12-1-1937

Municipal Corporations -- Remedies Allowed Holders of Invalid Bonds -- Constructive Trusts

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Available at: http://scholarship.law.unc.edu/nclr/vol16/iss1/17
anti-injunction legislation, North Carolina might probably avoid the abuses which the use of the injunction has thrust upon labor in other jurisdictions by passing the Model Anti-injunction Act.29

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Municipal bonds, issued for the erection of a school building, were invalid because the city had no constitutional power to devote funds to such purposes. The United States Circuit Court of Appeals for the Fifth Circuit held that the plaintiff, holder of the entire bond issue, was entitled to have the municipality made a constructive trustee of the school building. This had been built on a city lot with funds supplied from the bond issue and by the county board of public instruction. The court decreed that the way was to be left open to the interested parties (the city, county board, and bondholder) "for such adjustments, whether by sale or rental, as may be within their several powers." In a previous action for money had and received the plaintiff had failed because of the Statute of Limitations. In the instant case there is a clear dictum that such an action would not lie on the merits, for the city no longer had the money, nor had it been used for a proper municipal purpose.

It is settled that no action may be maintained on an invalid municipal bond. However, where the city had the power both to borrow money and to devote it to the purposes for which the bonds were issued, the invalidity being due to mere irregularities in form or manner of issuance, the bondholder may recover for money had and received.

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1 Nuveen v. Board of Public Instruction, 88 F. (2d) 175 (C. C. A. 5th, 1937), cert. denied 57 Sup. Ct. 794. The adjustment would probably be a pro rata share. But see Nuveen v. Quincy, 115 Fla. 510, 524, 156 So. 153, 159 (1934) (in a dictum the state court on the same facts said that a constructive trust should be refused).

2 State ex rel. Nuveen v. Greer, 88 Fla. 249, 102 So. 739 (1924).

3 See Nuveen v. Board of Public Instruction, 88 F. (2d) 175, 178 (1937).


5 Louisiana v. Wood, 102 U. S. 294, 26 L. ed. 153 (1880) (not registering bonds with proper authorities); Gause v. Clarksville, 1 Fed. 353 (C. C. E. D. Mo. 1880) (voters in bond election were not sworn properly); Geer v. School Dist. No. 11 in Ouray County, 111 Fed. 682 (C. C. A. 8th, 1901) and Fernald v. Gilman, 123 Fed. 797 (C. C. S. D. Iowa 1903) (municipality, although authorized to become indebted, was not entitled to secure the money by bonds); State ex rel. Northwestern Nat. Bank v. Dickerman, 16 Mont. 278, 40 Pac. 698 (1895) (non-compliance with notice requirement); Hoag v. Greenwich, 133 N. Y. 152, 30 N. E. 842 (1892) (bonds came due at different dates than allowed by law); Rainburg v. Fyan, 127 Pa. 74, 17 Atl. 678 (1889) (not filing statement as required).

6 Hitchcock v. Galveston, 96 U. S. 341, 24 L. ed. 659 (1877); Louisiana v. Wood, 102 U. S. 294, 26 L. ed. 153 (1880); Read v. Plattsmouth, 107 U. S. 568,
NOTES AND COMMENTS

recovery is quasi-contractual on the theory that the municipality has received a benefit from the bond money which it would be inequitable to retain without compensation.\(^7\) Where the funds have not been used for the benefit of the city, recovery is denied.\(^8\)

On the other hand, where the city was totally without power to incur indebtedness at the time,\(^9\) or for the purpose\(^10\) for which the bonds were issued, recovery for money had and received is denied.\(^1\)

The reasons advanced for refusal to grant this relief are either based on the administrative policy that all persons dealing with a municipality must be presumed to know the limits of its power, and therefore act at their peril,\(^2\) or on the theory that a refusal to find an implied promise to pay makes more effective a direct constitutional prohibition of such indebtedness.\(^3\) Regardless of the varying language of the courts, the motive for refusing relief is the protection of the taxpayer.\(^4\)

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\(^7\) Sup. Ct. 208, 27 L. ed. 414 (1882) (although generally cited for this proposition, the case allows recovery where the debt incurred was in excess of limitation); Gause v. Clarksville, 1 Fed. 353 (C. C. E. D. Mo. 1880); Bangor Savings Bank v. Stillwater, 45 Fed. 544 (C. C. D. Minn. 1891); Geer v. School Dist. No. 11 in Ouray County, 11 Fed. 682 (C. C. A. 8th, 1901); Fernald v. Gilman, 123 Fed. 797 (C. C. S. D. Iowa 1903); Chelsea Savings Bank v. Ironwood, 130 Fed. 410 (C. C. A. 6th, 1904); Gilman v. Fernald, 141 Fed. 941 (C. C. A. 8th, 1905); Board of Commissioners of Bayou Terre Aux Boeufs Drainage Dist. v. McClellan et al., 164 La. 808, 694 (1927); State ex rel. Northwestern Nat. Bank v. Dickerman, 16 Mont. 278, 40 Pac. 698 (1895); Hoag v. Greenwich, 133 N. Y. 152, 30 N. E. 842 (1892); Rainsburg v. Fyman, 127 Pa. 24, 17 Atl. 678 (1889); Paul v. Kenoshia, 22 Wis. 589, 85 N. W. 425 (1901). There is authority that unless there is privity between bondholder and municipality there can be no recovery. Lumbermen's Trust Co. v. Ryegate, 61 F. (2d) 14 (C. C. A. 9th, 1932); Henderson v. Nat. Bank of Evansville, Ind., 185 Ky. 693, 215 S. W. 527 (1919); see Coquard v. Oquawka, 192 Ill. 355, 368, 61 N. E. 660, 664 (1901).


\(^3\) Aetna Life Ins. Co. v. Middleport, 124 U. S. 534, 8 Sup. Ct. 625, 31 L. ed. 537 (1887); Hedges v. Dixon County, 150 U. S. 182, 14 Sup. Ct. 71, 37 L. ed. 1044 (1893); Travelers' Ins. Co. v. Mayor, etc. of Johnson City, 99 Fed. 663 (C. C. A. 6th, 1900); Swanson v. Ottumwa, 131 Iowa 540, 106 N. W. 9 (1906); Waitz v. Ormsby County, 1 Nev. 370 (1865); Bolton v. Wharton, 163 S. C. 242, 161 S. E. 454 (1931).


\(^7\) Balch v. Beach, 118 Wis. 267, 95 N. W. 132 (1903).

\(^8\) Morton v. Nevada, 41 Fed. 582 (C. C. W. D. Mo. 1890).

\(^9\) McAlvay, J., in McGurdy v. Shiawassee County, 154 Mich. 550, 561, 118 N. W. 625, 629 (1908) says: "he (the taxpayer) is the public for whose benefit the
wise, innocent taxpayers would suffer for the corrupt or unwise acts of their officials in incurring unauthorized debts.\textsuperscript{15}

The principal case is one of a very few in which a constructive trust has been decreed as a remedy for the holder of invalid municipal bonds.\textsuperscript{16} The idea was suggested as long ago as 1885 in \textit{Litchfield v. Ballou}.\textsuperscript{17} There, however, the action was brought on the theory of money had and received, and in a dictum the court denied plaintiff's right to a constructive trust because of the difficulty of tracing the funds,\textsuperscript{18} and because "equity will no more raise a trust in favor of the bondholder than the law will raise an implied assumpsit against a public policy so strongly declared." In a Kentucky case\textsuperscript{19} this relief was granted, but under the law of Kentucky\textsuperscript{20} it would seem that the bondholder could have recovered for money had and received. A recent New Mexico decision\textsuperscript{21} allowed the holders of invalid certificates of indebtedness to have school buildings, erected largely with funds from the certificates, held in trust for them to the extent of their proportionate shares. These certificates were invalid because the statute authorizing the board to borrow money was unconstitutional. The court stressed the fact that the certificates were merely irregular. This is doubtful. As the statute was unconstitutional, was not the board totally without power to borrow money for building a school? If the reasoning of the court is accepted, however, there could have been a recovery for money had and received.\textsuperscript{22} Thus, the principal case is the first square holding in which a constructive trust was used to give a bondholder succor otherwise denied him.

Is it desirable to decree a constructive trust as a remedy for the

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\item[15] This objection does not seem sound. The tracing problem in these cases is relatively simple, since even under the strict rule applied in a majority of jurisdictions, if the property can be traced step by step it does not matter if changes in form have occurred. The question is merely mathematical—the percentage of the bond money to the original value of the property involved. 4 \textsc{Bogert}, \textsc{Trusts and Trustees} (1935) §921; Scott, \textit{The Right to Follow Money Wrongfully Mingled With Other Money} (1913) 27 \textsc{Harv. L. Rev.} 125.
\item[16] 114 U. S. 190, 194, 5 Sup. Ct. 820, 822, 29 L. ed. 132, 134 (1885).
\item[17] Others are: \textit{Fordsville v. Postel}, 121 Ky. 67, 88 S. W. 1065 (1907); \textit{Shaw v. Board of Education}, 38 N. M. 298, 31 P. (2d) 993 (1934).
\item[18] See cases cited supra note 6.
\item[19] See cases cited supra note 6.
\item[20] The municipalities and which bears all the burdens put upon it, but which is not consulted when such burdens, as in this case (borrowing money without authority), are assumed.\textsuperscript{16}
\item[21] See cases cited supra note 6.
\item[22] See cases cited supra note 6.
\end{footnotes}
holder of invalid municipal bonds? To do so might deprive the citizens of the use of the school, utility, or other service made possible by bond funds. Similar fears underlie the statutory refusals to allow mechanics' liens on public buildings. Frequently, the res is constructed partially from bond proceeds and partially from tax money. In this situation, the contributing taxpayers' interests are jeopardized, as full value would seldom be obtained under the forced sale or lease necessary to adjust the rights of the interested parties. If the value of the res has increased, the bondholder-beneficiary of the constructive trust might actually receive a return greater than the amount of the debt. If bond funds had been mingled with other monies all parties might share pro rata. A constructive trust is thought of as a remedy where there has been fraud, misrepresentation, duress, or something more than mere breach of contract. None of these is present in the case under consideration. The bondholder was not obligated to buy the securities and may be said to have walked in with his eyes wide open to the usual risks. If the denial of money had and received is necessary to effectuate the constitutional prohibition, is not the refusal of a constructive trust equally required?

On the other hand, to deny a constructive trust where money had and received will not lie is to give the community a benefit for which it has not paid and legally cannot pay. Thus, the city is unjustly enriched at the expense of the bondholder.

If the money derived from the bonds is still intact in the city treasury there should be no objection to a constructive trust. The bondholder is only regaining that which he supplied and no inconvenience or loss is suffered by citizens or taxpayers of the municipality. In any other situation, however, the courts, for the reasons suggested, should be very hesitant to decree this relief. The principal case appears to have been unwisely decided.

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23 N. C. Code Ann. (Michie, 1935) §2445 requires contractors of public buildings to give bond to help cover materialmen's and laborers' claims. This is because North Carolina has no statute providing for mechanics' liens on public buildings. Snow and Ellington, Royster & Co. v. Board of Commissioners of Durham County, 112 N. C. 336, 17 S. E. 176 (1893); Morganton Hardware Co. v. Morganton Graded Schools, 151 N. C. 507, 66 S. E. 583 (1909).

24 When possible the bondholder would seek relief in an action for money had and received if the property had decreased in value, for that remedy would enable him to regain all that he had expended. But in the numerous cases where money had and received would not lie the constructive trust would certainly cause taxpayer loss.


26 By analogy to cases in which a trustee has wrongfully mingled trust money with his own for purchasing life insurance, where the cestui, by the weight of authority, is entitled to a pro rata share of the money derived from the policy, See Scott, supra note 18 at 128. There are cases, however, allowing the cestui to receive only insurance proceeds equivalent to the trust money with interest. 4 Bogert, Trusts and Trustees (1935) §924.