunding scheme by spreading it over a number of years, the municipal corporation has little to gain. It will not be relieved of its burden just because it is currently unable to pay. See note 91 supra and accompanying text. Litigation will do nothing to improve its credit rating; furthermore, a court might saddle the municipal officials with the duty to levy a rather oppressive tax. See notes 118-128 infra and accompanying text. One commentator has described this process of litigation as a "common law trial by battle." Dimock, Legal Problems, supra note 3, at 41. In summary,

up to now the only assistance which has been given by judicial proceedings to the solution of the problem of municipal insolvency has been the use of the judicial process by the creditors as a threat to the very existence of the municipality. Almost as valuable as this threat has been the ability of the municipalities successfully to defy it. The interaction of these two forces has in time produced settlement. Id. at 43.

See Dession, supra note 43, at 201 ("litigation by creditors is but ancillary to this main process of extra-judicial negotiation").

Movement toward settlement results from the tension between the bondholder's effort to collect his debt in full and the municipal corporation's effort to preserve itself
setting that courts must decide when a municipal corporation is insolvent with respect to its general obligation bonds. Unfortunately, those courts which have addressed this issue have engaged in little real analysis. The result is considerable confusion as to the meaning of insolvency in the context of municipal corporations.

It should first be noted that the fact that a municipal debtor does not have sufficient revenues on hand at the end of a year to meet its bonded general obligations is completely irrelevant to the issue of its solvency. The reason is that the municipal corporation, within wide limits, has control over the amount of revenue it raises. In a very real sense a municipality has the power to decide for itself whether its obligations will exceed its assets at the end of any particular fiscal year. But the taxing power must be exercised so as to generate sufficient revenue to pay the bonded obligations. If the debtor refuses, the court may order it to do so at the behest of the bondholders. This elementary point is basic to the meaning of insolvency. If the maximum tax levy which a court is willing to order will not produce sufficient revenue to meet all the principal and interest past due and due for the year of the levy, then the municipal corporation is insolvent. This definition of insolvency serves to mark the point beyond which a court cannot give the bondholder his due.

Courts have not articulated this definition, although they have regularly applied it. The proof of this assertion lies in the fact that in any case in which the municipal corporation has not been insolvent as defined above, the court has had no basis upon which to award the bondholders any less than the entire amount of their obligation.

and regain its solvency. Courts are trapped rather helplessly between these adversaries. Certainly the judiciary recognizes that it has only precarious authority over the debtor, that it lacks certain remedial tools requisite to the imposition of a satisfactory settlement, and that its most valuable function may be to exercise authority in a way that will stimulate a voluntary settlement or force the parties to submit to available statutory schemes. See May v. Board of Directors, 34 Cal. 2d 125, 208 P.2d 661 (1949); State ex rel. Bottome v. City of St. Petersburg, 126 Fla. 233, 170 So. 730 (1936) (withholding mandamus to enable debtor to pursue a voluntary statutory remedy). Much of what courts do when a municipal corporation pleads insolvency may be understood in light of this perception of their role and of the goals of the bondholder and the municipality.

95. See, e.g., Rittenoure v. City of Edinburg, 159 F.2d 989, 993 (5th Cir. 1947) (municipality insolvent when it is unable to meet its obligations as they mature).
96. See State ex rel. Dos Anigos, Inc. v. Lehman, 100 Fla. 1313, 131 So. 533 (1930). In Dos Anigos the municipal debtor defaulted on some of its general obligation bonds. The bondholders sought a writ of mandamus ordering the debtor to pay all past due interest (though not past due principal). Id. at 1316, 131 So. at 535. The debtor pleaded its poverty, brought on by the Depression, as a complete defense to the writ. Id. at 1318, 131 So. at 536. The court could find no authority to support
ever a court gives the bondholders less, it has impliedly recognized that the municipality levying the maximum tax cannot meet its bonded obligations as they become due.  The reluctance of many courts to recognize this as insolvency may be attributed to a semantic dilemma. Courts have often viewed the taxing power pledged to secure general obligation bonds as “inexhaustible.”  The power, of course, is “inexhaustible” only in the sense that it must be exercised to its limit so long as obligations remain unpaid.  In this ultimate sense it may be that a municipal corporation can never be “insolvent.” There is no assurance, however, that this “inexhaustible” taxing power will be adequate to meet the debtor's obligations as they fall due. Courts nevertheless seem to have difficulty with the proposition that an entity with an “inexhaustible” source of revenue can be “insolvent.”

The Determination of Insolvency

Before a court can determine that a municipality is insolvent, it must first identify those assets from which the municipality must pay the obligation. In theory, a general obligation bond pledges all assets of the debtor to secure it. But, as has already been noted, a creditor may seize only property held by the municipal corporation for use in some non-governmental function.  As a practical matter, this means that most, such a defense.  Id. at 1323, 131 So. at 537. The debtor then argued that the court should spread the tax levy over a number of years to ease its tax burden.  Id. at 1327, 131 So. at 539. The court noted that the burden might be heavy, but concluded that the debtor had not shown that it had obligated itself beyond its ability to pay in fact. Therefore the court had no basis on which to soften the mandated tax by spreading it over several years.  Id. at 1328-30, 131 So. at 539-40.  Cf. East St. Louis v. Amy, 120 U.S. 600, 604 (1887) (spreading of levy not justified unless to prevent oppressiveness); Defoe v. Town of Rutherfordton, 122 F.2d 342, 343, 345 (4th Cir. 1941) (mandated tax levy will not be eased absent a showing of inability to raise the required money).

97. See State ex rel. Bottome v. City of St. Petersburg, 126 Fla. 233, 238, 170 So. 730, 732 (1936) (dictum) (court can spread tax levy over a number of years “where to require full satisfaction of all that is adjudged to be made by a levy for one year, would be unduly oppressive on the public corporation debtor, or seriously embarrass its financial structure as an agency of local government”); State ex rel. Gillespie v. County of Bay, 112 Fla. 687, 725, 151 So. 10, 23 (1933).


99. Id. at 221, 150 So. at 516 (Brown, J., dissenting).

100. See Kerr Glass Mfg. Corp. v. City of San Buenaventura, 7 Cal. 2d 701, 710, 62 P.2d 583, 587 (1936) (recognizing that an “inexhaustible taxing power” may in fact be exhausted “by reason of economic conditions resulting in a tax-collecting incapacity”).


102. See notes 42-48 supra and accompanying text.
if not all, physical assets owned by the corporation will not figure into the financial calculations necessary to determine insolvency. The only asset of the municipal corporation of real value to the bondholders is its general revenues, secured by the taxing power. Thus any inquiry into the financial status of the municipality begins with an evaluation of this fund.

Unfortunately for the bondholder, the same principles that restrict his access to the physical assets of the municipal corporation restrict his access to the general revenue fund. In any case in which that fund is not adequate to pay both the current operational expenses of the corporation and its bonded obligations, the former have complete priority:

104 Where the interest and principal of a municipal bonded debt is payable out of the general revenues of the town, no part of such revenues that is necessary to meet current, legitimate municipal expenses can be subjected to the payment thereof, but only the surplus of income after the governmental expenditures have been met or provided for can by any process of law be applied to such debt.

When the general revenue fund, after adjusting for current operating expenses, is inadequate to meet the bonded obligation, courts and bondholders look to the municipal corporation's taxing power. This is the asset that secures that fund. The bondholder has the right to demand that the debtor employ it for his benefit. The question of the corporation's solvency thus ultimately comes down to a court's valuation of the taxing power. In making this valuation, the court would, in theory, determine the tax levy (within permissible constitutional and statutory limits) which will produce the maximum flow of revenue into the general revenue fund.

103. See note 57 supra and accompanying text.
104. See, e.g., Johnson v. City of Sheffield, 236 Ala. 411, 414, 183 So. 265, 268 (1938); White v. Mayor of Decatur, 119 Ala. 476, 480, 23 So. 999, 1000 (1898); State ex rel. Phelps v. Borough of Fort Lee, 14 N.J. Misc. 895, 903, 188 A. 689, 693 (Sup. Ct. 1936); Township Comm. v. First Nat'l Bank, 111 N.J.L. 412, 414-15, 168 A. 757, 758 (Ct. Err. & App. 1933); Fordham 41, 54.
105. White v. Mayor of Decatur, 119 Ala. 476, 480, 23 So. 999, 1000 (1898). But cf. State ex rel. Southard v. City of Van Wert, 126 Ohio St. 78, 84, 184 N.E. 12, 15 (1932) ("Current expenses must be secondary to levies to meet mandatory requirements, such as discharge of bonded indebtedness, and interest thereon . . . "). It should be noted that the Southard court found specifically that the municipality had not demonstrated that it lacked the power to raise money sufficient to pay both current expenses and its other obligations. Id.

The degree to which courts scrutinize these current expenses will be discussed at notes 108-16 infra and accompanying text.
106. See notes 73-80 supra and accompanying text.
107. See State ex rel. Buckwalter v. City of Lakeland, 112 Fla. 200, 220, 150 So. 508, 515-16 (1933) (Brown, J., dissenting) (noting practical limit upon the amount of tax revenue which can be generated no matter how high the levy); Note, supra note
Having singled out the appropriate assets, it is next necessary to determine how a court should decide whether a municipal corporation is insolvent, and, assuming insolvency, how a court should assess the actual ability of the debtor to pay. Courts forced to make these determinations have not been generous in explaining their results. Nevertheless, the reported cases do provide a framework for analysis.

The first step in the analysis requires that the court determine the amount of general revenue needed to meet the current operating costs of the municipal corporation. This must be done because these costs have priority over the bonded debt. If the general revenues are insufficient to pay both the expenses and the bonded debt, then the court must consider the extent of the tax which it will order the debtor to impose. Should this tax fail to generate the full amount necessary to pay its obligations, the debtor is insolvent under the definition posited above.

It can be assumed that the debtor will submit its own estimate to the court and that the creditors will attack various parts of the estimate as containing items not necessary for the maintenance of the corporation's essential functions. The question facing the court will be whether and to what extent it should defer to the municipal corporation's conception of its necessary operational expenses.

Some deference is owed to the municipality for much the same reason that courts limit the bondholder to the remedy of mandamus in the first instance. Since the courts lack the power to levy and to collect a tax, it can be argued that they lack the power to determine the propriety of particular public expenditures. Both the power to levy a tax and the power to appropriate money for a particular purpose may be viewed as purely legislative functions (within broad constitutional limits). No court should be anxious to become involved in matters

62, at 948 (increase in tax levy above a certain maximum will produce no appreciable revenue).

The practical problems involved in reaching any conclusion on the size of a maximum levy will be discussed at notes 124-28 infra and accompanying text.

108. The term "current" is used to exclude those expenses that can be characterized as debts the payment of which would create a preference. See White v. Mayor of Decatur, 119 Ala. 476, 482, 23 So. 999, 1001 (1898) (mortgage owed for several years is not a current expense). However, if a municipal debtor needed to borrow funds in order to maintain its daily functions, the obligation thus created would be a "current" expense. See State ex rel. Phelps v. Borough of Fort Lee, 14 N.J. Misc. 895, 903, 188 A. 689, 693 (Sup. Ct. 1936) (giving holder of tax anticipation notes priority over bondholders because "[a] municipality must be able to borrow money to carry on its ordinary business . . . . [M]unicipalities are free to pledge tax revenues . . . .").

109. See notes 104-05 supra and accompanying text.
110. See notes 95-97 supra and accompanying text.
111. See notes 61-64 supra and accompanying text.
112. "If this court should hold that the judiciary may take over and control the
having such immediate and widespread political ramifications. Thus a court would never itself levy and collect a tax. This should not mean, however, that the same court would never scrutinize particular public expenditures to determine whether they are in fact necessary (or at least appropriate) current expenses.

Some degree of review can be justified on the ground that the consequence of a finding that an expense is not necessary (or appropriate) is to deny such an expense priority over the corporation's obligation to its bondholders. To implement this finding, a court could merely conditionally enjoin the particular expenditure, i.e., the municipality could be ordered to make the expenditure only on condition that it first comply with the court's orders with respect to paying the bondholders. Certainly this approach is far less intrusive on the legislative prerogative than an order which results in the levying and collection of a tax by the court itself. Moreover, the granting of an injunction is not a novel exercise of the judicial power and does not carry with it the mechanical difficulties that would attend any attempt to collect a tax. Courts thus possess and should exercise the essentially negative power of passing on the appropriateness of a municipality's current expenditures when it pleads insolvency.

The standard of review to be applied in this determination is crucial. One commentator has taken the view that the propriety of public expenditures is a matter of municipal discretion which should be free of judicial control even to the extent of revising prepared estimates of current expenditures. He would allow courts to interfere "with governmental estimates when and only when bad faith or mistake is established." Certainly one can find courts which have made the same broad statement:

[T]he courts [cannot] determine what municipal expenditures are necessary. If a given expenditure is within charter authorization, and therefore, abstractly considered, a legitimate municipal charge, the courts cannot pass upon the advisability or wisdom of its being made or incurred. That is a matter within the discretion of the municipal authorities. . . . It may be that abuse on the part of such authorities of this discretion would be controlled; that, if bad faith attended its exercise, the courts would intervene . . . .

agencies of government and substitute its judgment for the discretion vested in the legally constituted authorities, the legislative and executive branches of government might as well cease to function." Depew v. Venice Drainage Dist., 158 La. 1099, 1102, 105 So. 78, 79 (1925) (holding that in absence of statute, a court has no power to appoint receiver for insolvent municipal corporation).

113. Fordham 46.
114. Id.
115. White v. Mayor of Decatur, 119 Ala. 476, 481, 23 So. 999, 1000-01 (1898)
Few courts, however, have had to consider the degree of scrutiny they should apply to a public debtor's list of "necessary" current expenses. It can be argued that courts should use a standard slightly stricter than bad faith, since the bad faith standard would seem to offer the bondholder little protection and might make the court little more than a rubber stamp for a spendthrift municipal debtor. It appears that courts would do no great harm to the principle of separation of powers were they to employ some standard of reasonableness when evaluating the appropriateness of current municipal expenses.\textsuperscript{116}

Having determined which current municipal expenditures are necessary and therefore which expenditures have a prior claim on general revenues, the court must then determine the extent of a municipality's so-called "inexhaustible taxing power."\textsuperscript{117} As with estimates of necessary expenses, courts might be expected to defer to the debtor's own projection of the maximum practicable levy; setting the amount of a tax levy is, after all, a classic legislative function. Precisely the opposite is true, however. Courts begin with the presumption that the municipal debtor must levy a tax sufficient to pay all its general obligation bonds as they mature.\textsuperscript{118} This is the debtor's promise in the bond contract,\textsuperscript{119} and in most cases a statute will compel this result.\textsuperscript{120} The issue is not how much the mandated levy should be, but rather, on what basis does a

\begin{flushright}
\textit{White} a bondholder to whom the municipality was in default sought to obtain a writ of mandamus to have the mayor and council set aside enough revenues to pay his judgment. \textit{Id}. at 479, 23 So. at 1000. He challenged several municipal expenditures on the ground that they were not made for legitimate municipal purposes. Those expenditures were for water, power, streets, public schools, and a mortgage. The court found all but the last item to be proper. \textit{Id}. at 481-82, 23 So. at 1001. The court found that the mortgage payment was not a valid current expense of administering the government but was, rather, a preference to one particular creditor. The court therefore ordered the municipal officials to pay these excess general revenues to the bondholder. \textit{Id}. at 482-83, 23 So. at 1001.

\textit{Clay County v. McAleer}, 115 U.S. 616, 618 (1885); \textit{East St. Louis v. United States ex rel. Zebley}, 110 U.S. 321, 324-25 (1884) ("[T]he question, what expenditures are proper and necessary for the municipal administration, is not judicial; it is confided by law to the discretion of the municipal authorities. No court has the right to control that discretion . . .."); \textit{Morrissey v. Shenango Furnace Co.}, 280 F. 798, 802-03 (8th Cir. 1922) (amount of revenue needed to function governmentally is "a matter wholly nonjudicial in its character . . .").

\textit{Defoe v. Town of Rutherfordton}, 122 F.2d 342, 344 (4th Cir. 1941); \textit{Maryland Cas. Co. v. Leland}, 214 N.C. 235, 239, 199 S.E. 7, 10 (1938) (suggesting that the needs of government "economically administered" have a prior demand on tax revenues).

\textit{Defoe v. Town of Rutherfordton}, 122 F.2d 342, 344 (4th Cir. 1941); \textit{Maryland Cas. Co. v. Leland}, 214 N.C. 235, 239, 199 S.E. 7, 10 (1938) (suggesting that the needs of government "economically administered" have a prior demand on tax revenues).

See notes 95-101 supra and accompanying text.

\textit{East St. Louis v. Amy}, 120 U.S. 600, 604 (1887).

\textit{East St. Louis v. Amy}, 120 U.S. 600, 604 (1887).

The promise is limited only by the state constitution and applicable statutes, see notes 73-78 supra and accompanying text, and the bondholders may be charged with knowledge of both.
court mandate a levy less than that compelled by the bond contract and applicable statutes.¹²¹ That basis is a finding of insolvency.¹²²

The presumption that the municipal corporation must levy a tax sufficient to meet its obligations suggests that the burden of proving an inability to do so rests with the debtor. In fact, courts do seem to place that burden upon the corporation.¹²³ This result seems fair, as the debtor stands to benefit from a finding of insolvency and will usually be in the best position to supply a court with the data needed to determine the tax to be levied.

There is no indisputably correct formula for a court to apply in deciding the amount of the tax levy it will mandate for the benefit of the bondholders. In theory, the court would impose a levy designed to generate the maximum amount of revenue.¹²⁴ Although it is unlikely that a court could do this with any degree of precision, a general approach to the problem may be articulated. If a court orders a levy which is smaller than the optimum, the debtor receives a windfall of sorts. The consequences of a levy larger than the taxpayers can bear,

¹²⁰ See United States ex rel. Metzger v. Vero Beach, 90 F.2d 70, 72 (5th Cir. 1937); May v. Board of Directors, 34 Cal. 2d 125, 128-29, 208 P.2d 661, 663 (1949); State ex rel. Dos Anigos, Inc. v. Lehman, 100 Fla. 1313, 1322, 131 So. 533, 537 (1930).
¹²¹ See State ex rel. Dos Anigos, Inc. v. Lehman, 100 Fla. 1313, 1328-31, 131 So. 533, 539-40 (1930).
¹²² See note 95 supra and accompanying text.
¹²³ Defoe v. Town of Rutherfordton, 122 F.2d 342, 343 (4th Cir. 1941) (no basis for finding that city cannot raise sufficient revenue); see State ex rel. Dos Anigos, Inc. v. Lehman, 100 Fla. 1313, 1328, 131 So. 533, 539 (1930) (city failed to show that it had bonded beyond its ability to pay in fact).

The locus of the burden of proof in municipal insolvency cases is not as clear as it might otherwise be. There are at least two reasons for this. The first is that most of the cases were litigated during the Depression. Courts apparently took much for granted in light of judicially noticeable general conditions. See State ex rel. Buckwalter v. City of Lakeland, 112 Fla. 200, 220, 150 So. 508, 516 (1933) (Brown, J., dissenting). A second cause for confusion is that several insolvency cases seem to place the burden on the bondholder to show that the debtor was not insolvent. See, e.g., Morris, Mather & Co. v. Port of Astoria, 141 Ore. 251, 267, 15 P.2d 385, 390 (1932). In these cases the bondholder was attempting to compel payment in full from a limited fund—in effect to obtain a preference over other bondholders. In light of the potential injustice resulting from such a preference, the courts have demanded that the suing bondholder show that the debtor is not insolvent so that full payment of his obligation will not prejudice the rights of other secured creditors. See id. ("It was incumbent upon the plaintiff to prove that the resources out of which it sought payment were sufficient to satisfy all").

¹²⁴ State ex rel. Buckwalter v. City of Lakeland, 112 Fla. 200, 221, 150 So. 508, 516 (1933) (Brown, J., dissenting) ("All that the bondholder has the real right to demand is that... the debtor taxing unit shall be compelled to so exercise the taxing power as to produce the maximum of cash returns"); Rippel v. Asbury Park, 118 N.J.L. 45, 48-49, 190 A. 489, 490 (Sup. Ct. 1937).
however, may be disastrous. At the least, an excessive levy would induce those taxpayers able to pay to leave the municipality's tax base in search of a more congenial tax home, stifling potential growth. At the worst, such a levy would result in tax delinquencies and the consequent ownership of the property by the debtor itself. In the hands of the debtor, such property would not produce tax revenues. These possibilities suggest that courts would do well to take a rather conservative approach when deciding the proper amount of a levy.

Considerations of public policy . . . ordain that the taxing power shall be reasonably used. Its unbridled exercise ordinarily frustrates the ultimate purpose . . . and pushing it to the extreme in an attempt to raise the moneys necessary for the satisfaction of a relatively large indebtedness oftentimes renders the remedy inefficacious, as well as subservive of the public interest.

Although such considerations are not often articulated, courts have traditionally approached this issue with caution.

Beyond this, little which is concrete can be said concerning methods for calculating the optimum levy. Precedent can have little value in

125. See Water Users Ass'n v. Board of Directors, 34 Cal. App. 3d 131, 109 Cal. Rptr. 592, 593 (1973); Provident Land Corp. v. Zumwalt, 12 Cal. 2d 365, 85 P.2d 116 (1938) (per curiam). In Zumwalt, the debtor irrigation district was in default on nearly $400,000 in principal and interest due on its general obligation bonds. The court noted that about one-half of the taxable land in the district had already been deeded to the district for nonpayment of taxes. Id. at 316, 85 P.2d at 117. Further, no buyer could be found. While the land was in the debtor's possession no effective remedy existed for the bondholders. "[W]here there are no assessable lands, there is no remedy of assessment." Id. at 377, 85 P.2d at 121. The court did give the bondholders access to rentals derived from the land, subject to the usual limitation for the priority of current governmental expenses. Id. at 376-77, 85 P.2d at 121.

126. Provident Land Corp. v. Zumwalt, 12 Cal. 2d 365, 371, 85 P.2d 116, 121 (1938) (per curiam); El Camino Irrigation Dist. v. El Camino Land Corp., 12 Cal. 2d 378, 380, 85 P.2d 123, 124 (1938) (per curiam) (when district takes over land on which taxes are delinquent, "[t]he land . . . acquired by a district is not subject to assessments and hence produces no revenue except minor amounts from rentals").

The alternative of letting land pass to the debtor by way of delinquency could conceivably be beneficial to creditors. This would be so if, once in the possession of the debtor, such property could be executed upon and sold for the benefit of the creditors. The theory would be that the property is held by the debtor in a nongovernmental proprietary capacity. See notes 42-43 supra and accompanying text. This argument has been rejected with respect to a debtor considered to be a state agency. The El Camino court did not consider the argument with respect to a municipal corporation. 12 Cal. 2d at 383-84, 85 P.2d at 125.

127. Of course in any particular case a court may have good reason for being less conservative. If, for example, the court feels that the debtor is not proceeding in good faith or if it wishes to stimulate the debtor to settle voluntarily, it might lean toward a stiffer levy. See May v. Board of Directors, 34 Cal. 2d 125, 134-35, 208 P.2d 661, 667 (1949) (debtor refusing to negotiate or resort to federal statutory remedy).

this area since no two municipalities will have the same financial problems and since most of the reported decisions were handed down during the Depression. All of this undoubtedly means great uncertainty for bondholders who must resort to common law remedies, as they can never predict with assurance what a court will require of a financially embarrassed municipal corporation.

**Mandamus Against an Insolvent Debtor**

Assuming that a court has valued the taxing power of the debtor and has found it less than adequate to meet its obligations as they become due, the question arises as to how this finding of insolvency affects the remedy ordinarily provided—mandamus. Technically, the poverty or insolvency of the corporation is not considered to be a defense to issuance of the writ;\(^1\)\(^2\)\(^9\) the creditor is said to have a legal right to its issuance.\(^1\)\(^3\) However, as a practical matter, the insolvency of the municipal corporation directly affects the nature of the writ that is issued.\(^1\)\(^3\)

When it has been shown that the municipal corporation is insolvent, the courts, having said that the writ issues as a matter of right, must circumvent their own statements. They do this by holding that although the writ's issuance cannot be denied on equitable grounds, equitable principles do control the nature and the enforcement of its commands.\(^1\)\(^2\) In practice courts have exercised this "equitable discretion" by spreading a tax levy over a number of years when it would otherwise be the debtor's duty to levy it in a single year.\(^1\)\(^3\) This avoids

---

129. May v. Board of Directors, 34 Cal. 2d 125, 130, 208 P.2d 661, 664 (1949); State *ex rel* Dos Amigos, Inc. v. Lehman, 100 Fla. 1313, 1323, 131 So. 533, 537 (1930); Fordham 52 ("The prevalence of extreme public and private financial distress has been definitely rejected during this and earlier periods of stringency as a defense to coercer taxation").

130. Defoe v. Town of Rutherfordton, 122 F.2d 342, 344 (4th Cir. 1941); City of Sarasota v. State *ex rel* Evans, 127 Fla. 126, 133, 172 So. 728, 731 (1937).

131. This conclusion is simply an exercise in common sense, because a court will generally not order someone to do a futile act—to pay creditors by levying a tax which by definition will raise no money.


133. E.g., King v. United States *ex rel* Tiedtke, 100 F.2d 797, 798 (5th Cir. 1939); United States *ex rel* Metzger v. City of Vero Beach, 90 F.2d 70, 72 (5th Cir. 1937); State *ex rel* Gillespie v. County of Bay, 112 Fla. 687, 725-26, 151 So. 10, 23 (1933);
an oppressive tax burden. It should be emphasized that a finding of insolvency must precede this exercise of equitable discretion.\textsuperscript{134}

In at least one jurisdiction, enforcement of the writ has been temporarily withheld.\textsuperscript{135} This action was taken not on the theory of avoidance of an oppressive and useless tax levy, but rather in response to attempts of the municipal debtor to develop a refunding plan.\textsuperscript{136} This approach may be criticized in the abstract because the total denial of the creditor’s remedy was not grounded in the total inability of the debtor to pay. In practice, however, this disposition may be a way to insure the fairest result to all of the corporation’s creditors. The purpose of withholding the writ is to prevent recalcitrant bondholders from destroying a negotiated settlement between the embarrassed debtor and its creditors.\textsuperscript{137} Withholding mandamus may be a way to induce acquiescence by a dissenter or at least to prevent such a creditor from starting a stampede to the courts. Moreover, in light of the existence of a federal statute designed to provide a composition binding upon all bond-

---

\textsuperscript{134} See East St. Louis v. Amy, 120 U.S. 600, 604 (1887) (court has discretion to spread levy over a number of years when a one-year levy would otherwise “be so oppressive as to make it proper not to have it all collected at one time . . .”).

\textsuperscript{135} The number of years over which the court may spread the levy would be a function of its valuation of the taxing power as discussed at notes 124-28 \textit{supra} and accompanying text.

\textsuperscript{136} State \textit{ex rel.} Bottome v. City of St. Petersburg, 126 Fla. 233, 170 So. 730 (1936).

\textsuperscript{137} In \textit{Bottome}, a bondholder sought a writ of mandamus to compel the municipality to levy a tax to pay its obligations. The debtor argued that it was in the delicate process of trying to refund its obligations; that a bondholder committee representing ninety percent of its outstanding debt had recommended acceptance of the plan; and that if the bondholder were successful in getting immediate payment this would jeopardize the refunding plan by causing other bondholders to sue individually. The debtor asked that the court withhold the writ for a “reasonable time” so that the debtor would have an opportunity to succeed in its refunding scheme. Finding that the municipality did indeed have a “definite and certain bona fide” plan to refund its obligations in the near future, the court stayed the enforcement of the writ “for a reasonable period of time.” \textit{Id.} at 238-39, 170 So. at 732.

It should be noted that the court at no point explicitly found that the debtor was in fact insolvent. The court may have assumed as much; alternatively, such a determination may have been implicit in its finding of a “bona fide” refunding plan. Finally, that finding may not have been a prerequisite for the court’s denial of the remedy sought by the bondholder. Cf. City of Safety Harbor \textit{v. State ex rel. Smith}, 136 Fla. 636, 187 So. 173 (1939) (court below did not abuse discretion by granting writ when debtor’s refunding scheme had not yet materialized); John Wittbold \& Co. \textit{v. City of Ferndale}, 281 Mich. 503, 507-08, 275 N.W. 225, 226-27 (1937) (rule that mandamus may be withheld pending success of debtor’s refunding scheme not applicable on facts presented).

\textsuperscript{137} See Note, \textit{supra} note 62, at 947 (in hands of dissenting bondholder remedy of mandamus may disrupt a compromise acceptable to large majority).
holders, the refusal of a state court to grant a common law remedy may be viewed as an exercise in comity. Absent any ability to gain a preference, bondholders may be more inclined to negotiate and to cooperate with the municipality in resorting to the federal statute. This reasoning was especially valid when the existing federal statute contained a threshold requirement of fifty-one percent bondholder approval of a plan before a municipal debtor could even invoke federal jurisdiction. Since this requirement has been eliminated and the federal courts have been given the power to stay all other proceedings relating to the collection of debts from the petitioner, state courts may have fewer occasions to exercise their discretion to stay the issuance or enforcement of the writ. Nevertheless, this type of equitable discretion provides the court with a flexibility which is useful and which should be retained.

VI. CONCLUSION

Central to an understanding of the structure of municipal finance is

139. Cf. City of Asbury Park v. Christmas, 78 F.2d 1003, 1004 (3d Cir.), cert. denied, 296 U.S. 624 (1935). In Christmas, the bondholder sought a writ of mandamus to compel the city to levy a tax. Federal jurisdiction rested on diversity. The common law in New Jersey provided that the writ issued as a matter of right to aid bondholders. See Borough of Fort Lee v. United States ex rel. Barker, 104 F.2d 275, 280 (3d Cir. 1939). However, New Jersey had recently enacted special legislation designed to expedite these proceedings by, among other things, providing for a special commission to process complaints against defaulting municipalities. At the time of the instant petition that commission was in the process of working out a refunding plan for the debtor. Dimock, Progress, supra note 3, at 198. In light of the existence of the state remedy, the federal court, applying principles of comity, exercised its discretion to withhold the writ. Id. at 194; see Note, supra note 67, at 708. After Erie R.R. v. Tompkins, 304 U.S. 64 (1938), the Third Circuit reversed itself on this point. It held that since the New Jersey courts would not have withheld mandamus completely the federal court could not do so. Borough of Fort Lee v. United States ex rel. Barker, 104 F.2d 275, 280 (3d Cir. 1939). The decision has been criticized on this point, see Dimock, supra, at 199-201, and has been implicitly overruled on its other main point, see Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502 (1942). However, it is important to note that the Third Circuit, in reversing itself in Fort Lee, in no way reached the question whether, as a matter of sound policy, a court should exercise its discretion and withhold mandamus when the debtor has or is availing itself of a statutory remedy. It held only that New Jersey courts would not do this and that Erie therefore compelled the same result in the federal courts. The essential policy on which the Asbury court relied remains sound. See Dimock, supra, at 195, 199.
an appreciation of the problems which face holders of general obligation bonds when their obligor defaults. These remedies are defined initially by the debtor's pledge of its full faith and credit. Beyond this, bondholders' remedies are further circumscribed by various public policies. Some of these retain their validity while others may be anachronistic. Failure to examine these policies has resulted in both overly pessimistic and overly optimistic opinions with respect to the efficacy of the available remedies. The purpose of this Note has been to describe those remedies with special attention to their inherent limitations and to provide a framework within which those limitations may be evaluated.

Three interrelated yet conceptually discrete considerations appear to limit available remedies. The first and most obvious are those pre-existing limitations on the extent of the remedy of which the bondholder may be held to have been on notice. These are the restrictions which are to be read into the pledge of full faith and credit that was extended at the time the contract was made. An example of such a limitation would be a statutory or constitutional limit on the debtor's taxing power. A bondholder should be aware of such a limitation; when he accepts a bond which is so restricted, he takes the risk that the limit may be exceeded.

The second class of limitations is comprised of the restrictions on the form of the remedy. While the form of the remedy may also be altered by statute (of which possibility the bondholder may be held to have notice), these limitations are not an aspect of the full faith and credit pledge. Rather, they arise from the courts' refusal to exercise the taxing power directly. These self-imposed limitations stem from judicial notions of the division of governmental powers. The indirect remedy of mandamus, as noted, leaves the bondholder vulnerable to various frustrating tactics which may go so far as to emasculate the remedy.

The third class of limitations relates to the first in that it also limits the extent of the remedy. The current operating expenses of the municipal corporation are given priority over payment of the bonded debt. This is true regardless of the severity of the financial condition of the debtor municipality or the remoteness of the likelihood that the bondholders will ever be paid. The source of this limitation lies neither in the pledge of full faith and credit nor in notions of separation of powers; it comes, rather, from the concept of sovereignty. The inherent priority of the needs of the community is here elevated to the status of a legal principle.

Any criticism of these court-imposed limitations on the extent and form of the remedy entails an examination of the source from which the
particular limitation emanates. Thus the rule which gives priority to the current operating expenses of the debtor must stand on a policy of preservation of the essential functions of the sovereign at the expense of private creditors. While some may question the long-term consequences of favoring the public, it is difficult to argue that a court should be permitted to preside over the destruction of a governmental unit. Indeed, the policy behind this limitation would appear to be so basic that it may be doubted whether a bondholder could successfully enforce an explicit contractual provision for its abrogation.\textsuperscript{143}

Conversely, the court-imposed limitation upon the form of the remedy available to bondholders, based as it is upon ideas of proper judicial functions, is open to substantial criticism. As courts apply it to municipal corporations, mandamus can be viewed as a formalistic application of the doctrine of separation of powers. This is demonstrated by a comparison of theory and practice. The basis for the use of mandamus rather than a more direct remedy is that the levying of a tax is a legislative function; a direct levy by a court would be an unacceptable intrusion into the legislative domain. But when a municipal corporation defaults on its general obligation bonds, the courts, acting under the rubric of mandamus, order the municipal officials to levy and collect a tax of specified amount and to pay over any surplus revenues generated. Thus the only aspects of the "legislative" process in which courts refuse to become involved are the purely mechanical steps of voting to impose a levy and of collecting it. The truly legislative aspects of the process—the decision to levy a tax and the determination of the amount of that levy—are carried out by the judiciary. The legislative body retains its symbolic function, but without any substantive power.

Courts justify their exercise of the power to set the amount of the tax and to order its imposition and collection by pointing out that the state has already lowered the barriers of the separation of powers doctrine by enacting statutes which make the bonds payable from general revenues and which make "mandatory" the levy of a tax sufficient for this purpose.\textsuperscript{144} It is not clear, therefore, that a municipal tax officer's willful disobedience of a court order should prove an insuperable barrier for a creditor when the court has already told a legislative body how it must vote. There is no reason to believe that the state, having given the judiciary a remedial power essentially legislative in

\textsuperscript{143} See Comment, \textit{supra} note 4, at 1338-52.

\textsuperscript{144} Another example would be a statutory prohibition against the bondholders seizing the property of individual inhabitants upon the default of the municipal corporation in which they reside. See notes 49-56 \textit{supra} and accompanying text.
nature, intended for that remedy to be thwarted by the mere bad faith of a local governmental official.

This is not to dispute that mandamus is ordinarily the preferred remedy. Certainly the courts are not well equipped to levy and collect taxes. The cooperation of the municipal debtor in the court's consequent supervised use of its taxing machinery would relieve the court of the heavy burden of directly overseeing a most unpopular process. Moreover, a court should respect the municipal corporation's form of government to the greatest extent possible. The remedy of mandamus serves such policies well. But the formalities surrounding the mandamus remedy should not be used to thwart creditors' legitimate recoveries. When the municipality refuses in bad faith to comply with a court's mandate, the court should have the power to levy the tax directly.

This Note has sought to outline the remedies available to a creditor when a municipal debtor defaults on its obligations. The position of the creditor can be gloomy indeed, given the functions which a municipality must carry out and with which the court will not interfere and the rigid denial of effective remedy to which the use of mandamus can lead. It is to be hoped that closer judicial analysis in the future will lead to less deference to an artificial separation of powers concept and that more effective remedies will evolve. Until such time, however, the municipality will hold a controlling position in a default situation, and the creditor's most effective remedy will lie in careful bond purchases rather than in attempted collection after default.