A History of The Indiana Internal Improvement Bonds

By LEE NEWCOMER

In 1839, the whole program of internal improvements in Indiana collapsed. Work was stopped in that year on all of the state projects with the exception of the Wabash and Erie Canal. Much of the blame for this breakdown must be laid, not on the undertaking, but on the business methods followed. The works contemplated were rather extensive considering the sparse population of the state at the time, nevertheless the internal improvement program would have had a fair chance of success if it had been properly managed, in spite of the great depression that followed the panic of 1837. However, the business methods followed by the state were anything but good.

Since the sales of public lands granted to Indiana by Congress were disappointing about five-sixth of the funds necessary for the proposed work on roads, canals, and railroads had to be raised by bond issues. The "System" orators had promised no higher taxation, and consequently the Assembly had made no provision for payment of the interest on the bonds. It was necessary therefore to pay interest charges out of the receipts from the sale of bonds.[1] The entire business of the Commissioners who handled the funds was poorly conducted. No records were kept. Their reports were incomplete or inconsistent and it seems that the bonds were signed and delivered to the members of the board to sell as best they could. The annual report of the Canal Fund Commissioners in 1837 is revealing. It contains the statement: "The Board in the contracts which were made during the present year on the sale of the state bonds, made no stipulations as to the kind of funds to be received. . . ."[2]

Agents selling the bonds seem to have taken advantage of provisions such as this. Many of the bonds were sold on credit or exchanged for other securities in the face of a law to the contrary. In several instances, the purchaser lost through speculations and could not pay. In some cases, the agent of the state was at the same time a member of the firm

[1] *House Documents* (Indiana), 1837, No. 13, "Report of the Canal Fund Commissioners," 2.

[2] *Ibid.*

of brokers who took the bonds, sold them, and then failed to pay the proceeds. The cost to the state in negotiating the sale amounted to a fourth of the face value of the bonds. From a total bond issue of almost $15,000,000, the State realized $8,593,000 in cash, $4,000,000 in worthless securities, while about $2,000,000 was embezzled or misappropriated by its officers and agents.[3] Much of this loss resulting from the sale of the bonds might have been avoided if the authorities had not been in such a hurry to complete the works projected. They yielded to pressure from interested citizens and indulged in the most precipitate haste in letting contracts.[4]

The state government paid little attention to all these irregularities until the money began to fail after 1839. A resolution offered in the Senate at that time referred to "notorious" current rumors of fraud, gross negligence, mismanagement, and wasteful, and unlawful expenditures by the Board of Internal Improvements. In his message of December, 1841, the Governor asserted: "Every fair and impartial mind must receive the impression, that Indiana has been in many cases the victim of preconcerted imposition and fraud."[5]

By 1839, the state could find no more purchasers for its bonds, and, consequently, the entire system collapsed. Fortunately, the credit of the state failed before all the indebtedness contemplated under the Mammoth Bill of 1836 had been incurred. As it was, the state was bankrupt. Its income was not sufficient to cover interest payments. Additional money could not be raised through taxation because of the stagnation in business and fall in the appraisal value of all property since the panic of 1837.[6]

The Indiana General Assembly of 1839 seemed bewildered by the state of affairs. The stealing of public funds went on before the eyes of the members while they tried to investigate. Petty party politics engaged the attention of the legislators and prevented the adoption of any measures to meet the interest payments.[7] Treasury notes were issued to meet some of the state's obligations. These notes further upset the currency system, and then, to make the financial confusion

[3] Logan Esarey, *A History of Indiana* (Indianapolis, 1918), I, 376-377.

[4] Elbert J. Benton, "The Wabash Trade Route in the Old Northwest," *Johns Hopkins Studies in History and Political Science*, Series 21, 59.

[5] *Senate Journal* (Indiana), 1841, 19-20.

[6] *General Laws of the State of Indiana*, 1840, 228.

[7] *Indiana Journal* (Indianapolis), March 14, 1840.

worse, land scrip was issued and made receivable for tolls and duties on the Wabash and Erie Canal. This scrip depreciated greatly and caused contractors working on the canal to find it almost impossible to obtain materials and labor at a fair price owing to the inconvertibility of the scrip into good money. As a consequence, the work on the canal was not pushed.[8]

A large part of the Indiana Internal Improvement bonds had been sold to the Rothschilds, Barings, and Lloyds of London and Paris. These creditors kept making insistent appeals for the payment of their interest.[9] The London firms and the big New York banking houses had bought the bonds in the first place, but they no longer held them. They were interested in payment because they had sold the bonds as good securities to private individuals of small property and of moderate income. By this time, the bonds had depreciated to thirty cents on the dollar, but speculators had not acquired many of them. Most of them were still in the hands of the original purchasers.[10]

In the hope of getting some action out of the Indiana Legislature, the bondholders hired Charles Butler of New York to look after their interests. After visiting Michigan on a similar mission, he reached Indiana in 1845. He gave a series of addresses over the State for the purpose of rallying the anti-repudiation sentiment, but no sweeping opinion for full payment could be aroused. Many persons believed that the State should not pay the bonds since it had been swindled out of so much of the money.[11] Others saw no way of raising the money with which to meet the obligations.[12]

The most important project included in Indiana's internal improvement program was the Wabash and Erie Canal. This canal had already been completed from the Maumee River to Terre Haute on the Wabash. In 1844 Congress had made a liberal land grant for its continuation to the Ohio River.[13] A convention was assembled at Terre Haute during the summer of 1845 for the purpose of uniting public opinion in favor of

[8] *Report of the Superintendent of the Wabash and Erie Canal*, 1845, 144.

[9] Extra *State Sentinel* (Indianapolis), June 17, 1842.

[10] *Proceedings of the Canal Convention Assembled at Terre Haute* (May 22, 1845), 15-16.

[11] Esarey, *op. cit.*, I, 380-381.

[12] *House Journal* (Indiana), 1845, 380.

[13] *U.S. Senate Documents*, 28 Cong., 2 Sess., V, No. 11, 8-9.

this extension to Evansville. In his opening speech, the president of the convention declared that the canal was an enterprise presenting "the most practicable and feasible" plan of enabling the State to liquidate the public debt. It was said that the federal land grant along the proposed route would be nearly enough to pay for the canal's construction, and, judging by the receipts of the Ohio canals, the extension to Evansville would be highly successful as a financial proposition.[14] The completion of the canal was regarded favorably by political leaders, scientific men, business men, and farmers. Competent engineers estimated in 1845 that the Wabash and Erie Canal, if completed, would be yielding revenues of $400,000 a year by 1850 and $500,000 a year by 1855.[15] Mr. Butler was convinced of the wisdom of extending the canal. He told the convention:

> I have carefully compared the prospective profits of this canal with the certain profits of the Ohio Canal. . . and such is the confidence of your bondholders in the revenue to be derived from this canal that I think they would even be willing to come forward and say to you, "Pay us by your State tax and otherwise, a portion of the interest on your public debt, and we shall be willing to look to the revenues of this canal for the balance."[16]

The convention earnestly recommended this plan to the people of the state.[17] Butler went to Indianapolis to urge the legislators to take action but he found that the prospects there were none too bright. Politicians on both sides were afraid to move. The governor, who was a candidate for senator in the ensuing election, was afraid to commit himself. He dared not use the words "pay" or "tax."[18]

In December, Butler spoke before the Legislature. His address urging payment was generally received with favor, and so he went to work with a committee to draft a plan of settlement. Butler's first proposal to the committee was that the state pay by taxation the whole of the deft and three per cent of the interest, but for the remaining two per cent the bondholders were to rely on the canal tolls. The creditors were

[14] *Proceedings of the Canal Convention at Terre Haute* (May 22, 1845), 3 ff.

[15] *Memorial of the Holders of Certificates of Stock in the Wabash and Erie Canal*, 1857, 3-30, *passim*.

[16] *Proceedings of Canal Convention at Terre Haute* (May 22, 1845), 19.

[17] *Address to the Citizens of Indiana* (Terre Haute, 1845), 8.

[18] Charles Butler to his wife, Nov. 29, 1845, and Dec. 7, 1846. These letters and others by Butler are found in G. L. Prentiss, *The Union Theological Seminary* (Asbury Park, N. J., 1899), 454-456.

also to supply one third of the necessary capital for completing the canal to Evansville. Butler compromised when the committee regarded this proposition as beyond the ability of the state to pay, and submitted a second proposition. According to this proposal, the bondholders would practically release the state from the payment of one-half of the entire funded debt and would make that half a charge against the canal.[19]

This proposal by Butler was reported on favorably by the committee and its recommendation was introduced in the Legislature in the form of a bill. The measure was thoroughly discussed and encountered stiff opposition in some of the newspapers as well as in the capitol building. Heated speeches and numerous political threats were made during the debate. One man claimed that it sold the people out, land and all to the British.[20] However, country newspapers, ministers, and numerous other groups supported the bill. One Sunday, the young Henry Ward Beecher preached a strong sermon in favor of the Butler plan to a full church containing many members of the Legislature.[21] Attempts were made to delay action on the bill until after the elections but the measure finally came to a vote and was passed in January, 1846.[22]

According to the terms of the Butler Bill, the old bonds were to be surrendered and new bonds issued to the holders. The principal and half the interest of these new securities were to be paid by the state and the other half of the interest was to be paid by the revenues of the canal. The state, put the canal and all lands in trust for its creditors. Three trustees were to be appointed, two by the bondholders and one by the state, to administer the trust. The bondholders were to advance $2,225,000 to complete the canal to Evansville. When this subscription had been made and when one-half of the old bonds had been turned in and cancelled, the act was to go into effect. An important provision reserved the right to the state to take over the canal after the creditors had secured full payment from its revenues. An option contained in the act gave the state the right, if it preferred to do so, to make one-half of the principal in addition to one-half the interest a charge against the canal. Under this option two certificates could

[19] *Documentary Journal* (Indiana), 1845, Part II, 232 ff., "Report of Joint Select Committee . . . in Relation to the Public Debt."

[20] *Indiana Democrat* (Indianapolis), Jan. 23, 1846.

[21] Butler to his wife, Jan. 4, 1846, Prentiss, *op. cit.*, 481.

[22] Butler to his wife, Jan. 18, 1846, *ibid.*, 489.

be issued for each old bond turned into the State. One-half of these new certificates would be payable through taxation and the other half by the canal revenues. After the state should call in the old bonds "its faith and revenues shall be only responsible for the payment of one-half of said principal and interest. . . for the other half. . . the holders shall look solely and exclusively to said canal . . . .[23] It was understood by all parties that the state would follow this option in carrying out the bill.[24]

The bondholders met in London in May, 1846, to consider the act of the Indiana Legislature. They assented to the principle of the payment of half of the debt from the canal revenues, but certain changes were suggested. Accordingly, Butler came back to Indiana in December, 1846, to present the amendments to the Legislature. A bill incorporating these modifications was passed on January 27, 1847. In the new act the amount to be advanced by the stockholders for the completion of the canal was reduced from $2,225,000 to $800,000. The new bill also definitely put into force the option contained in the former law.[25]

The bondholders agreed to the new bill and soon surrendered most of their bonds. In July, the governor transferred the canal and the lands involved to trustees representing the bondholders in full payment and discharge of one-half the debt. The state levied a property tax of twenty-five cents per hundred dollars and a seventy-five cent poll tax to pay the other half of the debt.[26]

A committee of the United States Senate later endorsed the settlement as the best that could be had under the circumstances.[27] Indiana has been accused of repudiation, but the settlement of 1847 was not of that nature. Instead it was a settlement in which the debtor surrendered the entire property mortgaged to the creditor and *in addition agreed*

[23] *State of Indiana, An Act to Provide for the Funded Debt, Passed 19th January, 1846, and an Act Supplementary thereto, Passed 27th January*, 1847 (New York, 1847), 16-17.

[24] *Indiana Democrat*, Jan. 13, 1846; *Reports of U.S. Senate Committees*, 1847, No. 86, 11.

[25] General Laws of the State of Indiana (Indianapolis, 1847), 3. In his *History of Indiana*, I, 383, Dr. Logan Esarey contends that the act of 1847 differed radically from the act of 1846. In the opinion of the writer, this view is mistaken. *Cf.* Benton, *The Wabash Trade Route*, 71-73; Charles Roll, *Indiana* (Chicago, 1931) II, 24; *Indiana Democrat*, Jan. 13, 1846.

[26] Speech of Jason B. Brown on the "Wabash and Erie Canal Bond Question," delivered before the Indiana State Senate on Jan. 12, 1871. This speech was printed and is found in some libraries.

[27] *Reports of U.S. Senate Committees*, 1847, No. 86, 1-4.

to pay one-half of the debt. Nevertheless, Indiana did compromise with her creditors. It is doubtful whether the state could have met all of its obligations, because the currency had been disrupted by floods of treasury notes, bank-scrip, and canal-scrip. Ohio, however, under similar circumstances had made the effort and had met her debt through taxation.[28] Although Indiana's credit was strengthened after the passage of the Butler Bills, the reputation of the state suffered some because of the compromise, but mainly because of what happened afterwards.

Later developments were, of course, unknown in 1847, and at that time both borrower and lender confidently expected that the Wabash and Erie Canal would pay its share of the internal improvements debt. There is no good reason to think that Butler and the bondholders were not satisfied with the agreement. Both thought that the canal would pay if extended to Evansville. The Act of 1847 held out to the bondholders every reasonable assurance of reimbursing themselves from the revenues of the canal. At that time the canal was regarded by intelligent persons both in and outside the state as being a main channel of transportation for future years. It was subject only to the competition of the Wabash River. After passage of the bill, Butler wrote to his wife saying: "My labors have been crowned with complete success. The public credit of Indiana is restored and her bondholders provided for."[29]

The compromise was not forced upon the creditors. Butler suggested it. The bondholders sought the agreement and they definitely ratified it. The resolution of May 30, 1846, signed by Rothschild, Baring Brothers, and the other large foreign bondholders stated that they "concurred in the principle laid down in the act of the legislature. . . for the adjustment of the public debt of the State, by the payment of one moiety by the property and tolls of the canal, the state to be freed from responsibility on that portion of the debt. . . ."[30]

The state of Indiana acted in good faith in 1847. It also expected the canal to pay. If the state had anticipated the

[28] Esarey, *op. cit.*, I, 380-382.

[29] Butler to his wife, Jan. 17, 1846, in Prentiss, *op. cit.*, 492. Butler, a man of high moral and religious principles, would hardly have had any interest in deceiving his wife in this letter.

[30] *Reports of U.S. Senate Committees*, 1847, No. 86, 11.

failure of the canal, it would hardly have made such careful provisions for the return of the canal after the debt had been paid. In both the Act of 1846 and the Act of 1847, the State expressly reserved the right to resume the ownership of the work when that part of the debt authorized to be taken out of the canal revenues had been paid.[31] As late as 1853, a competent observer believed that the Wabash and Erie Canal would again pass into the hands of the state, because of the ultimate payment of the whole of the debt.[32]

However, these expectations failed to materialize. The railroads came in the next few years and took away most of the business of the Wabash and Erie Canal. With the dwindling away of the receipts of the canal, the creditors who had agreed to accept the canal revenues in payment for half of their bonds, saw their security steadily shrinking. The bondholders became alarmed and sent petitions to the Legislature urging that their rights be safeguarded. In 1857, a committee presented a memorial asking for payment in full because the state had allowed railways to be constructed that would compete with the canal. As a result, the security of the bondholders had been made practically valueless. The bondholders did not doubt the state's policy in granting railroad charters. They admitted that it was correct to take advantage of improved means of transportation, but they asked redress for the impairment of their security which they contended had been guaranteed from harm or molestation. The bondholders also argued that the state could not ignore interests which it had already created, and that it was therefore morally bound to make reparation.[33]

Indiana had attempted to forestall railroad competition. After the passage of the Debt Act of 1847, the Legislature in three annual sessions had refused to grant charters to proposed railroads in the Wabash Valley, because railroads there would curtail the canal revenues.[34] However, the Legislature was not able to withstand the strong pressure for railroads, and in a few years the Wabash Valley Road was constructed.

[31] *Act to Provide for the Funded Debt* (See note 23, above), 12, 29.

[32] Israel D. Andrews, *Report on Colonial and Lake Trade, Senate Executive Documents* (32 Cong., 1 Sess.), No. 112, 362.

[33] *Memorial of Holders of Stock in the Wabash and Erie Canal,* 1857, 24-25.

[34] *Documentary Journal,* 1857 (Indiana), Part II, No. 6. "Annual Report of the Board of Trustees of the Wabash and Erie Canal," 1856, 278.

In 1870, a case arose that involved the old issue between the state and the bondholders concerned in the settlement of 1847. John W. Garrett brought suit to secure payment on forty-one of the canal bonds which had not been turned in under the terms of the Butler Bill of 1847. The Governor consulted his legal advisors to determine the best method of dealing with this unwelcome situation. He was told that Garrett had the legal right to payment in spite of provisions to the contrary in the act of 1847. To refuse payment because he had failed to turn in his bonds under the conditions of the Butler Bill would amount to repudiation and would violate the section of the United States Constitution forbidding a state to pass a law impairing the obligation of contract.

While the government of Indiana could not have been held for the payment of the bonds, because a state cannot be sued, nevertheless Garrett could have collected from the trustees of the canal. If the state had permitted the trustees who represented the bondholders to pay these bonds, such action would have amounted to confiscation of property of bondholders who had accepted the Butler Bill, and in that case the state would have become morally bound to rescind the Butler Bill and to pay all the bondholders. Pressure of public opinion would probably have forced such action.[35] In order to avoid such a possibility the matter was brought before the Legislature of 1871 which appropriated money to pay the Garrett bonds.[36]

Meanwhile, those bondholders who had accepted the compromise of 1847 were still petitioning for a complete settlement of the securities held by them. Considerable bitterness was evidenced in Indiana over this attempt of the bondholders to abrogate the terms of the Butler Bill and to obtain a new settlement for half of their bonds. They were called "swindlers" and "robbers."[37] Most of the residents of Indiana seemed to agree with the opinion stated by Governor Morton in 1866 when he told Baron Rothschild that the revolution in transportation was an "act of God" for which the state could not be held accountable.[38] In order to settle the question and to prevent any future Legislature from paying the bonds, a con-

[35] *Documents in Relation to the Suit of John W. Garrett versus the Trustees of the Wabash and Erie Canal* (New York, 1871), 55-56.

[36] Jacob Piatt Dunn, *Indiana and Indianans* (Chicago, 1919), I, 410.

[37] Indianapolis *Journal*, Nov. 22, 1870.

[38] William Dudley Foulke, *Life of Oliver P. Morton* (Indianapolis, 1899), I, 461-462.

stitutional amendment was adopted in 1873, which provided that no law should ever be passed to pay the debts in question other than according to the provisions of the Butler Bill of 1847.[89] The ratification of this amendment closed the question of the Indiana Internal Improvement Bonds.

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[89] The amendment reads:

"No law or resolution shall ever be passed by the General Assembly of the State of Indiana, that shall recognize any liability of this State to pay or redeem any certificate of stock issued in pursuance of an 'Act to provide for the funded debt of the State of Indiana, and for the completion of the Wabash and Erie Canal to Evansville' passed January 19, 1846; and an act supplemental to the said act, passed January 28, 1847, which by the provisions of said acts, or either of them, shall be payable exclusively from the proceeds of the canal lands, and the tolls and revenues of the canal in said acts mentioned, and no such certificate of stocks shall ever be paid by this State."
This amendment became Section 7 of Article X of the Constitution of Indiana on March 7, 1873.