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Constitutional Law - Municipal Bankruptcy Act - Encroachment Upon State Powers - Ashton v. Cameron County - Water Improvement District No. 1

CONSTITUTIONAL LAW — MUNICIPAL BANKRUPTCY ACT—ENCROACHMENT UPON STATE POWERS—*ASHTON V. CAMERON COUNTY WATER IMPROVEMENT DISTRICT NO. 1*[1]

A Texas water improvement district filed a petition in a Federal District Court for a readjustment of its debts under the Municipal Bankruptcy Act of May 24, 1934,[2] alleging insolvency and inability to meet its obligations as they matured. The petition alleged that more than 30 per cent of the bondholders had accepted the plan of adjustment submitted for confirmation and that ultimately more than two-thirds would do so. Owners of more than 5 per cent of outstanding bonds intervened and moved to dismiss the petition. *Held* (four justices dissenting), the Municipal Bankruptcy Act was an unconstitutional encroachment upon State governmental powers; the fiscal affairs of a State political sub-division cannot be subjected to the control of the Federal government, irrespective of consent having been given thereto by the State.

The case presents an interesting development in the interrelationship of the State and Federal governments under our constitutional system,—particularly in view of the unanimous decision in *Baltimore National Bank v. State Tax Commission,*[3] with which it is difficult to reconcile the reasoning of the majority of the Court, and which is mentioned in the dissenting opinion only.

The Act, in authorizing State political sub-divisions to petition for a readjustment of their obligations, specifically provided in section 80(c)[4] that the Court should not, by any order or decree, interfere with any of the political or gov-

[1] — U. S. —, 80 L. Ed. 910, 56 S. Ct. 892 (1936); *rehearing denied*, October 12, 1936, 4 U. S. L. Wk. 146, 57 S. Ct. 15 (Mem.).
[2] 11 U. S. C. A., sec. 301-303.
[3] — U. S. —, 80 L. Ed. 388, 56 S. Ct. 417 (1936).
[4] 11 U. S. C. A., sec. 303(c).

ernmental powers of the taxing district, or any of the property or revenues of the district necessary for essential governmental purposes; and in section 80(k)[5] that nothing in the Act should be construed to limit or impair the power of a State to control any political sub-division in the exercise of its political or governmental powers, including the power to require approval of any petition or readjustment plan; written approval of any agency established by a State to exercise supervision over the fiscal affairs of any political sub-division was expressly required for the reception of a petition filed under the Act, or the putting into effect of any plan of readjustment.[6]

The District Court, in dismissing the Improvement District's petition, proceeded upon an analogy to the cases dealing with the exercise of the Federal taxing power upon State governmental agencies, and pointed out that the State here had given no permission to the Federal government to extend the provisions of the Bankruptcy Act to its political sub-divisions.[7] Subsequently, however, Texas passed a statute[8] expressly authorizing all political sub-divisions in the State to proceed under the Federal Act. This was apparently viewed as unnecessary by the Circuit Court of Appeals, which in reversing the District Court, held that the Act was obviously not intended to interfere with any sovereign rights of the State, and said that the consent in advance of the State was not essential in order to enable its political sub-divisions to take advantage of the law.[9]

In any event, the issue, as presented to the Supreme Court, was whether Congress had power to permit State political sub-divisions to become, with the consent of their State, voluntary bankrupts.

In refusing to recognize such power, the majority of the Supreme Court, like the District Court, relies upon the

[5] 11 U. S. C. A., sec. 303(k).

[6] For the conditions leading to the passage of the Act, see the dissenting opinion; see, also, Dimock, Legal Problems of Financially Embarrassed Municipalities (1935) 22 Virginia L. R. 39.

[7] *In re* Cameron County Water Improvement District No. 1, 9 F. Supp. 103, 106 (S. D. Tex. 1934); see note (1935) 35 Columbia L. R. 428.

[8] Tex. Laws 1935, c. 107.

[9] Cameron County Water Improvement District No. 1 v. Ashton, 81 F. (2) 90[illegible] (C. C. A. 5th, 1936).

analogy furnished by such cases on the taxing power as *Collector v. Day*,[10] and *Indian Motorcycle Co. v. United States*.[11] Clearly, the argument runs, the Federal government could not have taxed the bonds of the respondent, since this would constitute an unwarranted interference with State fiscal matters; and the power to legislate as to bankruptcies, being of no higher rank or importance than the power to tax, must be subject to the same limitation implied by the necessity of preserving the governmental independence of the States. Congress having no power to act, cannot be given such power by the consent or submission of the States, citing *United States v. Butler*.[12]

Somewhat parenthetically, the Court observes that since the States were without power to make the readajustments contemplated by the Act directly, in view of the Constitutional prohibition against impairing the obligation of contracts, they could not accomplish the same result indirectly by giving permission to Congress to act.

That Congress could not validly have provided for involuntary bankruptcy proceedings against State political sub-divisions would seem to follow from the cases dealing with the power to tax.[13] The analogy, at least, is close, since in either case there would be presented an assumption of control on the part of the Federal government over the exercise of State governmental functions, against an unwilling and objecting State. In the instant case, however, the State, so far from objecting, is actively seeking Federal action.[14] The Act in section 80(k) leaves it entirely within the power of a State to prevent the assumption of control by the Federal courts, which was regarded in *Massachusetts v. Mellon*[15] as sufficient answer to a State's contention that

[10] 11 Wall. 113, 20 L. Ed. 122 (1870).
[11] 283 U. S. 570, 75 L. Ed. 1277, 51 S. Ct. 601 (1930).
[12] 297 U. S. 1, 80 L. Ed. 287, 56 S. Ct. 312 (1936).
[13] Cf. Hopkins Federal Savings & Loan Association v. Cleary, 296 U. S. 315, 80 L. Ed. 209, 56 S. Ct. 235 (1936). See, however, for an argument to the contrary, note (1936) 31 Illinois L. R. 383; and cf. United States v. California, 297 U. S. 175, 80 L. Ed. 367, 56 S. Ct. 421 (1936), and Board of Trustees of the University of Illinois v. United States, 289 U. S. 48, 77 L. Ed. 1025, 53 S. Ct. 509 (1933).
[14] Ten states filed a brief, as *amici curiae*, in support of the petition for a rehearing. 4 U. S. Law Wk. 73.
[15] 262 U. S. 447, 67 L. Ed. 1078, 43 S. Ct. 597 (1923).

its field of governmental power had been invaded through the exercise of the Federal spending power.

In any event, there is no apparent reason why, in questions rising out of our dual system of government, the rules should differ in the case of an invasion by the Federal government in the field of State power and in the case of an invasion by the State in the field of Federal power. Yet it was specifically held in *Baltimore National Bank v. State Tax Commission, supra,* that a Federal governmental instrumentality may be subjected to the State taxing power if the Federal government consents thereto.[16] Presumably, the same result would obtain, if, under like conditions, a State governmental agency were subjected to Federal taxation. If so, we have the anomalous result, that the State may voluntarily subject its political sub-divisions to the burden of Federal taxation, but may not voluntarily obtain for them the benefit of Federal bankruptcy laws. If not, we have an equally anomalous result, in that Federal governmental agencies may be, with Federal consent, taxed by the State, but that State governmental agencies, may not be taxed by the Federal government even with the consent of the State; the reason for the immunity from taxation in either case being precisely the same.

If, however, the power of the Federal government to extend the benefits of the Bankruptcy Act to State political sub-divisions, is to be based upon the consent of the State, there would seem to be much force in the suggestion that the States would thereby be enabled to evade the express prohibition of Art. 1, section 10 of the Constitution. The dissenting opinion argues that any impairment of existing contracts is effected by the decree of the Federal Court approving a plan of composition and not by the law of any State. But if the consent of the State is necessary before the Federal Court may rightfully act, it would seem more true that the impairment is in the first instance caused by the State, since it is the State's Act (in the instant case the Texas stat-

[16] The Court said: "Taxation by state or municipality may overpass the usual limits if the consent of the United States has removed the barriers or lowered them".

ute of 1935) which alone is effective to enable the scaling down of the obligations of its political sub-divisions. That the State could not directly authorize this is clear.[17]