The Municipal Bond Cases Revisited

by

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ABSTRACT

Recent high-profile attempts to repudiate municipal bonds break from what had become a stable American norm of honoring public debt. In the nineteenth century, though, hundreds of cities, towns, and counties walked away from their bonds. The Supreme Court's handling of repudiation in the so-called municipal bond cases conjured intense animus. But time and the archaic prose and sheer volume of the opinions have obscured the cases' significance.

This article reconstructs the bond cases with an eye to modern disputes. It reports the results of our reading all 203 cases, decided 1859–1899, in which the Justices opined on bond validity. At a high level, our findings correct a stock narrative in the literature. The standard account paints the Court as a reliable champion of northeastern capitalists in what resembled regional or class politics more than law. That story does not withstand scrutiny, however. We find, for example, that the Court ruled for the repudiating municipality about a third of the time. The decisions had a readily articulable logic at the heart of which lay the law/fact distinction. Estoppel barred issuers in most instances from denying factual predicates of bond validity, but it did not prevent scrutiny of legal predicates. Where law was at stake, the Justices were willing to hold bonds void on even highly technical grounds. The framework developed by the Justices over this forty-year period, we argue, may be of use to courts facing these issues once again for the first time in a century.

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Introduction

Bond repudiation is once again in the air. In 2014, the City of Detroit, mired in bankruptcy, argued that more than $1 billion of its securities were void.[1] The matter settled.[2] Three years later, in Puerto Rico's restructuring proceedings, the Commonwealth's Financial Oversight and Management Board declared worthless $6 billion of recently issued general obligation bonds.[3] More recently still, a lawsuit in Illinois[4] and another brought by an instrument of Venezuela[5] have challenged the validity of billions of dollars more of government bonds. The form of argument in each instance is the same: securities for which a government received hundreds of millions or billions of dollars were issued *ultra vires*, are therefore void, and holders are entitled to nothing.

Until Detroit's bankruptcy, the *ultra vires* defense to government debt

[1]City of Detroit's Memorandum, *In re* City of Detroit, No. 13-53846 (E.D. Mich. Bankr. Aug. 28, 2014), ECF No. 152.

[2]*In re* City of Detroit, 524 B.R. 147 (Bankr. E.D. Mich. 2014).

[3]Omnibus Objection, *In re* Fin. Oversight & Mgmt. Board for Puerto Rico, No. 17-BK-3283 (LTS) (S.D.N.Y. Jan. 14, 2019), ECF No. 4784.

[4]Petition, Tillman v. Pritzker, No. 2019-CH-000235 (Cir. Ct. Sangamon Cnty., Ill., July 1, 2019); *see also* Tillman v. Pritzker, No. 4-19-611, Ill. App. (4th) 190611 (Aug. 6, 2020) (reinstating case after circuit court had declined to grant petition).

[5]Complaint for Declaratory and Injunctive Relief [Doc. 1], Petróleos de Venezuela, S.A. v. MUFG Union Bank, N.A., No. 1:19-cv-10023-KPF (S.D.N.Y. Oct. 29, 2019); *see also* W. Mark C. Weidemaier & Mitu Gulati, *Unlawfully-Issued Sovereign Debt* (unpublished manuscript, July 9, 2020) (analyzing choice-of-law in sovereign bond repudiation litigation). The district court rejected PdVSA's repudiation argument on summary judgment. Opinion and Order, [Doc. 215], Petróleos de Venezuela S.A. v. MUFG Union Bank, N.A., 19 Civ. 10023 (KPF) (Oct. 16, 2020).

lay dormant for the better part of a century. The period since the Great Depression has for the most part been a quiet time in municipal finance.[6] By no means do recent attempts at repudiation rest on a novel theory, however. As a justification for nonpayment, *ultra vires* is almost as old as the municipal bond itself.[7] The argument's form is impeccable. Municipalities are corporations of defined powers. State law typically restricts their power to incur debt. If local officials don't abide those restrictions when issuing a bond, orthodox corporate theory deems the issuance not to be a municipal act at all. To repudiate is, then, in a sense, just to insist on the basic logic of the corporation.

During the second half of the nineteenth century, hundreds of cities, towns, and counties insisted on just that. In the years following the Panic of 1873, as much as twenty percent of all municipal debt in the country was in default.[8] Many repudiated bonds were issued hopefully—one might even say naively—in the 1850s and 1860s to subsidize railroad construction.[9] Railroads were connecting the country, and no one wanted to be left off the grid. When the new infrastructure's anticipated benefits failed to materialize, however, and hard times came, the answer for many municipalities was to repudiate. They ceased paying coupons, citing one or another reason their bonds had been issued illegally. The result was a torrent of litigation running through the (mostly federal) courts and petering out only near the turn of the century. Between 1859 and 1899, the Supreme Court alone, in the so-called "municipal bond cases," decided several hundred disputes arising from repudiation. The cases touched on a multitude of issues, from jurisdiction to remedies. The bulk of the Court's decisions, though—approximately 200 of them—were about bond validity, about the enforceability of municipal bonds in the hands of innocent purchasers.

This article reconstructs the logic and significance of the Court's validity cases with an eye to modern disputes. Some of the old cases have been cited in the briefing and commentary around recent repudiation efforts, but with-

[6]Municipal debt market watchers will recall the Washington Public Power Supply System fiasco of the early 1980s as an exception. The WPPSS bonds were revenue bonds. Litigation concerned not the bonds' validity, but certain municipalities' obligation to "buy" non-existent power from the issuer (and so create "revenue"). But the economic logic of, and many of the legal arguments raised in, the municipalities' defense tracked the logic of and arguments around repudiation.

[7]Bridgeport, Connecticut, sought to repudiate on just such a theory as early as 1840. For the story, see Charles A. Heckman, *Establishing the Basis for Local Financing of American Railroad Construction in the Nineteenth Century: From* City of Bridgeport v. The Housatonic Railroad Company *to* Gelpcke v. City of Dubuque, 32 AM. J. LEGAL HIST. 236 (1988).

[8]John A. Dove, *Financial Markets, Fiscal Constraints, and Municipal Debt: Lessons and Evidence from the Panic of 1873*, 10 J. INST. ECON. 71 (2014).

[9]*See, e.g.*, MICHAEL A. ROSS, JUSTICE OF SHATTERED DREAMS: SAMUEL FREEMAN MILLER AND THE SUPREME COURT DURING THE CIVIL WAR ERA 22-24 (2003) (telling the story of Keokuk, Iowa, whose leaders thought it could "eclipse both Chicago and St. Louis" as a gateway to the West).

out a firm grounding in their doctrinal or historical context. A happy century in the municipal debt markets has obscured the bond cases' analytical structure. Much has changed since the likes of Chase, Waite, and Fuller presided over the Court. Their procedural world is unfamiliar and their prose hard to parse.

To be sure, if the municipal bond cases have been neglected, they have never been entirely forgotten. They appear, for example, in the best synoptic histories of American law and of the Supreme Court.[10] A few of the cases have proved important to specialists in federal courts.[11] But academic attention has overwhelmingly focused on a small number of especially dramatic episodes and, more generally, on the cases' politico-economic setting and ramifications.[12] Very little attention has been paid to the cases *as law*.

The analysis we present is the product of a close reading of every one of the Court's municipal bond cases decided between 1859 and 1899.[13] At a high level, our findings correct a stock narrative in the academic literature. In general, the municipal bond cases pitted farmer against capitalist. The cases arose because towns and counties especially in the Midwest didn't want to, or couldn't, pay bondholders in the Northeast and abroad.[14] The standard academic account portrays the Justices in political rather than legal terms: as champions of the investing class none too concerned about the law but arrayed against the champions of the agricultural class, namely the state courts.[15]

Taken as a corpus, however, the bond cases belie a notion of the Court as

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[10]*See, e.g.*, 2 CHARLES WARREN, THE SUPREME COURT IN UNITED STATES HISTORY 528-32 (1922); 6 CHARLES FAIRMAN, OLIVER WENDELL HOLMES DEVISE HISTORY OF THE SUPREME COURT OF THE UNITED STATES 918-1116 (1971); HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 90-91 (1991); MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW 1870-1960: THE CRISIS OF LEGAL ORTHODOXY 22-24, 206 (1992).

[11]*See, e.g.*, L.A. Powe, *Rehearsal for Substantive Due Process: The Municipal Bond Cases*, 53 TEX. L. REV. 738 (1975); David P. Currie, *The Constitution in the Supreme Court: Contracts and Commerce, 1836-1864*, 1983 DUKE L.J. 471, 493-95.

[12]For an especially insightful recent example of this kind of analysis, see David Schleicher, *Hands On! Part I: The Trilemma Facing the Federal Government During States and Local Budget Crises* 21-32 (2020) (unpublished manuscript).

[13]We searched for cases manually, paging through the U.S. Reports. If our sample is incomplete, it captures at least a very large fraction of the reported bond cases.

[14]Among these were the first "vulture" bond buyers. *See* FAIRMAN, *supra* note 10, at 924-25 (discussing the banker Henry Amey, who bought repudiated bonds at a discount and litigated to favorable settlements).

[15]*See, e.g.*, Mary Cornelia Aldis Porter, *John Marshall Harlan the Elder and Federal Common Law: A Lesson from History*, 1972 SUP. CT. REV. 103, 118 ("It was not an especially attractive chapter in the Court's history. The image projected was of hard-hearted judges determined to extract their pound of flesh, willing to wield any instruments to do the job."); Powe, *supra* note 11, at 745 (describing "the Court's approach to sustaining the bonds at all costs."); Schleicher, *supra* note 12, at 22-23 ("Below the surface it was clear: parchment barriers and constitutional commitments to state sovereignty were no match for the Court's desire to protect capital markets and ensure future infrastructure investment.").

a proxy engaged in class or regional battle. The standard account of the cases rests on three propositions: that disagreement between federal and state courts about the content of the law was ubiquitous;[16] that the Court almost always decided for the creditors;[17] and that it did so frequently when the law favored the issuer.[18] Yet none of the three legs of the argument bears its weight under scrutiny. There were occasional conflicts between the Supreme and state high courts, and they yielded intriguing legal questions and sometimes pyrotechnical judicial rhetoric. But the Justices disagreed with a state high court in only 6 percent (10 of 172) of unique validity cases. Moreover, the oft-repeated claim that the Supreme Court ruled unhesitatingly for bondholders is simply false. The Court ruled for the repudiating issuer in 33 percent (57 of 172) of the validity cases. The quality of the Court's decisionmaking cannot, of course, be established quantitatively. In our view, it was generally very strong; but even if the quality was low, the Justices' willingness to rule against bondholders undermines the notion that their reasoning was poor because it was motivated by a predilection to favor creditors. This is not to say they decided every case in a uniquely correct manner, or even that their errors were randomly distributed. But our findings do imply that writers invoking the bond cases should rethink rather than repeat a picture of the postbellum Court as an essentially politico-economic institution.

What is remarkable about the bond cases is the Court's legalism. The decisions conformed to a readily articulable analytic structure, even if the Justices did not always clearly articulate it.

The path of decision begins with a familiar law/fact distinction. A bond's validity might be contested on either ground. The issuer might contend, for example, that it had no power to issue bonds for the conceded purpose of

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[16]*See, e.g.*, FAIRMAN, *supra* note 10, at 936 ("Those conflicts will fill this and the following chapter [nearly 200 pages].").

[17]*See, e.g.*, Powe, *supra* note 11, at 746 ("Throughout the entire series of decisions, with few—and therefore notable—exceptions, the Court upheld any municipal bonds aiding railroads regardless of defects in their issuance."); HOVENKAMP, *supra* note 10, at 90-91 ("In the three decades following *Gelpcke* some three hundred bond cases before the Supreme Court. The Court invariably upheld the validity of the bonds, state repudiation notwithstanding, when the creditors were citizens of another state.").

[18]*See, e.g.*, FAIRMAN, *supra* note 10, at 1101 ("Preoccupation with the protection of bondholders caused a majority of the Justices to be insensitive to all other considerations in these complex situations. What is more, slovenly work concealed egregious deviations even from professed principles."); Powe, *supra* note 11 at 748 ("By assisting railroads while forbidding aid to manufacturers, the municipal bond cases demonstrated that the Court was picking and choosing among ends. . . . The cases indeed seem governed by no higher principle than the implementation of the Court's perception of sound public policy."); Schleicher, *supra* note 12, at 22-23 (saying the Justices "engaged in some wild jurisprudential gymnastics, violating established precedent, and disregarding fraud and malfeasance in its zeal to force municipalities to pay their debts.").

subsidizing a private manufacturing company (legal);[19] or else that bonds supposed to have been issued for a concededly lawful purpose, such as building a courthouse, were in fact issued in a bribery and misappropriation scheme (factual).[20]

In cases turning on factual argument, the central theme of the Court's output was the adaptation of estoppel doctrine to the municipal context. It was customary for bonds, like other sealed instruments, to recite circumstances relevant to issuance. Estoppel allowed bona fide bond buyers to credit whatever facts—but only facts—the issuer declared true at the time of issuance. To the extent a municipality sought to repudiate by denying such a fact, it was lost. Thirty-one percent (53 of 172) of the unique validity cases were resolved this way (in whole or in substantial part). The mere existence of estoppel presumably discouraged many more cases from arising at all. Estoppel did not resolve all fact-based repudiation arguments, however. It did not block trial if the bond, fairly construed, failed to recite a contested fact. Even if it did, an authoritative record contravening the recital took precedence. In some twenty cases hinging on a fact claim, the Court directed a trial or a judgment for the repudiating municipality. Nevertheless, estoppel could save the Justices from reaching the substantive question of *ultra vires*.

In cases turning on legal grounds, by contrast, the merits were unavoidable. Estoppel had no place. Law being a matter of public record, no litigant could plead reliance on another's representation of it. If at the time a municipality issued a contested bond it had power to do so, assuming as true all facts recited on the bond, then judgment would go for a bona fide holder. If not, judgment would go for the repudiator. The municipality prevailed in almost 40 percent of cases (49 of 128) presenting a substantial legal ground of invalidity.

To say the bond cases were decided in a formally coherent and forensically defensible manner is not, of course, to deny they had an economic logic. The function of estoppel by deed was always to dispense with trial where ex ante verification is likely to be expensive or ex post factfinding inaccurate. New York investors are not well positioned to know, much less prove, what really happened at a bond election in rural Missouri. Estoppel allowed them to buy bonds secure in the belief they would not be called to do so. By contrast, law is relatively cheap to verify and needn't be proved to a jury. The case for protecting bondholders at taxpayers' expense is for that reason comparatively weak on matters of law. The Court's approach was thus consistent with a rudimentary if imperfectly calibrated information-costs model.

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[19]*See* Loan Ass'n v. Topeka, 87 U.S. 655 (1875); City of Parkersburg v. Brown, 106 U.S. 487 (1883); Cole v. City of La Grange, 113 U.S. 1 (1885).

[20]*See* Smith v. Sac Cty., 78 U.S. 139 (1871).

Investors could rely on assertions peculiarly hard for them to verify or prove but were charged with the risk of an illegal issuance, and therefore enlisted as monitors of local official behavior, where they could determine legality at relatively low cost.

The balance of the article looks at the bond cases from three angles. Part 1 places them in their historical context. It explains the economic and legal conditions in which the cases emerged and describes the procedural path by which they reached the Court. It then describes the standard academic account of the cases and reports aggregate statistics putting that account in doubt. Part 2 reconstructs the cases' logic. It sets out an analytical roadmap, so to speak, of the Court's decisions. Part 3 zooms forward in time, offering the ongoing dispute in Puerto Rico as a case study to sharpen intuition about how the cases worked. Their logic maps neatly onto the facts, we show, and if applied would validate bona fide purchasers' claims in the Title III proceedings. To be sure, the weight of the bond cases' logic today depends on Puerto Rico law. But whatever their precedential value, the cases represent a considered approach that may assist litigators and judges grappling anew with an old problem.

I. THE CASES AT A GLANCE

The "municipal bond cases" refer to some 300 matters involving repudiated city, town, or county debt settled by the Supreme Court in the second half of the nineteenth century and very beginning of the twentieth. Although memory of the cases has faded, they were a source of major political controversy in their day. They were so controversial, in fact, that in 1869, just four years after the Civil War ended, the *Dubuque Herald* reported that a suite of bond decisions had put Iowa "on the brink of rebellion."[21] President Grant threatened to send federal troops if necessary to levy a "tax" to pay jilted creditors.[22] Near the end of his life, the elder Justice Harlan was asked to list the most important opinions he had delivered during a tenure then already stretching more than three decades. Next to his famous dissents in *The Civil Rights Cases*,[23] *Plessy v. Ferguson*,[24] and *Lochner v. New York*,[25] Harlan pointed to the opinion for the Court in a case somewhat more obscure to modern lawyers, *Presidio County v. The Noel-Young Bond & Stock Exchange*.[26]

This part situates the cases in their politico-economic and legal context

[21]FAIRMAN, *supra* note 10, at 968.
[22]*Id.*
[23]109 U.S. 3, 26-62 (1883) (Harlan, J., dissenting).
[24]163 U.S. 537, 552-64 (1896) (Harlan, J., dissenting).
[25]198 U.S. 45, 65-74 (1905) (Harlan, J. dissenting).
[26]212 U.S. 58 (1909).

and provides summary findings about their aggregate character and disposition. In the 1850s and 1860s, as the American frontier pushed west and the shipping capacity of hubs like Chicago and St. Louis exploded, opportunity (but also risk) seemed to be everywhere. Once-remote cities, towns, and counties saw enormous potential value in connecting to the grid, as well as the specter of obsolescence in the status quo. The bonds these largely agricultural communities issued to finance infrastructure, especially railroad construction, thus became a principal route by which capital flowed from the Northeast and Europe to the banks of the Mississippi.

With capital moving but one way, regional conflict was perhaps inevitable when issuers began to disavow their debts and investors pressed their claims in court. The generic question posed by litigation was who ought to bear the loss when a project's anticipated benefits failed to emerge: the farmers whose land would be taxed to pay a bond or the bond's secondary-market purchaser? Academic writers have typically understood the bond cases to favor the East-coast financiers. The Court's decisions in these cases, according to the standard narrative, can be better understood in terms of its politico-economic commitments rather than legal reasoning. Our findings belie that story, however, showing that a gross attitudinal model of judicial decisionmaking cannot explain the cases as a corpus.

A. Background

1. *Westward Expansion and Municipal Bonds*

The debt whose eventual repudiation would spark the bond cases was a conduit for financing westward expansion. Completion of the Erie Canal in 1825 had opened the Great Lakes to trade with the East. As population in the Midwest grew, new infrastructure was needed to efficiently exploit the land. Civic facilities and irrigation projects would come in time. But in the 1850s and 1860s—the period of bond issuance from which most of the bond cases arose—the chief infrastructural concern of agricultural communities west of the Appalachians was to lure a railroad.[27]

Those who owned and worked the vast stretches on the American frontier, especially in the Midwest, had reason to invest in railroad construction. Access to the transportation grid could be expected to boost the value of farmland as well as bring a wider variety of manufactured goods to market. If all went according to plan, productivity gains attributable to cheaper shipping would more than pay for the cost of connecting. The region was cash-poor, however. The solution was debt. Government, with its power to tax would-be holdouts, was the institution through which local landowners could

[27]Eighty percent (138 of 172) of unique validity cases stemmed from debt incurred to finance railroad construction.

best tap eastern and foreign capitalists.[28]

Cities, towns, and counties in fact became the principal public financiers of shortline railroads. The federal government subsidized transcontinental roads with lavish land grants.[29] The work of building out the grid was largely left to private as well as state and local devices. As a matter of economic first principles, the states might have been best positioned to finance a rational railroad infrastructure. But they were legally barred from doing so. During the republic's first 50 years, the states had taken the lead in development.[30] They had issued long-term debt to finance ambitious, long-lived canal and railroad projects.[31] But the long recession following the Panic of 1837 was too much for many to bear. Nine defaulted; others came close.[32] In response, many states amended their constitutions to restrict or prohibit the financing of improvements at the state level—a practice newly admitted states mimicked.[33]

Local governments took up the slack.[34] The so-called "railroad-aid" bond became the subsidy mechanism of choice. The bond was part of a triangular transaction that worked in four generic steps. First, railroad promoters would procure from a state legislature a corporate charter. The state would also allow local governments in close proximity to the planned route to issue bonds to support construction. Second, a municipality, usually as one of a group of contiguous municipalities doing the same thing, would resolve to issue long-dated negotiable bonds paying periodic coupons at a designated New York bank. Third, a municipal officer would deliver the bonds to the railroad company. Sometimes the transfer was a donation; more often, it was an exchange for stock in the company.[35] Finally, the promoters, with the help

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[28]Vincent S.J. Buccola, *The Logic and Limits of Municipal Bankruptcy*, 86 U. CHI. L. REV. 817, 834-38 (2019).

[29]*See* LLOYD J. MERCER, RAILROADS AND LAND GRANT POLICY: A STUDY IN GOVERNMENT INTERVENTION 32-74 (1982).

[30]The federal government did not yet build infrastructure, and local governments borrowed only sparingly. In 1843, the aggregate stock of state debt was an order of magnitude greater than the stock of federal or municipal debt. A.M. HILLHOUSE, MUNICIPAL BONDS: A CENTURY OF EXPERIENCE 32 (1936). State debts totaled approximately $230 million. Municipal debts totaled approximately $27 million. And the federal debt was only $20 million. *Id.*

[31]*See* PAUL STUDENSKI & HERMAN EDWARD KROOSS, FINANCIAL HISTORY OF THE UNITED STATES 129-32 (1952); B.U. RATCHFORD, AMERICAN STATE DEBTS 73-96 (1941).

[32]*See generally* WILLIAM A. SCOTT, THE REPUDIATION OF STATE DEBTS (1893); RATCHFORD, *supra* note 31, at 98-104.

[33]*See id.* at 121-22.

[34]From 1843 to 1860, the debt stock grew from $27 million to $200 million. By 1900, more than $1 billion of municipal debt was outstanding, while state debts totaled $235 million. Put differently: in the 60 years after the first state defaults, state indebtedness stayed roughly constant in nominal terms, while municipal debt increased by 50 times. *See* HILLHOUSE, *supra* note 30, at 32-34.

[35]The difference was probably of little significance in most instances. Taxpayers were mainly anticipating access to the railroad, not dividends.

of a New York investment bank, would sell the bonds into the secondary market and use the cash proceeds to fund construction. The net effect was to put cash in the pocket of a railroad company and to leave cities, towns, and counties on the railroad's path in hock to investors scattered about the Northeast and Europe.

2. *The Ultra Vires Theory of Repudiation*

Railroads are risky ventures. Some roads financed by municipal bonds were never built. Others were built but couldn't deliver on optimistic forecasts. In the midst of two successive recessions—following the Panics of 1857 and 1873, respectively—disappointed local governments ceased paying coupons when due.[36] They did not simply default, however. They repudiated altogether the obligation to pay interest and repay principal.

Orthodox corporate legal theory supplied the basis of repudiation. Corporations, including municipalities, were (as they still are) understood to have limited, legislatively defined powers. These were powers in the sense that Hohfeld would later distinguish from "privileges": they declared what was possible for the corporation to do.[37]

The doctrine of *ultra vires* embodied this understanding. Corporate theory said in effect that law would clothe with a corporate character certain acts done in the right way at the right time by the right people. It followed that acts done by the wrong people at the wrong time in the wrong way, or which were not allowed in any case, just were not corporate acts. Judge Dillon adapted the idea to the municipal context in his famous treatise on the subject:

> The general principle of law is settled, beyond controversy, that the agents, officers, or even city council, of a municipal corporation, *cannot bind the corporation* by any contract which is beyond the scope of its powers, or entirely foreign to the purposes of the corporation, or which (not being in terms authorized) is against public policy.[38]

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[36]A.M. Hillhouse, *Lessons from Previous Eras of Default*, *in* MUNICIPAL DEBT DEFAULTS 10, 10-11 (Carl H. Chatters ed. 1933).

[37]*See* Vincent S.J. Buccola, *States' Rights against Corporate Rights*, 2016 COLUM. BUS. L. REV. 595, 604-09; Albert J. Harno, *Privileges and Powers of a Corporation and the Doctrine of Ultra Vires*, 35 YALE L.J. 13 (1925). The corporation's artificiality and plasticity were central to the classical understanding. *See, e.g.*, Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 250, 303 (1819) (reasoning that a corporation "possesses only those properties, which the charter of its creation confers upon it"); JOSEPH K. ANGELL & SAMUEL AMES, TREATISE OF THE LAW OF PRIVATE CORPORATIONS AGGREGATE § 256 (7th ed. 1861) (describing a corporation's charter as being "as it were the law of its nature").

[38]JOHN F. DILLON, TREATISE ON THE LAW OF MUNICIPAL CORPORATIONS 374 (1872). For business corporations, courts sanded down the hard edges of the doctrine as the nineteenth century closed, see generally Seymour D. Thompson, *The Doctrine of Ultra Vires in Relation to Private Corporations*, 28 AM.

The rule denying a counterparty's right to recover for a breach of contract if the contract was *ultra vires*—even where the counterparty had performed to its detriment—is but a corollary to this picture of the corporation.

In any case, it is the rule municipalities leaned on to repudiate their debts and provoke what became the bond cases. Most legislatures restricted quite severely the powers of most municipal governments to incur debt outside the ordinary course. There was nothing like a freestanding power to issue (or impose a tax to pay) negotiable bonds for capital investment. When legislatures allowed such bonds, they usually imposed conditions or limitations on issuance. The situation was complicated enough that a municipality could often find a plausible ground to deny that a bond bearing its name was, legally speaking, *its* bond. If the bond had issued inconsistently with state law, the reasoning went, then the ostensible "issuer" was no issuer at all and had no obligation to pay. Bondholders would typically have no quasi-contractual right to restitution, either, because the bonds (at least in the railroad-aid context) were not sold for cash but were instead delivered as a donation or in exchange for worthless railroad stock. "Hard luck on the speculators" was the municipal attitude.

3. *The Cases' Posture*

The typical case to reach the Supreme Court began in a federal circuit court as a bondholder's action for nonpayment of a matured coupon. The plaintiff in such a case lived in a state other than that of the municipal defendant—grounding federal diversity jurisdiction—and had acquired his bond or bonds in the secondary market.

The municipal defendant would raise *ultra vires* as a defense, admitting it had not paid the coupon but denying the obligation to pay.[39] It might give a range of reasons, but invariably the punchline was that it lacked power to issue a bond in the manner, for the purposes, or of the description of the contested bond. The argument could be legal or factual. The municipality might, for example, contend that it had no legal ability to create negotiable securities at all;[40] or that as a matter of fact the requisite proportion of tax-

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L. REV. 376 (1894), and legislatures did away with its rigor altogether in the twentieth. Not so for municipal corporations. With some exceptions, the doctrine is still in place today.

[39]There were other ways to test a bond's validity. Before a bond was delivered (or sold into the secondary market), a taxpayer could sue to enjoin delivery or for a decree that the bond be destroyed. *See, e.g.*, Knox County v. Aspinwall, 62 U.S. (21 How.) 539 (1859) (acknowledging this possibility). Even after the bond was in circulation, a taxpayer could sue to enjoin the responsible local officials from paying the bond or collecting a tax needed to pay it. *See, e.g.*, Ritchie v. Franklin County, 89 U.S. (22 Wall.) 67 (1875). The Court rarely heard such cases, however. Pre-issuance suits were exceedingly rare. Suits to block coupon payment or tax levy were somewhat more common but were usually brought in the state courts

[40]*See, e.g.*, City of Brenham v. German-Am. Bank, 144 U.S. 173 (1892); Police Jury v. Britton, 82 U.S. 566 (1872).

payers had not consented to issue the bond.[41] Depending on the argument and the parties' pleading tactics, a trial might be held. Often, though, the facts were not in dispute, or the circuit court thought disputed facts irrelevant to its judgment. Either way, the matter typically reached the Justices on a writ of error.

The question presented to the Justices in most of the cases, therefore—and in the cases we focus on—was an innocent purchaser's right to judgment on a contested bond given assumed, often stipulated, facts. As is true today, the Court could dispose of the cases in three principal ways. It could resolve the litigation for either the bondholder or the municipality or direct a trial of disputed facts.

Approximately two-thirds of all of the cases the Court heard involving some aspect of municipal repudiation were about validity.[42] Our analysis centers on them because of their numerosity, but also, more importantly, because they resemble recent repudiation disputes—the question being how courts ought to think about the validity of a bondholder's claimed right to payment on a bond said to have been issued *ultra vires*.

B. Characterization in Academic Scholarship

When the bond cases show up in modern academic literature, they are usually treated as an object lesson in the politico-economic basis of judicial decisionmaking. To be sure, the cases are mostly forgotten. The attention they now receive is meagre compared to their contemporary social importance and the judicial time they demanded. Proceduralists and specialists in federal courts have found some of the cases intriguing, but not for their instruction in the law of bond repudiation.[43] Those who have treated the cases as a distinctive episode have done so primarily with historical aims and have

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[41]*See, e.g.*, Town of Venice v. Murdock, 92 U.S. 494 (1875).

[42]Many cases that could be broadly classified as "municipal bond cases" did not pose a validity question. Sometimes litigation turned on case-specific facts. A municipality might, contest jurisdiction, assert a statute of limitations, or deny the plaintiff's *bona fides*, for example. Sometimes a bondholder's right to quasi-contractual relief was in issue, the bond's invalidity having been established previously. *See, e.g.*, Louisiana v. Wood, 102 U.S. 294 (1880); City of Litchfield v. Ballou, 114 U.S. 190 (1886). And sometimes disputes stemming from repudiation arrived in the remedial phase, when a judgment against the municipality had become final and the question was what if anything courts would do to secure compliance. *See, e.g.*, Knox Cty. v. Aspinwall, 65 U.S. 376 (1861) (allowing federal court to issue mandamus to state officials to levy tax needed to pay bonds); Olcott v. Supervisors, 83 U.S. (16 Wall.) 678 (1873) (forbidding federal court to impose tax themselves via a federal marshal or receiver).

[43]For example, Justice Swayne's Delphic opinion in *Gelpcke v. Dubuque*, 68 U.S. (1 Wall.) 175 (1864), has attracted interest for what is imagined to be either a novel application of the Contracts Clause or an extension of the federal courts' ability to opine on general law. *See, e.g.*, Powe, *supra* note 11; Currie, *supra* note 11, at 493-95. The cases of *Supervisors v. Rogers*, 74 U.S. (7 Wall.) 175 (1869), and *Olcott v. Supervisors*, 83 U.S. (16 Wall.) 678 (1873), have been noticed for their discussion of the federal courts' remedial powers vis-à-vis state-chartered corporations.

viewed their subject primarily in political terms.[44]

The standard account portrays a stable majority of the Court as staunch allies of eastern financiers more than as impartial arbiters of law. The picture is of a Court set on "sustaining the [repudiated] bonds at all costs,"[45] even where orthodox legal authority demanded otherwise, a Court "determined to extract their pound of flesh, willing to wield any instruments to do the job,"[46] a Court against whose concern for the debt market "parchment barriers and constitutional commitments to state sovereignty were no match."[47]

If it is the modern view, it is in no sense a novel one. Justice Miller, a member of the Supreme Court during the decision of most of the bond cases (1862-1890) and often a lone dissenter, was the first to cast the majority as essentially political players. It was hardly out of character when, in private correspondence, Miller described the bond cases as "a farce whose result is invariably the same, namely to give more to those who have already, and to take away from those who have little, the little that they have."[48] But Miller was not exactly uninterested himself. As a resident of Keokuk, Iowa, the epicenter of repudiation politics, he had felt the brunt of railroad disappointment and was personally litigating against the local railroad when he ascended to the bench.[49] Miller's views seem to have shaped modern thinking indirectly through the work of Charles Fairman, Miller's biographer and author of what is still the most extensive and heavily relied-upon history of the bond cases.[50] As Gerhard Casper remarked of Fairman's impressive effort, the work "leaves little doubt that he is appalled by the Supreme Court's performance."[51]

Whatever its pedigree, the standard account rests on three mutually supportive propositions about the cases that are assumed rather than proved to be true. *First*, the federal and state courts were locked in regional or class conflict, almost in a battle, the state courts stretching to find bonds invalid and the federal courts reflexively upholding and enforcing them. *Second*, the

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[44]*See, e.g.*, WARREN, *supra* note 10, at 528-32; FAIRMAN, *supra* note 10, at 918-1116; HOVENKAMP, *supra* note 10, at 90-91; HORWITZ, *supra* note 10, at 22-24, 206; Schleicher, *supra* note 12, at 21-32.

[45]Powe, *supra* note 11, at 745.

[46]Porter, *supra* note 15, at 118.

[47]Schleicher, *supra* note 12, at 22-23.

[48]Letter of Feb. 3, 1878, *in* CHARLES FAIRMAN, MR. JUSTICE MILLER AND THE SUPREME COURT, 1862-1890, 920 (1939)).

[49]*See generally* Michael A. Ross, *Cases of Shattered Dreams: Justice Samuel Freeman Miller and the Rise and Fall of a Mississippi River Town*, ANNALS OF IOWA 57, 201 (Summer 1998).

[50]FAIRMAN, *supra* note 48; FAIRMAN, *supra* note 10. Miller's friend and fellow Iowan, Judge Dillon, himself a critic of some of the early bond cases, undoubtedly influenced historians' views as well. *See, e.g.*, 2 DILLON, MUNICIPAL CORPORATIONS § 886 (5th ed. 1911) ("The Supreme Court . . . has upheld the rights of the holders of municipal securities with a strong hand, and has set a face of flint against repudiation, even when made on legal grounds deemed solid by the State courts, as well as by the municipalities.").

[51]Gerhard Casper, *Book Review*, 73 COLUM. L. REV. 913, 917 (1973).

Supreme Court almost always ruled for bond investors. Professor Powe has expressed this proposition most directly. "Throughout the entire series of decisions," he writes, "with few—and therefore notable—exceptions, the Court upheld any municipal bonds aiding railroads regardless of defects in their issuance."[52] *Third*, decisions upholding bonds frequently flew in the face of doctrine.[53]

C. Summary Findings

To test the standard account, we analyzed all 172 of the Court's unique validity cases decided between 1859 and 1899. We found them paging through the U.S. Reports from volume 62 to 175 and reading every case having to do with municipal debt. There were 196 reports featuring an argument that a municipal bond was unenforceable because issued *ultra vires*. We removed twenty-four of these as "duplicates"—cases presenting substantially identical issues to another, recently or contemporaneously decided case. (Some subjective judgment was required to "de-duplicate," but the gestalt is unaffected.) That left a core sample of 172 cases.

Our results cast doubt on the standard account of the cases. Two of its three premises are potentially susceptible to quantitative challenge. Neither bears its weight.

First, conflict between the Supreme Court and state high courts is overemphasized in the standard account. The Court acknowledged a direct conflict in ten instances. Four of these were about a single issue—namely, whether subsidizing construction of privately owned infrastructure is a proper legislative purpose.[54] (A handful of the excluded, "duplicate" cases reprised the issue.) Ten is no small number. The fact of occasional conflict is worth recognizing, not least because the courts were differing on the content of state law. But it is odd to anchor a story of a group of cases on a feature absent from 94 percent of them.

Second, and even more striking, it is simply not true that the Court always or almost always ruled for the bondholder. The municipality won 33

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[52]Powe, *supra* note 11, at 746.

[53]*See, e.g.*, Fairman, *supra* note 10, at 1101 ("Preoccupation with the protection of bondholders caused a majority of the Justices to be insensitive to all other considerations in these complex situations. What is more, slovenly work concealed egregious deviations even from professed principles."); Powe, *supra* note 11, at 748 ("By assisting railroads while forbidding aid to manufacturers, the municipal bond cases demonstrated that the Court was picking and choosing among ends. . . . The cases indeed seem governed by no higher principle than the implementation of the Court's perception of sound public policy."); Schleicher, *supra* note 12, at 22-23 (saying the Justices "engaged in some wild jurisprudential gymnastics, violating established precedent, and disregarding fraud and malfeasance in its zeal to force municipalities to pay their debts.").

[54]Gelpcke v. City of Dubuque, 68 U.S. (1 Wall.) 175 (1864) (Iowa; railroad); Olcott v. Supervisors, 83 U.S. 678 (1873) (Wisconsin; railroad); Township of Pine Grove v. Talcott, 86 U.S. 666 (1874) (Michigan; railroad); Cty. of Livingston v. Darlington, 101 U.S. 407 (1879) (Illinois; reformatory).

percent of the time (57 of 172 cases). It won more than 40 percent of the cases (57 of 137) in which it was not estopped from pressing its sole substantial argument on the merits (on which more below). Intriguingly, the municipal win rate was not constant over time. Bondholders were, in fact, more successful in the early cases. They lost only one of fifteen cases decided between 1859 and 1869. Municipalities prevailed more frequently in later years. There is reason to think the standard account may be a product of overweighting the early decisions. Among other things, the most famous and contentious of the cases, *Gelpcke v. Dubuque*, was one of the very first. It might be possible to salvage an image of the Court as a political ally of bondholders by limiting the account to the first 10 percent of the cases, but it doesn't fit the cases as a whole.

The third premise of the standard account holds that the Court systematically twisted the law until bondholders could win. The proposition is not quantitatively falsifiable, but the Court's willingness to rule for repudiating issuers makes it suspect.

Year	Cases	Muni wins	Muni win %
1859-1863	6	1	17
1864-1868	9	0	0
1869-1873	12	4	33
1874-1878	51	9	18
1879-1883	42	13	31
1884-1888	30	15	50
1889-1893	17	13	76
1894-1898	6	2	33

Our analysis also reveals stylized facts about the cases. First, repudiation came of age in the aftermath of the Panic of 1873. The first *ultra vires* bond cases to reach the Court did so in the late-1850s. But there were not many. The Court decided just twenty-seven validity cases in the fifteen years before 1873, but 123 in the fifteen years after.

Approximately 80 percent of the cases featured railroad-aid bonds. They were the subject of almost all the early repudiations. Later cases were more likely to involve bonds issued to finance civic infrastructure or industrial facilities.

The geographic pattern of repudiation mirrored, but lagged, infrastructure development after 1850. It began in the Midwest—always the epicenter—and spread over time to the inland South and to the West. Almost a quarter of all the cases (42 of 172) arose in Illinois. It along with Missouri (15

percent), Kansas (9 percent), and Nebraska (4 percent) accounted for more than half of all the cases. Iowa and Wisconsin were early hotbeds of repudiation and site of some of the most contentious episodes. Municipalities in Mississippi and Tennessee, and eventually in Texas and Colorado, also produced a critical mass of litigation.

II. THE CASES' ANALYTICAL STRUCTURE

At the heart of all validity cases lay a defense that the plaintiff's bond was issued *ultra vires*. Beyond that common theme, the cases were marked by the breadth and diversity of theories the repudiating municipalities offered. An argument that too few county taxpayers approved of a bond proposal differs in many respects from the contention that no city can ever issue debt to subsidize railroad construction beyond city limits. The most important difference—the key distinction to grasping the bond cases' analytical structure—is that one defines a dispute over a matter of historical fact and the other over a question of law (or legal fact).

With respect to matters of fact, bondholders broadly speaking could take comfort if the right words appeared on the face of a bond. Not so with respect to questions of law, where the courts were tasked with making an independent judgment. As a practical matter, the difference in treatment made sense. It was much cheaper for investors to discover—and in the event of litigation *demonstrate*—a municipal issuer's legal powers than to find out and prove what exactly was going on in a distant territory before a bond issued.

There was a formal legal reason for the difference in treatment, as well: factual but not legal contentions could be estopped by recitals on the face of instruments like bonds. Estoppel law was a critical part of the story of repudiation, though one rarely so much as noticed in the modern literature. Estoppel resolved almost a third of the validity cases (53 of 172) in whole or substantial part, and presumably dissuaded many more acts of repudiation.

This part tracks the Court's analytical approach to *ultra vires* arguments across the fact/law divide. It starts with facts, explaining in general terms the theory connecting recitals and estoppel, illustrating its application to two frequent types of repudiation argument, and describing the theory's limits. It then turns to law, surveying the most important arguments repudiators made and outlining the Court's responses.

A. Matters of Fact

1. *The Estoppel Framework*

In the mid-nineteenth century, the default rule of municipal power in most states allowed cities, towns, and counties to issue paper in support of

ordinary operations.[55] To finance capital expenditures, however—and, in some jurisdictions, to issue negotiable bonds at all—municipalities needed specific authorization.[56] Authority could come from a variety of sources. It could be embedded in a state constitution. It could be granted in municipal charters. It could be established in ordinary legislation. With respect to railroad-aid bonds, municipal power to issue bonds was often lodged in railroad company charters. But whatever its source, authority was invariably conditioned and limited. State law inevitably had something to say about such matters as the purposes for which a municipality could incur debt, how much debt it could incur, who could decide whether to incur it, by what processes it could do so, what a bond must say and how it could be made negotiable.

The predicates of many common restrictions would have been exceedingly hard or even impossible for distant investors to verify, let alone prove. Potential bond buyers in New York or London had no way to know whether, for example, the township clerk or supervisor of Coloma, Illinois, had properly noticed a required bond election months or years earlier.[57] Even if he had done, getting a local jury to say so would be difficult in almost any situation where a bondholder had to resort to compulsion. This was a problem. If the capital markets were to fund municipal railroad subsidies, investors would need assurances.

Issuers sought to give just that. The practice was for each bond to recite on its face that all predicates to lawful issuance had been satisfied, and for one or more municipal officials to sign off on the recitals. It was standard for a bond to recite, for example, the purpose of its issuance, the source of authority to issue it, and the fact that all conditions to issuance were satisfied. Recitals could be highly specific. The bond might specify, for example, the date on which a taxpayer vote approving the issuance was held, and even the results of the vote.[58] But recitals could also be quite spare, for example declaring simply that the bond had been issued "in conformity with" a named authorizing act.[59]

But to what effect? How could a municipality's say-so alter the legal status of its bonds? Estoppel was the answer. The Supreme Court preserved the

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[55]DILLON, *supra* note 38.

[56]*Id.*

[57]*See* Town of Coloma v. Eaves, 92 U.S. 484 (1875).

[58]*See, e.g.*, Cty. of Dixon v. Field, 111 U.S. 83 (1884) ("This bond is one of a series of eighty-seven thousand dollars issued under and in pursuance of an order of the county commissioners of the county of Dixon, in the state of Nebraska, and authorized by an election held in the said county on the twenty-seventh day of December, A. D. 1875, and under and by virtue of chapter 35 of the General Statutes of Nebraska, and amendments thereto, and the constitution of the said state, art. 12, adopted October, A. D. 1875.").

[59]*See, e.g.*, Marcy v. Township of Oswego, 92 U.S. 637 (1875) (recital that bonds were issued "by virtue of and in accordance with" a named statute).

confidence of capital market investors not by jettisoning the theory of *ultra vires*, but by translating to the municipal context a longstanding procedural rule that would often prevent courts from having to reach the *ultra vires* question.[60]

The doctrine was simple to state: "[W]here a party has solemnly admitted a fact by deed under his hand and seal, he is estopped, not only from denying the deed itself, but every fact which it recites."[61] There were exceptions to its application, as we shall see. But importantly, municipal bonds would have seemed just the kind of instrument a holder could rely on to estop subsequent factual contentions inconsistent with its recitals.

Municipal bonds did, however, pose one apparent circularity the Court needed to reckon with. It was universally understood that only a valid instrument can set up an estoppel.[62] In the usual situation where estoppel by deed applied, validity was not in question. Natural persons—who as of the 1850s were still the predominant targets of an estoppel—have for the most part broad capacity to create valid instruments. A party setting up an estoppel might have to prove that the relevant instrument was not a forgery, but, having done so, the rule applied in a straightforward way. With a municipality the matter was different. Its bond, if issued inconsistently with the statutory and constitutional predicates, was invalid. To set up an estoppel, then, it would seem a bondholder might have to prove the very facts for which he wanted to rely on the estoppel.

The Justices cut the knot with a rule of construction announced in the very first municipal bond case and applied without fail thereafter. Unless state law declares otherwise, they reasoned, courts should think of local officials charged by authorizing legislation to execute bonds as performing a quasi-judicial function.[63] Their execution and delivery of the bonds was a kind of adjudication of the merits of the matters recited.[64] As the Court put it in one case, "[a] recital is itself a decision of the fact by the appointed

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[60]Estoppel by deed covered all sealed instruments (not only conveyances). *See, e.g.*, EDWIN TYRRELL HURLSTONE, A PRACTICAL TREATISE ON THE LAW OF BONDS 1, 32-33 (1835) ("The condition of a bond is frequently preceded by a recital of certain explanatory facts, and in such case if a *particular thing* be referred to, the recital will operate against the parties to the bond as a conclusive admission of the fact recited; for it is a general rule that a party is estopped from denying that which he has expressly admitted under his hand and seal."); JOHN WILLIAM SMITH, THE LAW OF CONTRACTS 4, 16 (1847) ("The next peculiarity of a contract by deed is its operation by way of estoppel; the meaning of which is, that the person executing it is not permitted to contravene or disprove what he has there asserted, though he may where the assertion is in a contract not under seal."). The doctrine had been recognized at common law at least since Coke. MELVILLE M. BIGELOW, A TREATISE ON THE LAW OF ESTOPPEL 360 (1913) (citing *Commentary on Littleton* § 352a).

[61]Parker v. Campbell, 21 Tex. 763 (1858).

[62]*Id.*

[63]Knox Cty. v. Aspinwall, 62 U.S. (21 How.) 539 (1859).

[64]*Id.* at 545.

tribunal."[65] If, hypothetically, a resident were to sue before a bond was delivered, on the ground of its illegality, a court could entertain the suit and enjoin issuance if appropriate. But once a bond was delivered, the facts it recited were in effect res judicata.[66] With the problem of circularity resolved, orthodox application of estoppel would resolve many disputes and prevent many more from arising.

2. *Estoppel Applied: Voting Conditions & Debt Limits*

Although estoppel could resolve a dispute wherever a factual predicate to issuance was in doubt, it was most frequently invoked as a response to two recurring arguments. These were arguments that a bond was invalid because of non-compliance with a voting requirement or because of non-compliance with a debt limit. Viewed together, these cases demonstrate the range of estoppel doctrine as well as hint at its practical limits. The voting-condition cases were ideal candidates for estoppel, practically speaking—they involved private facts that would have been impossible for bondholders to investigate. The same is not necessarily true of debt-limit disputes. Nominally estoppel doctrine treated both kinds of case alike. This is not to say, however, that the law ignored the importance of the "publicity" of contested states of affairs. As we shall see, the Court denied recitals their conclusive effect in contexts where investors arguably could have cheaply verified the facts recited.

Voting Conditions. The most common argument for repudiation to which estoppel could apply asserted that a bond was invalid because issued inconsistently with a required taxpayer vote. Voting conditions were ubiquitous in bond authorization statutes—as they still are today—and even found their way into many constitutions. The precise terms varied widely. They typically required a local official or board to notice a vote on a specific proposal—a proposal to issue bonds for a particular purpose, of a particular amount and tenor, paying a particular coupon. Only if the required majority or supermajority approved could bonds validly issue.

When municipalities wished to repudiate, they often cited a defect in the voting procedure. They might deny that an election was ever held, or that an election conceded to have been held was properly noticed, or that the requisite share of voters in fact approved the proposal. The potential for opportunism was obvious, even if in some instances local officials had in fact ignored the law. For a plaintiff bondholder to establish otherwise would entail a trial

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[65]Town of Coloma v. Eaves, 92 U.S. 484, 492 (1875).

[66]*Knox Cty.*, 62 U.S. (21 How.) at 545. There were some interesting earlier analogs—other procedures where a non-"judge" could conclusively determine facts binding in a subsequent judicial proceeding. One involved a notary's power to establish conclusively a married woman's certification of consent to her husband's conveyance of her or homestead property. *See* HERMAN, COMMENTARIES § 597 (1886).

at which all the witnesses, if they could be found at all, would be financially interested.

In the very first repudiation case to reach the Supreme Court, *Knox County v. Aspinwall*,[67] the Justices held that recitals of compliance with a voting requirement would estop *ultra vires* arguments denying compliance. This one application of estoppel would eventually resolve, in whole or substantial part, more than 20 percent of all the validity cases (37 of 172).

Knox County is emblematic of the fact pattern and the Court's resolution. The case concerned the validity of bonds issued to subsidize construction of the Ohio & Mississippi Railroad. In 1848, Indiana's legislature incorporated the Ohio and Mississippi Railroad Company and authorized counties through which the proposed road was to run to subscribe to its stock.[68] The commissioners of each such county were directed to poll the voters at annual elections. If a majority of qualified voters approved, the commissioners were to subscribe on behalf of the county and pay for the subscription with 30-year bonds bearing a 6 percent annual coupon.[69]

The commissioners did subscribe. They transferred $200,000 of county bonds to the railroad, which in turn sold the bonds to New York to raise cash for construction.[70] Litigation began when the county refused to pay coupons five years later.[71] According to the commissioners, the vote on which authority to issue bonds rested had been irregularly conducted. The election had not been properly noticed and was a nullity.[72]

As the case reached the Supreme Court, the Justices faced a purely legal question: Would the fact of an irregular election preclude judgment for the bondholders? The county pressed *ultra vires*. Justice Daniel, in dissent, would have given it judgment and forced a trial of the fact.[73] But the majority of the Court, ruling for the bondholders, did not get that far. The county's argument was too late. Its bonds recited that they were issued "in pursuance of" the authorizing statute.[74] Since the authorizing statute conditioned issuance on a proper election, the county commissioners when executing the bonds had resolved the matter insofar as subsequent bond buyers were concerned.

Debt Limits. Apart from voting conditions, the most frequent fact-based *ultra vires* argument asserted violation of a debt limit. These arguments involved disputed facts of a more public nature—the finances of a municipality

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[67]62 U.S. (21 How.) 539 (1859).

[68]*Id.* at 542.

[69]*Id.*

[70]*Id.* at 543.

[71]*Id.* at 541.

[72]*Id.* at 541.

[73]*Id.* at 546 (Daniel, J., dissenting).

[74]*Id.* at 545 (bonds recited that they were "issued in pursuance of the third section of act, &c., passed by the General Assembly of the State of Indiana, and approved 15th January, 1849")

as opposed to the happenings at a town hall meeting—but the same analysis still applied.

Debt limits were first adopted in response to perceived overborrowing in the 1850s and 1860s.[75] They really came into vogue, however, by statute as well as by constitutional amendment, after fallout from the Panic of 1873 left many municipalities hobbled. Debt limits were usually expressed as what a modern lawyer would think of as a leverage ratio. Municipalities were made unable to issue bonds when doing so would cause the ratio between some measure of indebtedness—either total debt or periodic debt-service requirements—and a measure of the tax base to exceed a specified figure.

The Court held that recital of compliance with a limit could estop *ultra vires* arguments denying it.[76] The amount of debt a municipality had issued, the value of its tax base, the size of levy needed to service or repay debt: these were matters of fact. A municipality that recited compliance with a law imposing a debt limit was, in doing so, declaring that the issuance would not cause it to exceed its debt or leverage capacity and would be estopped to say otherwise in litigation. Seven validity cases were resolved on this ground.

The first debt-limit case to reach the Court, *Marcy v. Township of Oswego*, is exemplary. The case arose from a Kansas statute authorizing townships to issue railroad-aid bonds but limiting the amount to what a township could service with an annual one-percent levy on taxable property.[77] Oswego issued $100,000 of bonds. The bonds recited conformity to the authorizing (and limiting) statute:

> This bond is executed and issued by virtue of and in accordance with an act of the legislature of the said State of Kansas, entitled 'An Act to enable municipal township to subscribe for stock in any railroad, and to provide for the payment of the same, approved Feb. 25, 1870,' and in pursuance of and in accordance with the vote of three-fifths of the legal voters of said township of Oswego, at a special election duly held on the seventeenth day of May, A.D. 1870.[78]

When bondholders sued for payment of dishonored coupons, the sole issue for the trial court was whether Oswego ought to be allowed to prove that the bonds were issued contrary to the debt limits. In other words, could Oswego set up as a defense the fact that the levy needed to service $100,000

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[75]The people of Iowa adopted the first constitutional limit as early as 1857. The next state to do so, Illinois, followed more than a decade later, however. HILLHOUSE, *supra* note 30, at 178.

[76]*Marcy v. Township of Oswego*, 92 U.S. 637 (1875), and *Township of Humboldt v. Long*, 92 U.S. 642 (1875), were both decided October 1, 1875.

[77]Marcy, 92 U.S. at 638.

[78]*Id.* at 639.

of bonds would have exceeded one percent of the value of taxable property in the township? The Justices' answer, when the case reached them, was no. Justice Strong, writing for the majority, described the case as "free from difficulty."[79] The rule of the voting conditions cases applied. The ratio of debt-service obligation to taxable property, like the ratio of yeas to nays, is, as the Court put it, a matter of extrinsic fact.[80]

3. *The Limits of Estoppel*

This is not to say bondholders always prevailed when repudiation was grounded in an assertion of fact. Estoppel had its limits. The conditions on its application were well defined. In twenty-four cases, the Court, facing a factual *ultra vires* defense, held that the municipality could not be estopped from denying a fact necessary to the contested bond's validity. Any of three reasons would do: first, the bonds failed to recite facts which, if true, would necessarily defeat the municipality's defense; second, records made authoritative by law contravened such recitals; or third, the plaintiff was not a good-faith purchaser of the bonds.

a. No Recital

Estoppel extended only as far as a contested bond's recitals. Trial was appropriate if a bond did not assert on its face the fact the denial of which grounded a municipality's repudiation. In eleven cases, the Supreme Court concluded that a contested bond did not adequately recite facts on which bondholders thought they could rely. Some of these were quite hard on the bondholders.

A good example both of the principle in action and of the Court's willingness to read recitals narrowly is *Buchanan v. Litchfield*.[81] At issue in the case was the validity of bonds sold to finance construction of a water-works. After the Great Chicago Fire of 1871, the Illinois legislature authorized cities to "borrow money, and levy and collect a general tax in the same manner as other municipal taxes may be levied and collected, for the erection, construction, and maintaining of [ ] water-works."[82] Litchfield's city council took up the opportunity, directing the mayor to raise cash by selling $50,000 of twenty-year, coupon-bearing bonds.[83] Little more than two years later, after the water-works were built, the city refused to pay its coupons.

Litchfield argued that it needn't pay, because the bonds had been issued *ultra vires*. The Illinois constitution prohibited municipalities from incurring

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[79]*Id.* at 640.

[80]*Id.* at 641.

[81]102 U.S. 278 (1880). The case is worth understanding also because it has been misunderstood in briefs and commentary in recent cases (and we shall return to it in our discussion of Puerto Rico.

[82]*Id.* (citing statute).

[83]*Id.*

debt in excess of five percent of the assessed value of local taxable property.[84] Litchfield contended it lacked power to issue bonds, whatever the statute said, because the city was already at the constitutional debt limit when it issued them. The city already owed $70,000 on a base of $1,400,000, it contended.[85]

A trial court accepted Litchfield's view of the facts. When the case reached the Supreme Court, therefore, the question presented was narrow: was the truth of the city's indebtedness at the time of issuance relevant? The bondholder argued not, but the Court held that it was.[86] In light of the proceedings below, the bonds were unenforceable. The problem for the bondholders was that the bonds, as the Court read them, did not recite compliance with the constitutional debt limit.[87] They did recite that they were issued in conformity with the conditions of the water-works authorization statute, but that was insufficient. They did not recite conformity with the constitution. No recital, no estoppel.[88]

Another interesting example is *Hopper v. Town of Covington*.[89] In *Covington*, a town sold 10-year bonds and then repudiated. The town defended a bondholder's action on *ultra vires* grounds. The town's charter authorized it to sell bonds for certain, specified purposes, but, the town said, the bondholder could not prove that any of those purposes explained these bonds. The Court ruled for the town. The purpose for which the bonds were issued was a factual question. But the bonds recited nothing at all about their rationale. It was thus the bondholder's obligation to prove a valid purpose, and this bondholder could not do so.[90]

b. Authoritative Record Contravenes Recital

Even if a bond recited a fact necessary to valid issuance, estoppel would not protect a bondholder if authoritative records available at the time of issu-

[84]ILL. CONST. art. 9, § 12 (1870) ("No county, city, township, school district, or other municipal corporation shall be allowed to become indebted in any manner or for any purpose to an amount including existing indebtedness in the aggregate exceeding five per centum on the value of the taxable property therein to be ascertained by the last assessment for State and county taxes previous to the incurring of such indebtedness.").

[85]*Buchanan*, 102 U.S. at 282.

[86]*Id.* at 293.

[87]*Id.* at 292 ("[I]t will be observed that the bonds issued by the city of Litchfield contain no recital whatever of the circumstances which, under the Constitution of the State, must have existed before the city could legally incur the indebtedness for which the bonds were issued. . . . Nor does the city ordinance recite or state, even in general terms, that the proposed indebtedness was incurred in pursuance of or in accordance with the Constitution of the State, or under the circumstances which permitted the issuance of the bonds.").

[88]After *Buchanan*, bondholders sought restitution as an alternative remedy. The Court rejected their argument. Litchfield v. Ballou, 114 U.S. 190 (1885).

[89]118 U.S. 148 (1886).

[90]*Id.* at 150.

ance contravened the recital. A recital was ineffective if a potential investor, looking only at the face of the bonds and other records made authoritative by law, would have had reason to doubt the recital. This exception to the effectiveness of recitals was especially important in debt-limit cases. Nine times the Supreme Court ruled for a repudiating municipality despite the existence of a recital of compliance with a debt limit.

The leading case of this type was *County of Dixon v. Field*.[91] The bonds at issue recited that they were "authorized by an election held in [Dixon] county on the twenty-seventh day of December, A. D. 1875, and under and by virtue of chapter 35 of the General Statutes of Nebraska, and amendments thereto, and the constitution of the said state, art. 12, adopted October, A. D. 1875."[92] The debt limit cited by the county was an artifact of "chapter 35 of the General Statutes of Nebraska, and amendments thereto." Therefore, said the bondholders, the recital was sufficient to estop the county from denying compliance with it.[93]

The Court sided with the county, however. The Justices observed, first, that each bond declared itself to be one of eighty-seven identical $1000 bonds. An investor wishing to test the 10 percent debt limit could therefore infer a minimum numerator of $87,000. The Justices further observed that the denominator of the debt ratio was (by statute) the assessed value of taxable property, as stated in the county's record books. For Dixon County in particular, the most recent assessment on file indicated taxable property in the amount of just over $587,000, meaning that the minimum debt ratio the challenged bonds created was almost 15 percent. Because it was open to any investor to establish the recital's falsehood, looking only at public records the law itself made authoritative, the Court concluded that the bonds were invalid.[94] It was a hard result on bondholders, but not an outlier in the Court's

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[91]111 U.S. 83 (1884).

[92]*Id.* at 91.

[93]Bondholders relied on the bonds' recitals as an alternative to a separate, legal argument rejected by the Court. A Nebraska statute authorized its counties, upon a two-thirds vote, to issue railroad-aid bonds with a face amount of up to 10 percent of the assessed value of taxable property in the jurisdiction. While the statute was in effect, the state adopted a new constitution one provision of which limited the amount of railroad-aid debt municipalities could incur: up to 10 percent of assessed value on a majority vote, or up to 15 percent of assessed value on a two-thirds vote. Dixon County officials seem to have read the provision to authorize incremental debt *ex proprio vigore*. They put to a vote a proposal to issue bonds amounting to just under 15 percent, and the proposition passed with almost four-fifths support. Bondholders argued that the margin of vote validated the bonds. But the Court understood the constitutional provision only as a limit on legislative authority the full extent of which the legislature had not yet exercised. The bonds therefore were enforceable only if bondholders could rely on a representation that issuance did not violate the 10-percent threshold. *Id.*

[94]On the limitation that the record be made authoritative by law, see *Gunnison Cty. v. E.H. Rollins & Sons*, 173 U.S. 255 (1899).

approach.[95]

A pair of cases out of Colorado nicely illustrate both the logic and limit of the Court's approach. *Lake County v. Graham*[96] and *Chaffee County v. Potter*[97] arose from the same bond authorization statute and the same constitutional debt limit, but the Court resolved them differently because the information available to investors at the time of issuance differed in important respects.

Colorado's legislature passed a law authorizing counties to refinance their debts with newly issued bonds.[98] The constitution, however, prohibited counties from incurring debt in excess of a specified fraction (which varied by county) of the assessed value of taxable property.[99]

In *Graham*, the county issued $500,000 of bonds. They recited conformity with the refinancing act, but, as in *Buchanan*, said nothing about the state constitution. When the county repudiated and a bondholder sued, the Court ruled for the county. Compliance with the debt limit was ripe for litigation, "because there [wa]s no recital in regard to it."[100] But the bonds would have been invalid even if they had recited compliance, the Court explained. Any bond buyer could have established noncompliance with the debt limit. Each bond declared the aggregate amount of the issuance, and, as in *Dixon County*, the assessed value of the jurisdiction was fixed by the assessor and a matter of public record. Dividing one number into the other was enough to be sure of the legal defect.

Three years later the Court reached the opposite conclusion in a similar case. In *Potter*, the county issued bonds under the same refinancing law and repudiated on the same ground as in *Graham*. In *Potter*, however, the Court sided with the bondholders. The difference between the cases lay on the faces of the bonds. The bonds in *Potter* recited conformity with the Colorado constitution and said nothing about the aggregate amount being issued.[101] This was enough to produce an opposite result. Because the bondholder, lacking an authoritative numerator, could not determine the county's conformity to the constitutional debt limit arithmetically, he could take comfort in a recital of conformity.[102]

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[95]*See, e.g.*, Lake Cty. v. Graham, 130 U.S. 674 (1889); Dist. Township of Doon v. Cummins, 142 U.S. 366 (1892); Nesbit v. Indep. Dist. of Riverside, 144 U.S. 610 (1892); Sutliff v. Board of Comm'rs of Lake Cty., 147 U.S. 230 (1893);

[96]130 U.S. 674 (1889).

[97]142 U.S. 355 (1892).

[98]Graham, 130 U.S. at 678–79.

[99]*Id.* at 676.

[100]*Id.* at 681.

[101]*Potter*, 142 U.S. at 362. They also omitted the aggregate amount of the issuance, so the alternative problem in *Graham*, *see supra* note 100, did not come into play.

[102]*Id.* at 363.

c. Bona Fides Lacking

Finally, estoppel was unavailable to bondholders who were not bona fide purchasers. This issue rarely arose in the cases that reached the Supreme Court—a plaintiff's lack of bona fides bore on the resolution of only four.[103] Nor does the rule implicate bond validity exactly, since its application is plaintiff- rather than bond-specific. That is, recitals could make a bond enforceable in the hands of some bondholders but not others.[104]

B. Questions of Law

The Supreme Court's approach to resolving legal contentions was less analytically daunting. Review was plenary. The Court's task was simply to compare a challenged bond's properties—its amount, its maturity, its stated purpose, and so on—to the powers the municipal issuer had at the time it purported to issue the bond. There was no escape from a binary decision on the merits.[105] If on any set of facts the municipality would have been able to create a security with the incidents of the contested bond, the bondholder won; if not, the bondholder was out of luck.[106] Construing municipal powers took judgment, of course. But nothing about the bond cases was especially striking in that respect. It was a quintessentially judicial task.

For that reason, our aim in this part is modest—to reflect some of the most common repudiation arguments the Court confronted and the conclusions it reached. Broadly speaking, two types of legal argument for repudiation reached the Court. One turned on legislative permission for the municipality to use negotiable bonds to finance the capital improvement the contested bonds contemplated. The other went to the constitutionality of

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[103]Smith v. Sac Cty., 78 U.S. 349 (1871); Scipio v. Wright, 101 U.S. 665 (1879); City of Ottawa v. Carey, 108 U.S. 110 (1883); Lytle v. City of Lansing, 147 U.S. 59 (1893).

[104]*Compare, e.g.*, Carey, 108 U.S. at 110 (donee loses), *with* Hackett v. Ottawa, 99 U.S. 86 (1878) (good-faith purchaser wins judgment on bonds from same issuance); Ottawa v. Nat'l Bank, 105 U.S. 342 (1881) (same).

[105]*See, e.g.*, Town of S. Ottawa v. Perkins, 94 U.S. 260 (1876) ("There can be no estoppel in the way of ascertaining the existence of a law. That which purports to be a law of a State is a law, or it is not a law, according as the truth of the fact may be, and not according to the shifting circumstances of parties. It would be an intolerable state of things if a document purporting to be an act of the legislature could thus be a law in one case and for one party, and not a law in another case and for another party; a law to-day, and not a law to-morrow; a law in one place, and not a law in another in the same State. And whether it be a law, or not a law, is a judicial question, to be settled and determined by the courts and judges.").

[106]In a few instances, bondholders might have pursued what today we would call unjust enrichment—what at the time could have been either an action at law for money had and received or a suit in equity to enforce a constructive trust. *See generally* C.W. Tooke, *Quasi-Contractual Liability of Municipal Corporations*, 47 Harv. L. Rev. 1143 (1937). But because the issuer in most cases, including all of the railroad-aid cases, had not received money directly, the holders of repudiated bonds were often left without recourse. *See id.* at 1149 (explaining that recovery "is limited to cases where it can be shown either that the money is in the treasury or has been expended for legitimate municipal purposes for which otherwise municipal taxation would be necessary").

legislative permission. The Court's judgments across these broad categories were in our view mostly sound and in any case often favorable to the repudiator. Of the 128 unique validity cases posing a pure legal challenge to a contested bond, the municipality prevailed in 49, for a win rate of 38 percent.[107]

1. *Legislative Authority*

The practice of municipal charter construction was to read narrowly the power to incur debt to finance capital improvements. Absent specification, municipalities were assumed to be able to borrow money and to issue nonnegotiable paper to finance expenses incurred in the ordinary course of governmental operations.[108] For example, they could give orders or warrants to pay for labor or services rendered.[109]

Negotiable bonds for extraordinary capital expenditures were another matter. It was questionable whether by default municipalities could create negotiable paper at all.[110] Moreover, they typically needed special permission to make capital investments.[111] *A fortiori* the power to issue bonds to finance a particular capital investment couldn't be assumed. It had to be located in positive law—in the municipal charter, in a railroad charter (for railroad-aid bonds), or in generally applicable law. The vagaries of interpretation being what they are, coupled with ambiguity in the distinction between implied and special municipal powers, rueful cities, towns, and counties often had at least a colorable argument that their bonds lacked legislative support.

One version of the argument focused on the use of negotiable bonds—as opposed to other methods of financing—to finance authorized projects. In *Seybert v. City of Pittsburg*,[112] for example, the Pennsylvania legislature had specifically authorized the city to subscribe to railway stock. The act was silent, however, about how the stock ought to be paid for. The city delivered what purported to be negotiable municipal bonds issued in fulfillment of the subscription. When the city later repudiated, it insisted that it had never been allowed to make and use bonds to that end. The Supreme Court, following Pennsylvania's high court, held the bonds valid. None of the judges disputed the form of the city's argument. They simply disagreed on how to construe the legislature's silence, inferring from what they saw as common usage a power to use bonds as "currency."

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[107]Of the 99 unique validity cases that posed *only* a legal challenge—that did not also lodge a fact-based challenge, in other words—the municipality prevailed in 37, for an almost-identical win rate.

[108]DILLON, *supra* note 38, at 126-28, 394-95.

[109]*Id.* at 394-95.

[110]*Id.* at 395-96.

[111]*See id.* at 95-150 (cataloging incidental and special municipal powers).

[112]68 U.S. (1 Wall.) 272 (1863). This was the first case featuring this argument to reach the Court. A similar case, relating to authority to create so-called "certificates of loan," was decided two years earlier. Amey v. Mayor of Allegheny City, 65 U.S. (24 How.) 364 (1861).

The Court's approach to construction in this kind of case changed over time. After a few early cases in the same vein as *Seybert*,[113] the Court grew skeptical of the notion that authority to undertake a capital expenditure carried with it implicitly a power to finance the expenditure with bonds. After 1867 the Justices never again found an implicit power to finance capital projects with negotiable bonds. Instead, they held bonds invalid in eight unique cases,[114] eventually overruling the presumption of *Seybert* in 1892.[115]

Another version of the argument denied legislative authority to make the capital investment in any form, with negotiable bonds or otherwise. It followed from the idea that municipalities could make extraordinary investments only with special authorization. The details of the argument were inherently unique to each case, and so defy easy summary. Two examples will illustrate.

In *Van Hostrup v. Madison City*,[116] the Indiana legislature authorized Madison, on the north bank of the Ohio upriver from Louisville, to "take stock in any chartered company for making a road or roads to the said city."[117] Madison's city council proposed, and a supermajority of its taxpayers agreed, to issue bonds in exchange for stock in the Columbus & Shelby Railroad. When the city later repudiated, it did so not on the ground that it shouldn't have used negotiable bonds, but rather on the theory that it couldn't take stock in the railroad at all. The authorizing law permitted it to take stock in a company building a railroad *to* the city. But the Columbus & Shelby was never slated to pass through or terminate within city limits. It would connect to an existing railroad that did, and in that sense enhance Madison's capacities for trade, but according to the city the phrase "to the city" precluded this particular investment. The Court held the bonds valid. The city's reading of the authorization too cramped. In the Justices' view, the grant from the legislature was designed to allow the city, if it wished, to invest in a connection to the interior of the state, and the Columbus & Shelby provided that.

Whatever purposive flexibility the Court was willing to read into bond authorization statutes, its flexibility had limits. In *Osborne v. County of Adams*,[118] a Nebraska statute authorized counties and their precincts generally "to issue bonds to aid in the construction of any railroad or other work of

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[113]*E.g.*, Rogers v. Burlington, 70 U.S. (3 Wall.) 654 (1866); Mitchell v. Burlington, 71 U.S. 270 (1867).

[114]Police Jury v. Britton, 82 U.S. 566 (1872); Claiborne Cty. v. Brooks, 111 U.S. 400 (1884); Town of Concord v. Robinson, 121 U.S. 165 (1887); Kelley v. Town of Milan, 127 U.S. 129 (1888); Hill v. City of Memphis, 134 U.S. 198 (1890); Merrill v. Monticello, 138 U.S. 673 (1891); City of Brenham v. German-Am. Bank, 144 U.S. 173 (1892).

[115]*City of Brenham*, 144 U.S. at 173.

[116]68 U.S. (1 Wall.) 291 (1864).

[117]*Id.* at 296.

[118]106 U.S. 181 (1882).

internal improvement."[119] Adams County issued bonds to subsidize the construction of a steam-powered grist-mill. When the county repudiated, the Court concluded that the bonds were invalid and unenforceable. A "work of internal improvement," as used in the Nebraska statute anyway, meant something like a railroad, the Justices concluded. A grist-mill, useful as it may be, just was not similar enough to a railroad to fit the statute.

2. *Constitutional Purpose*

When a particular bond's issuance had clear legislative license, a would-be repudiator could turn to its state constitution. If the act authorizing the bond was itself *ultra vires*, so too would be any municipal act predicated on it. The most remarked-upon of all the bond cases raised arguments to this effect.

The standard academic account criticizes the Court's performance in them. In some instances, as we shall see, the Justices enforced bonds issued under legislation whose unconstitutionality the responsible state high court had already announced. On that basis the standard account paints the Justices as result-oriented scofflaws.

We reject the standard interpretation. For one thing, the Court was right on the merits in these cases. In any event, the Justices' supposed ambition to uphold bonds at any cost is, as we have already shown, either false or in need of qualification. To ascribe the cases' deep logic to it is a mistake. Finally, the Court in fact invalidated some bonds on constitutional grounds, implying that any bias the Justices might have had could not have been always decisive.

Explicit Prohibitions. Some constitutional grounds for repudiation were premised on explicit prohibition. As political dissatisfaction with failed railroad projects mounted, state constitutions, especially in the Midwest, were amended to discourage or prohibit new subsidies.

One of the very first repudiation cases to reach the Supreme Court arose out of such an amendment. In *Aspinwall v. County of Jo Daviess*,[120] a statute allowed Indiana counties through which the Ohio & Mississippi Railroad would pass to issue bonds to help finance construction.[121] The taxpayers of Daviess County voted to issue $30,000 of bonds to that end, but before the commissioners could act, the constitution was amended to prohibit counties using debt to aid railroads.[122] The commissioners issued the bonds anyway. When the county eventually repudiated, a group of bondholders argued that

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[119]*Id.* at 182.

[120]63 U.S. (22 How.) 364 (1860).

[121]The bonds contested in the first repudiation case to reach the Supreme Court, *Knox County v. Aspinwall*, were issued under the same authorization. Knox and Daviess Counties are neighbors in southwest Indiana.

[122]63 U.S. (22 How.) at 375. The amendment declared that counties could subscribe to railroad stock only if the subscription was "paid for at the time"—paid for, that is, in cash. *Id.* at 376 (quoting amendment) ("No county shall subscribe for stock in any incorporated company, unless the same be paid for at

the amendment was inconsistent with the Contracts Clause.[123] The Justices disagreed. As the Justices put it, "the subscription was made, and the bonds issued, in violation of the Constitution of Indiana, and therefore without authority, and void."[124] Bondholders took nothing.

Implicit Prohibitions. The most controversial cases, however, were premised on what was said to be *implicit* in state constitutions. It would be unconstitutional, the argument went, for a government, state or local, to tax the public for the benefit of a private corporation. It did not matter if the private subsidy was calculated to generate a corresponding public benefit greater in value than the cost of the subsidy (for example, by bringing rail service to the jurisdiction). Nor did it matter how much electoral support the subsidy garnered. If the recipient of tax dollars—or general obligation bonds, which represent a promise to tax—was private, the argument went, the exaction would be unconstitutional.

Versions of the argument appeared in the state courts as early as the 1830s, when municipalities first began subsidizing privately managed infrastructure projects in earnest. The logic never caught hold, however. In *Goddin v. Crump*,[125] the Supreme Court of Appeals of Virginia became the first of many high courts to reject it. The court accepted the proposition that laws authorizing a municipality to take from *A* to give to *B* were improper. In its judgment, though, the right question to ask about municipal subsidies was whether they aimed to promote a project having a public use or redounding to the common good. The public or private designation of the outfit directly receiving the subsidy was irrelevant.

In the quarter century after *Goddin*, the courts of at least sixteen states concurred in the basic reasoning.[126] To be sure, the boundary between public and private use was never precisely articulated. Perhaps it couldn't be. But the courts settled at least on the view that encouraging the development of channels of commerce—canals, turnpikes, railroads—was a sufficiently public

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the time of such subscription; nor shall any county loan its credit to any incorporated company, nor borrow money for the purpose of taking stock in any company.")

[123]*Jo Daviess County*, 63 U.S. (22 How.) at 376-77. These bondholders were inspired by *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 627 (1819).

[124]*Id.* at 379.

[125]35 Va. (8 Leigh) 120 (1837). By permission of the legislature, the common council of Richmond had subscribed to stock of a canal company digging between the city and Virginia's western border. Goddin filed a bill in equity to enjoin collection of a tax the city imposed to pay for the stock. His chief argument was that the authorizing act was unconstitutional. But the court upheld the tax, reasoning that the canal would benefit the citizens generally, if at all, and so did not violate any implicit prohibition on taking from *A* to give to *B*.

[126]*See* Leavenworth Cty. v. Miller, 7 Kan. 479 (1871) (collecting cases); Talcott v. Pine Grove, 23 F. Cas. 652 (C.C. Mich. 1872) (same).

purpose to justify public aid.[127]

That was the backdrop for the events of *Gelpcke v. City of Dubuque*,[128] the first bond case raising an *implicit* constitutional ground for repudiation to reach the Court and by far the most well-known of all the bond cases. *Gelpcke* began typically as an action in the circuit court for payment of repudiated coupons. The city of Dubuque had (with the legislature's blessing) issued bonds to aid the Dubuque Western.[129] At the time, the Iowa Supreme Court, like so many of its sister courts, could boast a perfect record holding railroad subsidy a valid purpose for which governments could incur debt.[130] After the Dubuque Western bonds were issued, however—along with many millions of dollars of bonds of other Iowa municipalities—the Iowa Supreme Court changed its tune (and also its bench).[131] In *Iowa v. County of Wapello*,[132] the court, no doubt reflecting the mood of the state, overruled the old cases, holding railroad-aid to be an improper governmental purpose and implicitly unconstitutional.

In *Gelpcke*, the proper construction of Iowa's constitution was the only substantial question to reach the Justices. Before *Wapello* it would have been an easy case. There was only one view on the implicit limits of legislative power. After *Wapello*, though, the case posed a trickier question. Should the Justices defer to the most recent decision of the Iowa Supreme Court on what was, after all, a matter of local law? Or should they hew to the dominant usage in courts and legislatures across the country, including in Iowa? The majority's answer was to ignore *Wapello* and so hold the bonds valid. As Justice Swayne memorably put it, the Court would not "immolate truth, justice, and the law," by deferring to the recent decision, even if the Iowa court had "erected the altar and decreed the sacrifice."[133]

If the Court's judgment in the case (and subsequent cases presenting the same issue[134]) broke new ground institutionally, it was essentially conserva-

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[127]*See, e.g.*, Sharpless v. Mayor of Philadelphia, 21 Pa. 147 (1853); City of Bridgeport v. Housatonic R. Co., 15 Conn. 475 (1843),

[128]68 U.S. (1 Wall.) 175 (1863).

[129]*Id.* at 177-78

[130]*See* Dubuque Cty. v. Dubuque & Pacific R.R. Co., 4 Greene 1 (Iowa 1853); Iowa v. Bissell, 4 Greene 328 (1854); Clapp v. Cty. of Cedar, 5 Iowa 15 (1857).

[131]Iowa had adopted a new constitution under which the judges of the Supreme Court were to be popularly elected. Iowa Const. art. V, § 3 (1857).

[132]13 Iowa 388 (1862).

[133]*Id.* at 206-07. The Court's judgment has elicited criticism since the day it issued, as has Swayne's imagery. Notably, though, complaint has never been grounded in the merits. Justice Miller's dissent spelled out what eventually became conventional wisdom. 68 U.S. (1 Wall.) at 207-20. It was and is all about institutional settlement—that the Justices should have followed the state high court's most recently decided opinion.

[134]A handful of Iowa cases following *Gelpcke* featured the same argument. *See* Meyer v. City of Muscatine, 68 U.S. (1 Wall.) 384 (1863); Thomson v. Lee County, 70 U.S. (3 Wall.) 327 (1865); Rogers v.

tive on the merits. The Court would not recognize an implicit prohibition of railroad-aid subsidies in a state constitution, whatever the state's judiciary might say.

Insistence on this point was, however, consistent with the constitutional distinction between public and private uses that the Court continued to honor. In several cases where a municipal bond was issued to subsidize industry, rather than infrastructure, the Justices held the bond invalid. The first, *Loan Association v. Topeka*,[135] is instructive. With the Kansas legislature's permission, the city had issued bonds to an iron-works company to aid its construction of a local plant. The question for the Justices was whether it was within implicit limits on the legislature's power to authorize such a subsidy. Just the previous term the Court (with the same membership) had upheld the validity of Michigan railroad-aid bonds against a similar challenge.[136] But in *Loan Association*, the Justices (with only one dissent) held the bonds *ultra vires* for want of a valid public purpose. While acknowledging the difficulty in some instances of deciding "what is a public purpose in this sense and what is not," the majority had "no difficulty" placing manufacturers on the private side of the distinction.[137]

III. PUERTO RICO: A CASE STUDY

In Puerto Rico's Title III case under PROMESA,[138] the Financial Oversight and Management Board and the Unsecured Creditors Committee have objected to claims made by the holders of general obligation bonds the Commonwealth ostensibly issued in 2012 and 2014.[139] According to the objectors, the government sold these bonds in violation of a constitutional debt limit.[140] The Board has proposed to settle its objection by paying holders of

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City of Keokuk, 154 U.S. 546 (1865); Rogers v. Lee County, 154 U.S. 547 (1865); Rogers v. Burlington, 70 U.S. (3 Wall.) 654 (1865); Mitchell v. Burlington, 71 U.S. (4 Wall.) 270 (1866); Larned v. Burlington, 71 U.S. (4 Wall.) 275 (1866). The Court held fast. Later, the Court again disagreed with the judgment of a responsible state court, on the same issue, in *Wisconsin, Olcott v. Supervisors*, 83 U.S. (16 Wall.) 678 (1873), and *Michigan, Township of Pine Grove v. Talcott*, 86 U.S. (19 Wall.) 666 (1874).

[135]87 U.S. (20 Wall.) 655 (1875).

[136]Township of Pine Grove v. Talcott, 86 U.S. (19 Wall.) 666 (1874).

[137]*Loan Ass'n*, 87 U.S. (20 Wall.) at 665-66. In the quarter century after *Loan Association*, the Court had to confront easier and harder cases. Consistently it held invalid bonds issued to subsidize manufacturing. Parkersburg v. Brown, 106 U.S. 487 (1882); Cole v. LaGrange, 113 U.S. 1 (1885). By contrast, it enforced bonds issued to subsidize construction of a state reformatory for juveniles. Cty. of Livingston v. Darlington, 101 U.S. 407 (1879). And it wrestled with the merits of, Hackett v. Ottawa, 99 U.S. 86 (1878); Ottawa v. Nat'l Bank, 105 U.S. 342 (1881), but ultimately condemned, City of Ottawa v. Carey, 108 U.S. 110 (1883), bonds issued to improve a river for the benefit of manufacturers.

[138]Puerto Rico Oversight, Management, and Economic Stability Act, Pub. L. 114-187, 130 Stat. 549 (2016) (codified at 48 U.S.C. § 2101).

[139]Omnibus Objection, *In re* Fin. Oversight & Mgmt. Board for Puerto Rico, No. 17-BK-3283 (LTS) (S.D.N.Y. Jan. 14, 2019), ECF No. 4784.

[140]*Id.* The Creditors Committee argues in the alternative that some of the bonds were issued in viola-

the contested bonds a fraction of what holders of other, concededly valid, Commonwealth bonds would receive under a plan of adjustment.[141]

How would the Supreme Court that confronted the municipal bond cases have resolved the objection? Answering that question may at once help to crystallize the old cases' logic and shed light on the present-day litigation. This part walks through the analysis. The Board's proposed settlement implies roughly a 50-50 proposition if the dispute were litigated to judgment. To the extent the bond cases are a template for the Title III court, however, the repudiation argument is weak—much weaker than the proposed settlement would imply. Either the proposed settlement undervalues the claims, or Puerto Rico law differs in important respects from the law the nineteenth-century court applied. We note possibilities briefly.

The debt limit on which the Board and Creditors Committee rely ties the legality of bond issuance to the size of the Commonwealth's expected future debt-service obligations. It bars the Commonwealth from issuing general obligation bonds if doing so would cause the cost of debt service in any subsequent year to exceed 15 percent of recent, average annual revenues.[142] The objectors say that issuing the contested bonds caused the ratio, properly calculated, to exceed that threshold.[143] Properly calculated, they say, the ratio of future debt-service costs to annual revenues was 16.2% in 2012 and higher in 2014, and consequently the bonds issued in those years are void.[144]

On the logic of the bond cases, however, the objection falls flat. On that logic, the bonds' recitals are decisive. With respect to the 2014 issuance, for example, the form of bond annexed to Puerto Rico's bond resolution recites that it is "issued under the authority of and in full compliance with . . . the

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tion of a balanced-budget requirement. *See id.* at 32-35 (¶¶ 91-98). We think the argument weak and do not discuss it further.

[141]Andrew Scurria, *Puerto Rico Board Unveils $35 Billion Bankruptcy-Exit Framework*, WALL ST. J. (June 16, 2019), https://www.wsj.com/articles/puerto-rico-board-unveils-35-billion-bankruptcy-exit-framework-11560729189. The initial proposal was to pay contested bonds between half and two-thirds of what other, non-contested bonds would receive. The fraction has since been revised upward. Matt Wirz & Andrew Scurria, *Puerto Rico Bondholders Reach Tentative Deal With Oversight Board*, WALL ST. J. (Feb. 5, 2020), https://www.wsj.com/articles/puerto-rico-bondholders-reach-tentative-deal-with-oversight-board-11580934722.

[142]P.R. LAWS ANN. CONST. art. VI, § 2 (providing that no general obligation bonds "shall be issued by the Commonwealth if the total of (i) the amount of principal of and interest on such bonds and notes, together with the amount of principal of and interest on all such bonds and notes theretofore issued by the Commonwealth and then outstanding, payable in any fiscal year and (ii) any amounts paid by the Commonwealth in the fiscal year next preceding the then current fiscal year for principal or interest on account of any outstanding obligations evidenced by bonds or notes guaranteed by the Commonwealth, shall exceed 15% of the average of the total amount of the annual revenues raised under the provisions of Commonwealth legislation and covered into the Treasury of Puerto Rico in the two fiscal years next preceding the then current fiscal year").

[143]Omnibus Objection at 3-4 (¶¶ 6-7).

[144]*Id.* at 19 (¶ 64).

Constitution and laws of the Commonwealth."[145] This is a general but, as the Court long held, effective recitation of all facts "the Constitution and laws of the Commonwealth" make predicate to valid issuance.[146] One such fact, in 2012 and again in 2014, was that the ratio between debt-service costs and recent revenues did not exceed 15 percent. Under the basic estoppel rule, good-faith purchasers of the bonds would have valid claims irrespective of what the best estimate of the Commonwealth's debt-service obligations were *in fact* when the bonds issued.

Nor do any of the exceptions to estoppel seem to apply. Some writers have suggested that the constitutional pedigree of Puerto Rico's argument distinguishes it from mere statutory arguments to which recitals are an answer. The Litchfield case, discussed above,[147] has been cited as evidence.[148] But that case's rationale had nothing to do with a distinction between statutory and constitutional law. The Court thought the bonds had failed to recite

[145]Commonwealth of Puerto Rico Bond Resolution, adopted March 11, 2014, Authorizing and Securing $3,500,000,000 Commonwealth of Puerto Rico General Obligation Bonds of 2014, Series A, at B-2.

[146]*See, e.g.*, Marcy v. Township of Oswego, 92 U.S. 637 (1875) (construing recital that bonds were issued "by virtue of and in accordance with" a named statute as asserting compliance with the statute's debt limit); Cty. of Dixon v. Field, 111 U.S. 83 (1884) (construing recital that bonds were issued "under and by virtue of chapter 35 of the General Statutes of Nebraska, and amendments thereto," as asserting compliance with statute's debt limit).

[147]*See supra* notes 81-88 and accompanying text.

[148]It has been cited for the broad proposition that holders of municipal bonds issued in contravention of a constitutional debt limit are entitled to no compensation—not on the bonds, which are void, and not on an equitable theory. The idea has showed up in court, see City of Detroit's Memorandum in Support of its Motion to Dismiss in part FGIC's Counterclaims at 13-14, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Aug. 28, 2014), in academic writing, see Janice E. Kosel, *Municipal Debt Limitation in California*, 7 Golden Gate U. L. Rev. 641, 644 (1977) ("In *Litchfield*, the court held that when a constitutional prohibition against indebtedness is violated, bondholders are denied even the equitable remedy of restitution on a theory of money had and received."); Mitu Gulati & Mark Weidemaier, "Puerto Rico's Audacious Move: Can it Cut its Debt by $6 bn?," CREDIT SLIPS (Jan. 23, 2019), https://www.creditslips.org/creditslips/2019/01/puerto-ricos-audacious-move-can-it-cut-its-debt-by-6-bn.html (citing *Litchfield v. Ballou*); Joshua C. Showalter, *The Consequences from Issuing Invalid Municipal Debt: Examining the Voidable Debt Issues in the Detroit Bankruptcy and Puerto Rican Debt Crisis*, 21 N.C. BANKING INST. 195, 209-11 (2017) (arguing that the Litchfield cases suggest no remedy available for holders of illegally issued bonds), and the popular press, *see* Eva Lloréns Vélez, *Will the U.S. government be held liable for Puerto Rico's Debt*, CARIBBEAN BUS. (May 4, 2018) ("A U.S. Supreme Court ruling in the 1885 Litchfield v. Ballou case held that bonds created in violation of a municipal debt limit do not have to be repaid."); Ed Morales, *Who Is Responsible for Puerto Rico's Debt?*, THE NATION (June 7, 2016) (declaring that *Litchfield v. Ballou* "held that bonds created in violation of a municipal debt limit do not have to be repaid."); David Dayen, *How Hedge Funds Are Pillaging Puerto Rico*, AM. PROSPECT (Dec. 11, 2015) ("An 1885 U.S. Supreme Court ruling in *Litchfield v. Ballou* found that bonds created in violation of a municipal debt limit were unenforceable, and did not have to be repaid."); Paul Abowd, *Puerto Rico considers simple solution to debt crisis: Don't pay*, AL JAZEERA AMERICA (Oct. 24, 2015) (summarizing lesson that because city "had originally sold the bonds in violation of its legal debt limit . . . the city did not have to pay that debt"). *But see* Financial Guaranty Insurance Company's Opposition to City of Detroit's Motion to Dismiss in Part FGIC's Counterclaims at 25, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Aug. 28, 2014); James E. Spiotto, *Puerto Rico's Repudiation of General Obligation Bonds: A Real Risk or Just Kabuki Theater*, MUNINET GUIDE (Feb. 5, 2019).

compliance with the limit at all.[149] Its constitutional source was an accident.

A stronger albeit unpersuasive argument starts with the public record. As we have seen, the bond cases gave no effect to recitals the truth of which a hypothetical investor could gainsay arithmetically, at the time the contested bond was issued, looking only at the face of the bond and records made authoritative by law.[150] The Board and Creditors Committee offer fodder for such a calculation.[151] They cite the "Official Statements" produced in connection with each issuance. These Statements, attested by the Secretary of the Treasury of Puerto Rico, set out a rudimentary calculation of, and statement of compliance with, the debt limit.[152] The objectors argue that the calculations were incomplete, that certain items ought to have been modified, that investors could have determined the errors and reached more accurate conclusions on their own, and that to prudent investors, therefore, the Statements would have indicated the new bonds' illegality.

Judged on the logic of the bond cases, however, the argument falls short in two respects. First, Puerto Rico law does not make Official Statements authoritative records for testing compliance. When the Court overlooked recital in debt-limit cases, it did so, as the Justices emphasized, only because state law pointed to an authority of the relevant facts *other than* local officers.[153] Puerto Rico law does no such thing. Second, supposing the Statements were authoritative, they would be authority *for* not *against* validity. None of the bond cases suggests that a good-faith purchaser could be charged with failure to have made ad hoc adjustments to an authoritative record. They say, rather, that the good-faith purchaser can rely on recitals unless the law directs her to look instead at some other authority contradicting them. The Official Statements do not contradict recitals on the bonds.

To be sure, one can see as a matter of policy why the rule of cases such as *Dixon County* might be extended to meet the realities of modern public finance. The economic logic of estoppel by recital derives from the difficulty

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[149]Buchanan, 102 U.S. at 292.

[150]*See supra* notes 91–102 and accompanying text.

[151]Omnibus Objection at 19 (¶ 64).

[152]*See, e.g.*, Official Statement of the Commonwealth of Puerto Rico, adopted March 11, 2014 at 31–32.

[153]*Compare, e.g.*, Cty. of Sherman v. Simonds, 109 U.S. 735 (1884) ("[I]t appears from the findings of fact that the records of the commissioners contained an estimate of the indebtedness of the county made by them for the express purpose of fixing the amount of bonds to be issued, and in pursuance of which they were issued, which showed that there was no over-issue. This was a decision by the very officers whose duty it was under the law to fix the amount of bonds which could be lawfully issued. A purchaser of bonds was not required to make further inquiry, and if the finding of the commissioners was untrue, he could not be affected by its falsity."), *with County of Dixon*, 111 U.S. at 83 ("No recital involving the amount of the assessed taxable valuation of the property to be taxed for the payment of the bonds can take the place of the assessment itself, for it is the amount, as fixed by reference to that record, that is made by the constitution the standard for measuring the limit of the municipal power.").

bondholders faced in determining the facts as they existed on the ground in a place far, far away. The dynamics of the nineteenth-century bond markets no longer prevail, however. At least with respect to issuers of the size and importance of Puerto Rico, the banks and securities firms arranging major offerings are well positioned to discern the facts about the amount of bonded debt outstanding, about revenues, and so on. It may be that in the modern setting bond buyers are efficient monitors of excessive borrowing.[154] Our point is only that the doctrinal logic of the bond cases, as the Court articulated it, does not support the objectors' argument.

Nor, to be clear, do we suggest that the bond cases necessarily resolve the objection of the Board and Creditors Committee. Puerto Rico law could demand a different result. The effect of recitals was always ultimately a matter of state law, of inference from context.[155] The nineteenth-century Court did not seem to think the state policy varied in this respect as a general matter, but presumably that conclusion was historically contingent. Maybe Puerto Rico law ought to be construed differently.[156] Our aim is not to opine on the dispute's proper disposition, but more modestly to crystallize by illustration the sense of the bond cases and to spotlight the open question that is their precedential weight.

CONCLUSION

The standard academic account of the municipal bond cases casts them as artifacts of a contest essentially regional or economic rather than legal. Our review of each of the 172 unique cases challenging bond validity does not support the standard view, however. Simple facts, somehow overlooked, are

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[154]*See* Vincent S.J. Buccola, *An Ex Ante Approach to Excessive State Debt*, 64 DUKE L.J. 235, 282-84 (2014); Clayton P. Gillette, *Bondholders and Financially Stressed Municipalities*, 39 FORDHAM URB. L.J. 639, 654-76 (2012); Richard C. Schragger, *Citizens Versus Bondholders*, 39 FORDHAM URB. L.J. 787, 789-93 (2012).

[155]*See, e.g.*, Town of Coloma v. Eaves, 92 U.S. 484 (1875) (observing that estoppel is appropriate where it "may be gathered from the legislative enactment that the officers of the municipality were invested with power to decide whether the condition precedent has been complied with"); Town of Venice v. Murdock, 92 U.S. at 497-98 (estopping argument that signatures on petition to issue bonds were not genuine, on ground that "[the legislature] must have contemplated that the bonds would be offered for sale, and it is not to be believed they intended to impose such a clog upon their salableness as would rest upon it if every person proposing to purchase was required to enquire of each one whose name appeared to the assent whether he had in fact signed it").

[156]The Uniform Commercial Code adds another complication. Article 8 might moot the recitals altogether. Article 8's key provision declares simply that a security issued "with a defect going to its validity" is nonetheless valid in the hands of a bona fide purchaser. U.C.C. § 8-202(a) (Am. Law Inst. & Unif. Law Comm'n) (1994). On the other hand, the general rule might not control. One specification likely applicable to some but not all holders of contested bonds is carved out of the general rule. Where a bondholder is the initial "subscriber" and the defect in issuance "involves a violation of constitutional provisions," Article 8 leaves validity to (non-U.C.C.) state law. Moreover, it is not clear that the U.C.C., being a statute, could if it tried validate municipal acts *ultra vires* on account of the state constitution.

inconsistent with it. The simplest fact of all is that repudiating municipalities prevailed in more than a third of their challenges. If the Court favored bondholders and was willing to distort or ignore law to see them win, why did they lose so often?

To the contrary, our review discovered a Court preoccupied with the law's formal logic. If a bond was issued *ultra vires*, it was void, and there could be no judgment against the issuer. An established procedural device—estoppel by recital—meant, however, that the Court would not always reach the merits. Estoppel's domain was itself circumscribed. It applied only when a bond asserted on its face a fact necessarily denied by the argument for repudiation and state law pointed to no other authority on the matter. When the Court reached the merits of an *ultra vires* argument, it undertook a typically judicial task: comparing the incidents of the contested bond to the powers the issuer had at the time of issuance. This took judgment, as all construction does. Some decisions stronger than others. But the striking thing about the cases, taken as a group, is their legalism. Whatever one thinks of particular decisions, rank formalism is a better guide to the cases than attitudinal and similar models of judicial decisionmaking.