

October 2011

SPECIAL ASSESSMENT INDEBTEDNESS, POLITICAL SUBDIVISION LIABILITY, AND THE SPECIAL FUND DOCTRINE

This memorandum was requested to address the question of why the debt limitations of political subdivisions under Article X, Section 15, of the Constitution of North Dakota, do not apply to special assessment indebtedness incurred by political subdivisions when North Dakota Century Code Section 40-26-08 requires that if special assessment district revenues are insufficient to pay the indebtedness, the governing body of the political subdivision shall levy a tax upon all taxable property in the political subdivision to pay the deficiency.

The North Dakota Supreme Court in *Marks v. City of Mandan*, 296 N.W. 39 (1941), traced the history of the special fund doctrine and reviewed holdings of several earlier North Dakota Supreme Court decisions and stated:

From the foregoing cases it may be said that North Dakota has adopted what is generally termed as the "special fund" doctrine as applied to the obligations incurred by municipalities or the state itself with regard to special assessment funds for paving and sewers, contracts for the purchase of electric light plants and the erection of dormitories at state education institutions. This doctrine may be stated as an established rule of law. It is that, bonds, warrants, contracts, or other obligations issued or entered into by the state, or its municipalities, when specially authorized by statute, do not come within the meaning of the words "debt" or "indebtedness" as used by the debt limitations provisions of the constitution if these obligations are secured by and payable exclusively from revenues to be realized from public property acquired with the proceeds of the obligations or assessments on private property benefited by the special improvements.

In the *Marks* decision, the Supreme Court also was confronted with the argument that, if general taxation is required to cover any deficiency in special assessment revenue, an indebtedness is incurred in violation of the constitutional debt limit restriction. The court rejected this argument by determining that any potential obligation of general taxing authority is

merely a "contingent future liability" (quoting from *Bismarck Water Supply Company v. City of Bismarck*, 137 N.W. 34 (N.D. 1912)). In the *Marks* decision, the court stated:

Generally speaking, the special fund doctrine does not permit the fund to be fed from general or other revenues in addition to those arising from the specific improvement contemplated. *Garrett v. Swanton*, 216 Cal. 220, 13 P.2d 725. This limitation, however, is subject to an exception that has been recognized in a number of cases. The exception is based upon the theory of *Bismarck Water Supply Company v. City of Bismarck*, supra. Where the obligation of the municipality rests wholly upon a contingent liability, there is no debt created until the contingency occurs.

In addition, the court in the *Marks* decision stated that it has determined "that the legislature might constitutionally impose upon a municipality the obligation to levy general taxes to pay deficiencies arising in special assessment funds" This reference was to the validity of what is now Section 40-26-08 and in direct reference to the 1923 and 1929 amendments to that section which obligated cities to levy general taxes to cover deficiencies in special assessment funds.

Our office has contacted local bond counsel on the issue of what happens in the event of default or deficiency on special assessment bonds. This reply was provided:

Special assessment bonds do have a deficiency levy backing them. If a tax for a deficiency is actually levied, the amount of the deficiency is general obligation debt and must be counted against the city's debt limit. However, only the amount of the deficiency, i.e. one year's principal and interest, would be debt, not the entire outstanding principal amount of the special assessment bonds. It is possible, in smaller communities, that even the amount of the deficiency levy, one year's principal and interest, could exceed the city's debt limit and that deficiency levy would be void.