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States—Device for “Avoidance” of Constitutional Debt Limitation

Provision in the Wisconsin Constitution that “The state shall never contract any public debt...” led the Wisconsin Legislature to authorize a complex plan for financing an extension to an existing state office building. Following statutory authority, the State Building Commission (hereafter called “the commission”) proposed to lease the existing building, and the land upon which it stood, to the Wisconsin State Public Building Corporation (hereafter called “the corporation”), a dummy corporation. The consideration was one dollar, and the lease was made on condition that the corporation construct a desired extension to the office building. The lease was for fifty years, and expressly authorized the corporation to borrow money from the State Investment Board to finance construction of the extension by mortgaging the leasehold interest in the existing building and lands. By an agreement between the State Investment Board and a private insurance company, the latter was to take over the loan. The corporation was to re-lease the entire property back to the commission, for a term of thirty-four years, at a rate equal to the semi-annual payment of principal and interest on the corporation’s mortgage. The commission in turn was to rent space in the building to the various state agencies—the rent being paid from general tax revenues. Upon default of the corporation’s obligation the mortgagee-insurance company was given power to foreclose upon the leasehold interest and dispose of it at public auction. In a declaratory judgment action to determine the validity of this statutory plan, held: the statutes, insofar as they authorized mortgaging an interest in the existing building and lands, were unconstitutional and void. In so doing, the court repudiated a case precedent of twenty-five years standing, upholding a similar plan.

Debt limitations in one form or another appear in many state constitutions. Such limitations were largely an outgrowth of reckless financing and imprudent lending of state credit, to finance canals, railroads, and other internal improvements in the middle

3 The court decided that the corporation was “...not an agency or instrumentality of the state, but a private corporation organized for a public purpose... The fact that its purposes are of such a public character or that it has been incorporated by state officers, are insufficient to cause it to be a state instrumentality or agency.” State ex rel Thomson v. Giessel, 267 Wis. 331, 65 N.W.2d 529, 534 (1954).
4 State ex rel Thomson v. Giessel, 267 Wis. 331, 65 N.W.2d 529 (1954).
1800's, and were designed mainly to protect future generations from burdensome taxes, and to preserve state credit. It is evident, however, that if the word "debt" were given its broadest signification, many essential functions of state government would be impossible. Recognizing these considerations, the generally accepted view is that "debt," as referred to in state constitutional debt limitation provisions, results only when a liability which could be met out of future taxation has been incurred. Such interpretation has lead to judicial acceptance of the "special fund" doctrine, whereby an obligation to provide payment solely from a special fund resulting from the revenues of a given project does not constitute a debt.

In form, the financing arrangement in the instant case created no present liability, as the only apparent obligation of the state was to make future rent payments. Moreover, those rent payments were to be taken only from "revenues" derived from operation of the building. But the obligation to pay rent from the "special fund" was accompanied by a mortgage whereby the state might lose the use of its office building for a period of up to thirty-four years should the special fund "revenues" be insufficient to meet maturing rent. The court had no difficulty in determining the practical effect of the plan. Rather than risk loss of the use of its existing office building, the court felt the state would be effectively coerced to make its rent payments. Since revenue from operation of the building was to be derived solely from rent for office space, charged to the various state agencies, it is apparent that the ultimate burden would have been borne by the taxpayers of the state. Hence, the Wisconsin court concluded that the substance of the proposed plan of financing fell within the constitutional debt limitation.

In reaching its conclusion, the court pointed out that the legis-

5 Williams and Nehemkis, Municipal Improvements as Affected by Constitutional Debt Limitations, 37 Col. L. Rev. 177 n.1 (1937) describes the historical development of limitations upon state indebtedness.
7 Williams and Nehemkis, supra note 5, at 198; 23 Rocky Mt. L. Rev. 360 (1950).
lature would have had power to authorize the state to enter long-
term leases for office space to house state agencies. And if the
lessor of such premises leased to the state would mortgage them
to finance construction of improvements required under the lease,
the arrangement would have been proper.\textsuperscript{10} This dictum is con-
sistent with the generally accepted view that a long-term lease
of property does not result in “debt,”—the rationale being that
the common-law landlord-tenant relationship does not result in
present liability for future rent.\textsuperscript{11} But if a court is to examine
the real substance of a plan, it is difficult to see how the plan
spoken of with approval by the court would differ much in sub-
stance from the one it struck down. As a practical matter, the
compulsion upon the state to pay its rent, or be compelled to
move lock, stock, and barrel from a building which is the heart
of its governmental activity, would be almost as great, even though
the state stood to lose the use of no property to which it held legal
title. Be that as it may, however, there seems little basis for
disagreement with the holding of the case that the plan, as pro-
posed, would have resulted in an obligation of a sort sought to be
prevented by the constitutional limitation.

Nebraska has a constitutional debt limitation very similar
to that of Wisconsin.\textsuperscript{12} As a result, construction of university and
normal school dormitories has been financed by three party ar-
rangements, including a dummy corporation, similar to the Wis-
consin plan.\textsuperscript{13} At present, statutory authority exists for the is-
suance of further state school housing bonds.\textsuperscript{14} Statutory authori-
ization for turnpike authority financing was enacted in 1951 by
the Nebraska Legislature,\textsuperscript{15} but the authority was abolished by
the 1955 Legislature.\textsuperscript{16} Presently outstanding dormitory bonds
are payable solely from the “net rentals” derived from operation
of the dormitories.\textsuperscript{17} Statutory authority for financing proposed

\textsuperscript{10} State ex rel Thomson v. Giessel, 267 Wis. 331, 65 N.W.2d 529 (1954).
\textsuperscript{11} State ex rel Thomson v. Giessel, 267 Wis. 331, 65 N.W.2d 529 (1954); Bowers, Limitations on Municipal Indebtedness, 5 Vand. L. Rev. 37, 51 (1951).
\textsuperscript{12} Neb. Const. Art. VIII, § 1.
\textsuperscript{13} The dummy corporations are incorporated pursuant to Neb. Rev. Stat.
\textsuperscript{14} L.B. 138, passed at the 1955 Session of the Nebraska Legislature.
\textsuperscript{17} Neb. Rev. Stat. § 85-402 (Reissue 1950).
additional housing facilities for students eliminates use of a dummy corporation (to assure favorable tax treatment of the interest on such bonds), but the only obligation upon the state would be to provide payment solely from "revenues" of the project.\textsuperscript{18} Payment of proposed turnpike authority bonds would have been secured solely from a pledge of tolls resulting from operation of the turnpike.\textsuperscript{19}

The validity of these arrangements has not been litigated in Nebraska, but the Supreme Court of Nebraska has indicated that "debt" is not created where "...the burden on the taxpayers... [cannot] be in any manner affected thereby...."\textsuperscript{20} Consideration of the Nebraska statutes authorizing the financing plans referred to indicates that the ultimate burden could not be borne by the taxpayers of the state, for the special funds pledged are derived from independent sources of revenue, and \textit{not} from general tax funds. Hence, it appears that even if the principle of the Wisconsin case be applied in Nebraska, existing or presently authorized Nebraska financing should be unaffected, for the Wisconsin plan would have resulted in a greater burden upon the taxpayers.\textsuperscript{21}

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\textsuperscript{18} See note 14 supra.
\textsuperscript{20} Kirby v. Omaha Bridge Commission, 127 Neb. 382, 255 N.W. 776 (1934).
\textsuperscript{21} This conclusion is supported by the fact that Wisconsin itself approved turnpike authority financing in State ex rel Thomson v. Glessel, 265 Wis. 185, 60 N.W.2d 873 (1953), and affirmed that holding in the instant case by stating that turnpike bonds in Wisconsin would not constitute an indebtedness of the state.