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Constitutional Debt Limitations--Are Highway Authority Obligations "Debts" of the State?

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CONSTITUTIONAL DEBT LIMITATIONS—Are Highway Authority Obligations "Debts" of the State?—In an effort to meet the tremendous problems of financing the highways of the Commonwealth, the 1954 General Assembly of Kentucky enacted legislation which provided for the establishment of the Kentucky Highway Authority. Under the provisions of this legislation, known as the Kentucky Highway Authority Act, selected state highways were to be transferred to the Kentucky State Highway Authority by the Department of Highways. The Authority was to issue revenue bonds to secure funds with which to improve roads and then to lease them back to the Department of Highways at a sufficient rental to retire the bonds within forty years. These lease agreements were to contain pledges, for the full term of the leases, of the "current resources" of the Department of Highways for each biennium therein included. "Current resources", as defined by the Act, included substantially all funds biennially accruing to the Department of Highways except certain specified funds which had been previously ear-marked for other uses. The Governor refused to name the appointive members of the Authority and suit was instituted by the Commissioner of Highways to compel him to perform this duty which had been imposed upon him by the Act. The Circuit Court

1 Since World War II, vehicle registrations in Kentucky have almost doubled; construction and highway maintenance costs have risen greatly. These factors, coupled with the fact that highway construction was virtually halted during the war, have combined to render current revenues insufficient to meet current highway maintenance and construction needs, or to provide for needed expansions in the highway system of the Commonwealth. In 1954, Federal highway matching funds for use in Kentucky were materially increased, but because the funds can be used only for new construction and must be matched by state funds, it was doubtful at the time of the decision noted herein that Kentucky would be able to take advantage of the entire amount of Federal aid available because of lack of sufficient funds to devote to new construction. In the Declaration of Legislative Policy included within the Kentucky Highway Authority Act, it is stated: "It is the declared policy and purpose of the General Assembly, in enacting this Chapter, to foster, promote, and expedite the construction, maintenance and improvement of a modern and adequate system of roads throughout the Commonwealth, in the interests of the public safety and general welfare; and, in the furtherance of such policy and purpose, to authorize the maximum financial commitments permissible under the provisions of the Constitution." Ky. Rev. Stat. 175.005 (Supp. 1954).


3 Curlin v. Wetherby, 275 S.W. 2d 934, 935 (Ky. 1955).


5 Ky. Rev. Stat. 175.030(1) (Supp. 1954) provides that "Within ninety days after March 22, 1954, the Governor shall appoint the citizen members of the Authority. . ."
dismissed the plaintiff's petition, holding the Act void in that it violated the limitations upon the authority of the General Assembly to create indebtedness imposed by sections 49 and 50 of the Kentucky Constitution. On appeal, the Court of Appeals affirmed, holding unanimously that the provisions of the Act which permitted the Department of Highways to pledge, for the full term of the leases, its current resources for each biennium included in the leases, authorized the creation of an unconstitutional indebtedness of the Commonwealth. 

Curlin v. Wetherby, 275 S.W. 2d 934 (Ky. 1955).

It is a basic principle of Kentucky constitutional law that an obligation which is incurred in one biennium and which is payable in subsequent bienniums is a debt within the meaning of the limitations imposed upon indebtedness by the Kentucky Constitution. Obviously the lease agreements contemplated by the Act authorized the Department of Highways to contract obligations in one biennium which were to be payable in subsequent bienniums, and in that sense authorized the creation of a debt. The ultimate question, however, in the instant case was not whether the Act authorized a debt, but whether the Act authorized the creation of a debt of the Commonwealth within the meaning of the constitutional debt limitations. To sustain their contention that no debt of the state was authorized by the Act, the appellants advanced two theories: (1) that the Commonwealth itself would not be bound by the agreements in that the General Assembly in any future biennium could repudiate the leases by refusing to appropriate funds to the Department of Highways, or, in other words, the legislature, by failing to appropriate funds defined in the Act as "current resources" to the Department of Highways, could at any time effectively escape all liability under the lease agreements; and (2) that under the "special fund doctrine", obligations payable solely from funds appropriated to the Department of Highways under Section 230 of the Kentucky Constitution, as in the instant case, are

Sec. 49 of the Kentucky Constitution provides that "The General Assembly may contract debts to meet casual deficits or failures in the revenue; but such debts . . . shall not at any time exceed five hundred thousand dollars . . . ." Sec. 50 of that instrument provides that "No Act of the General Assembly shall authorize any debt to be contracted on behalf of the Commonwealth except for the purposes mentioned in Sec. 49, unless provision be made therein to levy and collect an annual tax sufficient to pay the interest stipulated, and to discharge the debt within thirty years; nor shall such act take effect until it shall have been submitted to the people at a general election, and shall have received a majority of all the votes cast for and against it . . . ."

State Highway Commission v. King, 259 Ky. 414, 82 S.W. 2d 443 (1935); Billeter & Wiley v. State Highway Commission, 203 Ky. 15, 261 S.W. 855 (1924); Crick v. Rash, 190 Ky. 820, 229 S.W. 63 (1921).

Sec. 230 of the Kentucky Constitution as amended in 1944 provides that " . . . No money derived from excise or license taxation relating to gasoline and
not debts of the Commonwealth within the meaning of the Constitutional prohibition against debt.

The court rather summarily disposed of the first contention of appellants in the following language:

We think that it is an inescapable conclusion that if a state agency performing a major function of government obligates the funds to be appropriated to it in future years, a debt of the state is created, because the state cannot abandon or discontinue the function and still continue to operate as a government.9

The court supported this conclusion by pointing out that Section 230 of the Kentucky Constitution restricts to road purposes the expenditure of all revenues from the gasoline tax and other motor vehicle taxes, and that any decision by a subsequent legislature to repudiate the lease agreements by refusing to appropriate these funds for road purposes would necessarily involve an abandonment of these revenue sources altogether.

The second argument advanced by appellants, based on an application of the special fund doctrine, proved considerably more troublesome to the court. It is almost universally held that obligations of the state or an agency thereof which are payable exclusively from a special fund, and for which the general credit of the state is not pledged, are not debts of the state within the meaning of state constitutional debt limitations.10 This unqualified statement of the rule is of little practical value without further inquiry into the rather difficult problem of what is necessary to constitute a special fund within the meaning of the doctrine. Nearly all jurisdictions agree that if an obligation is payable solely from the revenues realized from the operation of the particular utility or property acquired with the proceeds of the obligation, it is payable from a special fund and therefore is not

other motor fuels, and no monies derived from fees, excise or license taxation relating to registration, operation, or use of vehicles on public highways shall be expended for other than the cost of administration, statutory refunds and adjustments, payment of highway obligations, costs for construction, reconstruction, rights of way, maintenance and repair of public highways and bridges, and expense of enforcing state traffic and motor vehicle laws.”

*Supra* note 3, at 936-937.

a debt within the meaning of constitutional debt prohibitions. The rationale of this rule, known as the "self-liquidating plan" in Kentucky, is that the obligation never becomes a general liability of the state, or an additional burden on its taxpayers, as the rights of the creditors are limited to the income produced by the capital assets purchased with the funds which they have furnished.

Many jurisdictions have extended the special fund doctrine to include obligations payable solely from a fund created by the imposition of fees, penalties or excise taxes. Appellants contended that the "Good Roads Amendment" to Section 280 of the Kentucky Constitution, in setting aside the gasoline taxes and highway license revenues for road uses exclusively, created such a special fund, and that the rentals, being payable solely from that fund, were not debts of the Commonwealth within the meaning of Sections 49 and 50 of the Constitution. Special funds derived from fees and taxes can be created either by a general statute or by a constitutional provision which earmarks certain funds for specified limited uses. Sharp conflict exists on the issue of whether a fund of this type, created by a mere general statute, can be a special fund within the meaning of the doctrine.

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12 J. D. Van Hooser & Co. v. University of Kentucky, supra note 11. Under the Kentucky version of this "self-liquidating plan", the creditors are not strictly limited to income produced by the capital asset purchased with the proceeds of the obligation. The Kentucky court has repeatedly held that existing state property can be mortgaged and pledged to secure payment of the obligation. This in effect extends the special fund doctrine to a marked degree, for while the state cannot be sued by the creditors for a deficiency judgment, they can foreclose on state property which has been pledged, and to that extent practically can place a g"out of state general funds if necessary. Other cases involving this particular problem include Guthrie v. Curlin, supra note 11; Preston v. Clements, supra note 11; Meagher v. Commonwealth ex rel. Unemployment Compensation Commission, supra note 10; Hughes v. State Board of Health, supra note 10. For a contrary decision on this point, see Wilder v. Murphy, 56 N.D. 436, 218 N.W. 156 (1928).

13 See generally, Annot. 100 A.L.R. 900 (1936).

14 Supra note 8.

15 Cases which have held a fund created by statute to be within the special fund doctrine include the following: Willet v. State Board of Examiners, 112 Mont. 317, 115 P. 2d 257, 259 (1941); State ex rel. Capital Addition Bldg. Commission v. Connelly, 39 N.M. 312, 46 P. 2d 1037, 1101 (1935); State ex rel. Coleman v. Lewis, 181 S.C. 10, 186 S.E. 625, 632 (1936); Moses v. Meier, 148 Ore. 185, 35 P. 2d 981 (1934); Gruen v. State Tax Commission, 35 Wash. 2d 1, 211 P. 2d 651, 679 (1949). Cases holding contra include People ex rel. City of Chicago v. Bar-
In *Crick v. Rash*, the Kentucky Court of Appeals held that a fund composed of fees and taxes and created by statute is not a special fund within the meaning of the special fund doctrine as accepted in this state, saying that:

Under this contention the legislature . . . could divide the public revenue into numerous subdivisions, calling one the "Road Fund", another the "School Fund", . . . and others almost without limit. Debts could then be contracted in unlimited amounts and payable in the far distant future, and still be immune from attack as violating constitutional provisions limiting indebtedness, provided each debt was made payable out of some one of the specially designated funds into which all of the revenue collected by taxation from the people had been divided. A mere statement of the proposition carries with it, it seems to us, its own refutation.  

Insofar as this extension of the special fund doctrine to include statutory funds composed of fees and taxes is concerned, it would seem that the position thus taken by the Kentucky court represents the only view reasonably consistent with the language of the constitutional debt limitations. A contrary conclusion would strip such provisions of all effect and meaning.

However, in the instant case the court was not considering a fund created by mere statute, but was considering the question of whether a fund derived from fees and taxes, created by constitutional provision, is a special fund within the meaning of the doctrine as accepted in Kentucky. The issue had been previously decided in five other states, the court in each jurisdiction holding that an obligation, payable solely from a constitutionally created fund composed of fees, penalties, or excise taxes, was payable from a special fund and was therefore not a debt of the state within the meaning of constitutional debt limitations.  

Despite this persuasive authority the Kentucky
court refused to extend the special fund doctrine to include such funds, holding that the doctrine as accepted in this state contemplates only two types of special funds; those not belonging to the Commonwealth and those collected solely "from private persons in the way of compensation for individual benefits received or as fees for the use of the services of a facility," stating that:

... the gasoline tax and other motor vehicle taxes, being collected from the public generally, must be considered to be sources of public revenue, and as such subject to general constitutional prohibitions against creating obligations against further revenues.

The opinion of the court would seem to further indicate that under no circumstance will the special fund theory be extended in Kentucky to include funds derived from taxes.

The decision turns on the fact that the court considered the Act a deliberate legislative attempt to circumvent the "spirit and purpose" of the constitutional limitations on indebtedness. The court adopts the view that the purpose of the constitutional debt limitation is, at least in part, to prohibit the pledging of future fixed revenues, so that one legislature cannot paralyze subsequent ones by spending revenues otherwise available to each. The court concluded that:

... In the final analysis, the practical result of a state debt is that future government officials are prevented from expending, for what they consider the best purposes, the revenues received during their administration. The fact that the people have expressed through the Constitution, their desire that certain revenues [gasoline and auto license taxes] be expended for a specified purpose, does not mean that the people intended their periodically elected representatives to have any authority other than to expend current revenues for that purpose.

Other courts, in construing substantially similar constitutional debt limitations, have, as we have seen, held that an obligation payable from a constitutionally created fund composed of fees and taxes is not a debt of the state within the meaning of such limitations. Some jurisdictions have upheld this extended special fund doctrine solely upon the ground that the debts referred to in the constitutional limitations are debts which are to be paid from the general property tax, a ground which would leave the legislature almost without limitation

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1 For an example of this type of fund, see Tarter v. Skags, 184 Ky. 58, 211 S.W. 203 (1919).
2 Supra note 3 at 937.
3 Ibid.
4 Supra note 18.
in view of the diminishing proportional importance of the general property tax. In refusing to accept the reasoning followed by these other courts, the Kentucky court has refused to accept a judicial device, the extended special fund theory, which has enabled these other courts to lend approval to legislative schemes designed to circumvent similar constitutional limitations. There can be little doubt that the court has construed the constitutional debt prohibitions substantially as the original framers of these provisions in 1849 intended them to be understood.\textsuperscript{25} The hardship which this decision works on the highway program of the Commonwealth is not the result of an erroneous construction placed upon the Constitution by the Court of Appeals, but is rather attributable to the lack of foresight exercised by the framers of our fundamental law.\textsuperscript{26} The decision properly leaves to the people of the state the task of revising the Constitution to meet the needs of the Commonwealth as they themselves feel those needs exist.

\textit{Gibson Downing}

\textbf{Contracts—Bailments—Effect of Provisions Limiting Liability}

\textit{Printed on Parking Lot Identification Receipt—Plaintiff parked his car overnight in the Parkrite Auto Park in Lexington, Kentucky. He was handed what was apparently a receipt or identification stub upon the back of which was the following limitation of the bailee's liability:}

\begin{quote}

\textsuperscript{26} Even in 1849 some Kentuckians realized that restrictions such as those found in Sections 49 and 50 would become obnoxious to the Commonwealth. In arguing against the adoption of Sec. 35 of Article Second of the Kentucky Constitution of 1849, which eventually became Sec. 49 of the present Constitution, William Preston, Constitutional Convention Delegate from the City of Louisville said: "... There are a hundred reasons why this margin [the $500,000. limit] should be left with the legislature; and I hope that no personal differences of opinion, no little spirit of parsimony will prevail on this floor, on such a subject as this. I hope by our vote on this question we will at least say that the people of the Commonwealth of Kentucky can afford to repose discretion in their legislature, to redeem the honor of their state, as its emergencies might require. Impose this restriction, and you will find that in five or six years an impulse will have sprung up under the influence of wealth and growing prosperity that will call for another constitution.

"... A constitution, sir, is a thing that should be made for ages, if made as it ought to be. It is the embodiment of the great principles lying at the foundation of society, which should be disturbed as seldom as possible. ... I merely ask gentlemen to use some discretion; I ask them not to stigmatize the state by saying that they have no power in all time to come; I ask them not to deprive the state of that self-control which belongs to all truly and well organized bodies." Report of the Debates and Proceedings of the Convention for the Revision of the Constitution of the State of Kentucky, 1849 at 782-783.
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