HB 233

Nor

FISCAL NOTE

Bill Version: CSHB 233 (CRA)
(H) Publish Date: 2/4/00

STATE OF ALASKA
2000 LEGISLATIVE SESSION

Revision Date:
Title: Municipal Bankruptcy
Sponsor: CRA Committee
Requester:

Dept. Affected None
BRU
Component
Component Serial No.

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 01	FY 02	FY 03	FY 04	FY 05	FY 06
Personal Services	0.0	0.0	0.0	0.0	0.0	
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	
CAPITAL EXPENDITURES						
CHANGE IN REVENUES [ ]						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
1091 Designated Program Receipts						
TOTAL	0.0	0.0	0.0	0.0	0.0	

Estimate of any current year (FY98) cost:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

No impact on state agencies.

Prepared by John Mark For House CRA Phone 465-4897

Phone

Date 02/01/2000

COMMITTEE COPY

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December 6, 1999

Representative Andrew Halcro, Co-Chair
Community and Regional Affairs Committee
716 W. 4th Avenue, Ste. 620
Anchorage, AK 99501-2133

Re: HB 233

Dear Representative Halcro:

Thank you for giving me the opportunity to present you with my comments, thoughts, and suggestions regarding the legislation that you introduced to permit local governments in Alaska to seek protection from creditors in federal bankruptcy court.

In my opinion, HB 233 reflects good public policy. The 1994 Bankruptcy Reform Act requires that municipalities be specifically authorized by State law to seek the protections of Chapter 9 of the Bankruptcy Code. There is absolutely no reason why a municipality in the State of Alaska should be denied that remedy if it meets the other criteria governing eligibility for Chapter 9 relief.

My only concern is that HB 233 may be ambiguous as to the definition of "municipality." 11 U.S.C. § 101(40) defines a municipality as a "political subdivision or public agency or instrumentality of a State." However, pursuant to AS 01.10.060(a)(4), a municipality is defined as "a political subdivision incorporated under the laws of the state that is a home rule or general law city, a home rule or general law borough, or a unified municipality." In other words, the State law definition of "municipality" is more restrictive. It does not include an instrumentality of the State such as the University of Alaska or a regional educational attendance area established pursuant to AS 14.08 *et seq.*

Regarding regional educational attendance areas, it is important to note that pursuant to AS 14.12.020(c), "[t]he legislature shall provide the state money necessary to maintain and operate the regional educational attendance areas." Also, pursuant to AS 14.17.900(a), "[t]he state is not responsible for the debts of a school district."

Therefore, the definition of "municipality" in HB 233 should reference the Federal Bankruptcy Act definition. This would allow instrumentalities of the State to

avail themselves of Chapter 9 protections if they meet the other governing criteria. In short, if the federal remedy is available, access to that remedy should be authorized under State law.

I suggest that in HB 233 after the first reference to "municipality," the following phrase be added "as defined in the Federal Bankruptcy Act."

Thank you for your time and consideration.

Sincerely,

JERMAIN, DUNNAGAN & OWENS, P.C.

Gary C. Sleeper

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December 3, 1999
Via Facsimile 269-0248

Andrew Halcro
State Representative
716 West 4th Avenue, Suite 620
Anchorage, AK 99501

Re: HB 233
Municipal bankruptcy

Dear Representative Halcro:

Thank you for your letter of November 22, 1999. My law practice is limited to bankruptcy issues, so the legislation described in HB 233 is pertinent to my work.

As you probably already know, municipalities already have the right to file for protection from creditors under federal law. See enclosed copy of 11 U.S.C. §109(c). A separate chapter of the Bankruptcy Code, Chapter 9, provides bankruptcy relief for any municipality, including those in the state of Alaska.

In order for a state to utilize this section for protection from its' creditors, however, State law must specifically authorize a municipality to become a debtor. See §109(c)(2). I suggest you may want to consider rewording the bill to comport with language contained in the statute, at lines 1 and 6:

[Line 1] "An Act granting specific authority to each municipality....."

[Line 6] "... The state grants specific authority to each municipality...."

Sincerely,

Rhonda Lee Fehlen

Attachment: 11 U.S.C. §109(c)

Halcro-ch9.LT1.wpd

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December 8, 1999

OUR FILE: N/A

Rep. Andrew Halcro
Co-Chair, Community & Regional Affairs
Alaska State Legislature
716 West Fourth Avenue, Suite 620
Anchorage, AK 99501

Re: HB 233

Dear Mr. Halcro:

Receipt of your letter dated November 22, 1999 regarding the above-referenced legislation is acknowledged. Per your request, I offer the following general comments.

1. First, I believe it important to note that bankruptcy reorganization is not necessarily the panacea for all that ails a debtor.

2. Chapter 9 of the Bankruptcy Code is very similar in operation to chapter 11. Unfortunately, as those of us with experience practicing in the chapter 11 arena can attest, chapter 11 is a somewhat complex, cumbersome and expensive process. It was not designed with the small business in mind. Consequently, the corresponding provisions of chapter 9 suffer from the same shortcoming.

3. Bankruptcy notwithstanding, it must be recognized that any debtor, including a municipality under chapter 9, must be able to meet its ongoing obligations, *i.e.*, those that arise after the petition was filed. In many chapter 11 cases, the combined burden of the additional administrative expenses imposed by the bankruptcy process itself coupled with the "normal" on-going regular operating expenses, renders it impossible for a debtor to successfully reorganize. I suspect the same may be true with smaller municipalities in Alaska; especially those with a limited tax base, which is by far the vast majority of the smaller municipalities..

4. A municipality filing for bankruptcy protection is still subject to the power of the State to control the exercise of the political or governmental powers of the municipality, including expenditures for such exercise. Thus, notwithstanding a bankruptcy filing, the State may continue to exercise its governmental powers over municipalities, its political subdivisions.

5. In the event of a controversy or dispute between the municipality and the State, the Eleventh Amendment immunity of the State would preclude the resolution of that dispute or controversy in the bankruptcy forum. Any such dispute or controversy would have to be resolved, unless the parties resolve it otherwise, in the Alaska Superior Court.

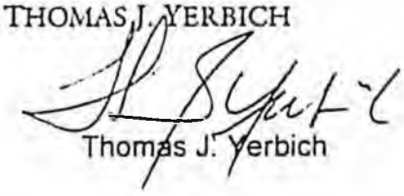
The foregoing should not be construed as opposition to the proposed bill. Quite to the contrary, should the Legislature fail to enact HB 233, under § 109(c)(2) of the Bankruptcy Code, an Alaska municipality would not be able to file a bankruptcy petition, even where such filing was appropriate and would benefit the municipality. My comments are intended to be merely a cautionary note about what could possibly be unreasonable expectations. In particular, I caution the Legislature that the fact an Alaska municipality would be empowered to obtain bankruptcy relief, while it may reduce the degree to which State assistance is required, it may not, in many cases, eliminate it.

The only change I would recommend would be to add a provision waiving the Eleventh Amendment immunity of the State in bankruptcy cases filed by municipalities. It makes little sense to require resolution of disputes between the municipality and the State be resolved in the State courts, a process that could delay or otherwise hamper obtaining the very relief required by the municipality. As with other disputes involving debtors and interested parties, it would probably be more efficient and less likely to hamper the reorganization process to permit disputes with the State to be resolved in the bankruptcy forum. This could be accomplished by simply redesignating the current language of the bill as subdivision (a) and adding a new subdivision (b) reading: "(b) For the purposes of proceedings brought by a municipality under this section, and that purpose alone, the state consents to the jurisdiction of federal courts and waives its immunity under the Eleventh Amendment to the Constitution of the United States."

In closing, I hope that HB 233 is never needed. But its necessity as a prophylactic measure certainly exists.

Very truly yours,

Law Office THOMAS J. YERBICH

By: 

Thomas J. Yerbich

ALASKA MUNICIPAL LEAGUE
Alaska Conference of Mayors
217 Second Street, Suite 200 ▪ Juneau, Alaska 99801 ▪ Tel (907)586-1325, Fax (907)-463-5480

January 25, 2000

Representative Andrew Halcro
Alaska State Capitol
Juneau, AK 99811

Dear Representative Halcro:

Thank for the opportunity to comment on HB 233, Municipal Bankruptcy. Our understanding is that passage of HB 233 allows municipalities the option to use Chapter 9 of the Federal Tax Code for municipal bankruptcy relief. Chapter 9 was formerly available to municipalities prior to a change in federal law, but now requires acceptance by state statute. HB 233 would once again allow municipalities the option of using Chapter 9.

While the option to use the Federal Tax Code as a tool in regard to municipal insolvency, it would not lessen the ultimate responsibility of the State to assume liability for municipal dissolutions. As you are aware, unfortunately, many communities are being driven into dissolution due to reductions in municipal revenue sharing programs by the Legislature.

Therefore, the Alaska Municipal League supports the adoption of HB 233.

Sincerely,

Kevin Ritchie
Executive Director

CC: AML Legislative Subcommittee – Revenue & Finance

BERING STRAIT SCHOOL DISTRICT

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24 January, 2000

The Honorable Andrew Halcro
State Capitol, Room 418
Juneau, AK 99801-1182

Dear Representative Halcro,

Thank you for scheduling time to me with me last Thursday, the 20th. It was a pleasure to have met you. Bering Strait School District remains interested in supporting HB 233 with the amendment that includes REAA's in the definition section.

Your efforts with issues addressing education are important and should you require information or assistance, please instruct your staff to contact me as needed. I hope this session is productive for you and I look forward to meeting you again.

Sincerely,

Dr. John A. Davis
Superintendent

cc. J. Walsh

BERING STRAIT SCHOOL DISTRICT

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17 December, 1999

Representative Andrew Halco, Co-Chair
Community and Regional Affairs Committee
716 West 4th Avenue, Suite 620
Anchorage, AK 99501-2133

Dear Representative,

I want to lend support to your proposed legislation, HB#233, regarding municipal bankruptcy. Though it is not an option our school district expects to use, we do feel it needs to be available to all REAA's. According to our legal team, it is now unclear who would be responsible should an REAA not be able to meet its obligations.

You previously received a letter from Gary Sleeper, an attorney associated with the firm our District is represented. We support his recommendation to make sure REAA's be included in the definition of municipalities. If this was not your intent or you believe this is not included I would urge you to reconsider and amend the proposed legislation.

Your efforts in drafting this and moving it on to the legislative agenda is necessary and responsible. We consider it a piece of unfinished business that resulted from the changes made at the federal level.

Should you have any question, please do not hesitate calling.

Sincerely,

Dr. John A. Davis
Superintendent

cc: S. Friedman, Atty.
J. Walsh

IN RE *COPPER RIVER SCHOOL DISTRICT*: COLLECTIVE BARGAINING AND CHAPTER 9 MUNICIPAL BANKRUPTCY

W. RICHARD FOSSEY* AND JOHN M. SEDOR†

I. INTRODUCTION

Beginning in the late 1970s, a number of school districts found it difficult to pay salary obligations under collective bargaining agreements with their employees.[1] Taxpayers' revolts, declining enrollment, shrinking state revenues, or other forces beyond a school district's control have often been responsible for this predicament.[2]

State law remedies for a school district unable to pay salaries under its collective bargaining agreements are often unclear and uncertain. Two school districts faced this problem by filing petitions under chapter 9 of the United States Bankruptcy Code ("the Code").[3] San Jose Unified School District, a California school district, filed a chapter 9 petition in 1983 and obtained court approval for rejecting its

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* Member, Bankston, McCollum & Fossey, P.C., Anchorage, Alaska; J.D., 1980, University of Texas School of Law; M.A., 1974, University of Texas; B.A., 1970, Oklahoma State University; Member, Alaska Bar Association. Mr. Fossey served as legal counsel for the Copper River School District during the bankruptcy proceedings that are described in this article.

† Associate, Bankston, McCollum & Fossey, P.C., Anchorage, Alaska; J.D., 1987, University of Michigan Law School; B.A., 1984, Kalamazoo College; Member, Alaska Bar Association.

Portions of this article first appeared in Fossey, *Inability to Pay Salaries Under Collective Bargaining Agreements*, 50 EDUC. L. REP. 651 (Feb. 16, 1989) and is reprinted with permission from West Publishing Company. All rights are reserved.

The authors would like to thank Dianna Brinkman for her assistance in preparation of this article.

1. *See, e.g.*, Board of Educ. of Chicago v. Chicago Teachers Union Local 1, 430 N.E.2d 1111 (Ill. 1981); Minneapolis Ass'n of Adm'rs and Consultants v. Minneapolis Special School Dist. No. 1, 311 N.W.2d 474 (Minn. 1981).
2. *Id.*
3. 11 U.S.C. §§ 901-946 (1982).

union contracts.[4] Subsequently, the school district settled with its unions, and its bankruptcy proceedings were dismissed.[5] Copper River School District, an Alaska school district, filed a chapter 9 petition in 1986.[6] In April 1988, its reorganization plan was approved by the bankruptcy court.[7] Under the reorganization plan, teachers' salaries were significantly reduced.[8] This article will discuss In re *Copper River School District* and the legal implications of a chapter 9 petition on a school district's collective bargaining agreements.

II. IN RE *COPPER RIVER SCHOOL DISTRICT*: ONE SCHOOL DISTRICT'S EXPERIENCE WITH THE UNITED STATES BANKRUPTCY COURT

Copper River School District is located in central Alaska. The district covers approximately 25,000 square miles and includes Wrangell-St. Elias National Park. In 1985, the school district served about 500 school children at six school sites.[9]

During the 1985-86 school year, Copper River School District's average teacher salary was the highest in the State of Alaska,[10] the state which had the highest average teacher salaries in the nation.[11] For that school year, the average salary for a Copper River School District teacher was $49,065.[12] The school district estimated that 57.98% of its operating budget for the 1985-86 school year went to teachers' salaries.[13]

Under the current negotiated agreement with the school district's teachers' union, the school district's salary costs were scheduled to

4. *In re* San Jose Unified School Dist., No. 583-02387-A (Bankr. N.D. Cal. filed June 30, 1983).

5. *Id. See also* Winograd, *San Jose Revisited: A Proposal for Negotiated Modification of Public Sector Bargaining Agreements Rejected Under Chapter 9 of the Bankruptcy Code*, 37 HASTINGS L.J. 231, 233-34 (1986).

6. *In re* Copper River School Dist., No. 3-86-00830 (Bankr. D. Alaska filed Dec. 22, 1986).

7. Order Confirming Chapter 9 Plan dated April 8, 1988, *In re* Copper River School Dist., No. 3-86-00830 (Bankr. D. Alaska filed Dec. 22, 1986).

8. Consent Order Modifying Plan dated April 8, 1988, and attached waiver dated April 8, 1988, executed by Copper Valley Teachers' Association, *In re* Copper River School Dist., No. 3-86-00830 (Bankr. D. Alaska filed Dec. 22, 1986).

9. ALASKA DEP'T OF EDUCATION, ALASKA EDUCATION DIRECTORY 26 (1986) (copy on file at offices of Alaska Law Review).

10. ASSOCIATION OF ALASKA SCHOOL BOARDS, ALASKA TEACHER SALARY AND BENEFITS FY 1986 AK-1 (1986) (copy on file at offices of Alaska Law Review).

11. *USA Today* reported that Alaska teachers' salaries were 164% of the national average. The newspaper did not report the year on which its statistics were based. USA Today, Feb. 19, 1987, at 5A.

12. ASSOCIATION OF ALASKA SCHOOL BOARDS, *supra* note 10.

13. Copper Valley Views, Feb. 5, 1986, at 1 (copy on file at offices of Alaska Law Review).

increase for the following school year.[14] Unless adjustments were made, the highest paid teacher in the Copper River School District for the 1986-87 school year would have cost the school district over $70,000 in salary, benefits, and extra-duty stipends for a nine-month contract.[15]

The Copper River School District receives virtually all of its revenues from the State of Alaska and has no authority to tax or issue bonds.[16] Unfortunately, its revenues were not sufficient to pay the extraordinarily high salaries which its collective bargaining agreement required. During the 1984-85 school year, the school district had operated with a deficiency of revenues over expenditures of approximately $433,000.[17] During the 1985-86 school year, the school district's expenditures exceeded revenues by $308,658 An emergency appropriation from the Alaska Legislature offset that deficit.[18]

In July 1986, in response to sharply declining oil revenues, the governor of Alaska cut state funding to all municipalities and school districts by ten percent.[19] This development substantially increased Copper River School District's severe financial problems.

On September 29, 1986, the school district's accountants prepared a cash-flow projection for the 1986-87 school year. The accountants projected that the school district would be completely out of funds by April 1987 and would end Fiscal Year 1987 with a deficit of $776,000.[20]

The Copper River School District's collective bargaining agreement with its teachers was not due to expire until June 30, 1987.[21] In November 1985, the school district reopened negotiations with the teachers' union in an attempt to negotiate salaries downward for the

14. NEGOTIATED AGREEMENT BETWEEN THE BOARD OF THE COPPER RIVER SCHOOL DISTRICT AND THE COPPER VALLEY TEACHERS' ASSOCIATION, JULY 1, 1984 - JUNE 30, 1987 [hereinafter NEGOTIATED AGREEMENT].

15. *Id.*

16. Chapter 14 of the Alaska Statutes describes the state's obligation to fund Alaska school districts. ALASKA STAT. § 14.17.010-14.17.250 (1987 & Supp. 1988).

17. COPPER RIVER SCHOOL DISTRICT, COMBINED FINANCIAL STATEMENTS AND SCHEDULES (June 30, 1985) (copy on file at offices of Alaska Law Review). Total school district expenditure for Fiscal Year 1985 was $5,196,530. *Id.*

18. Accountants' report filed March 17, 1988, *In re* Copper River School District, No. 3-86-00830 (Bankr. D. Alaska filed Dec. 22, 1988).

19. *See* Memorandum from Leland L. Dishman, Superintendent of Copper River School District to Copper River School District employees (July 22, 1986) (copy on file at offices of Alaska Law Review).

20. Accountants' report, *supra* note 18.

21. NEGOTIATED AGREEMENT, *supra* note 14.

1986-87 school year.[22] Negotiations were unsuccessful. In July 1986, the school district unilaterally cut all salaries by five percent below the previous year's salaries.[23] An advisory arbitrator subsequently endorsed these salary cuts for teachers.[24]

The teachers' union filed a lawsuit in an effort to force the school district to submit salary cuts to binding arbitration.[25] On December 22, 1986, the Copper River School District filed a petition under chapter 9 of the Bankruptcy Code in the United States bankruptcy court in Anchorage, Alaska.[26] This action automatically stayed all grievances and litigation. The school district, meanwhile, continued to pay salaries at reduced levels.[27]

Prior to filing the petition in bankruptcy court, the school district had considered a number of options to solve the financial crisis which was caused primarily by its high teachers' salary schedule. First, as stated above,[28] it had reopened negotiations in an effort to lower teachers' salaries. These negotiations were unsuccessful.[29] Second, it sought and received a one-time emergency legislative appropriation from the Alaska Legislature.[30] That appropriation solved the 1985-86 budget deficit but did not address the underlying problem — insufficient revenues to pay teachers' salaries under the collective bargaining agreement.

Next, the school district asked the Alaska Department of Education whether schools could be closed early due to insufficient revenue.[31] Not surprisingly, the school district was told that closing

22. *See* Letter from Leland L. Dishman, Superintendent of Copper River School District to the Copper Valley Teachers' Association (Nov. 27, 1985) (copy on file at offices of Alaska Law Review).

23. Memorandum, *supra* note 19.

24. Copper River School District v. Copper Valley Teachers' Association (1986) (Kienast, Arb.).

25. Copper Valley Teachers' Ass'n v. Copper River School Dist., 3AN-86-14779 Civil (Super. Ct. Anchorage filed Nov. 25, 1986).

26. *In re* Copper River School Dist., No. 3-86-00830 (Bankr. D. Alaska filed Dec. 22, 1986).

27. 11 U.S.C. § 362(a) (1982).

28. Letter, *supra* note 22.

29. It should be noted that the school superintendent for the school district when the chapter 9 petition was filed, Leland L. Dishman, was hired by the school board after the school district's financial crisis was apparent. Although in no way responsible for the school district's fiscal problems, he accepted the challenge of correcting them. The superintendent's leadership was largely responsible for the school district's financial recovery as described below.

30. COPPER RIVER SCHOOL DISTRICT, FY 1986 GENERAL PURPOSE FINANCIAL STATEMENTS 7 (June 30, 1986) (copy on file at offices of Alaska Law Review).

31. Telephone interview by Leland L. Dishman, Superintendent of Copper River School District, with the Department of Education.

schools early was not an option.[32] Finally, the school district made drastic budget cuts, including staff reductions which jeopardized its efforts to obtain accreditation for its high schools by the Northwest Accrediting Association.[33] These budget cuts were not sufficient to balance the school district's budget.

Moreover, it appeared that legal remedies outside the bankruptcy court were uncertain at best. In *Subway-Surface Supervisors v. New York Transit Authority*,[34] the New York Court of Appeals upheld the right of New York City to modify collective bargaining obligations during a fiscal crisis where the city established that the modification served an "important purpose" and was "reasonable and necessary."[35] On the other hand, in *Sonoma County Organization of Public Employees v. County of Sonoma*,[36] the California Supreme Court ruled that legislation voiding cost of living increases for public employees was an unconstitutional impairment of collective bargaining contracts. In that case, the court stated that the state had failed adequately to establish that California's Proposition 13 constituted a financial emergency.[37]

Some jurisdictions have ruled that a political entity's salary obligations may be set aside if requisite funds are not provided by the political entity with the powers of appropriation.[38] Copper River School District's crisis was due in part to a unilateral ten percent decrease in revenues by the State of Alaska for Fiscal Year 1987.[39] Nevertheless, no Alaska case law or statute authorized the school district unilaterally to cut salaries if the state cut funding to the school district.

The Copper River School District's primary goal was to provide an education program to school children of the Copper Valley for the 1986-87 school year. Alaska law gave the school district no clear guidance on how to proceed. Moreover, the school district wished to

32. *See* Letter from Steve Hole, Deputy Commissioner of Education, to Leland L. Dishman, Superintendent of Copper River School District (Jan. 28, 1987) (confirming the school district's obligation to keep schools open) (copy on file at offices of Alaska Law Review).

33. *See* Letter from Carl L. LaMarr, Chairman of Alaska Committee of the Northwest Accrediting Association, to Leland L. Dishman, Superintendent of Copper River School District (Feb. 24, 1986) (copy on file at offices of Alaska Law Review).

34. 44 N.Y.2d 101, 375 N.E.2d 384, 404 N.Y.S.2d 323 (1978).

35. *Id.* at 110, 375 N.E.2d at 389, 404 N.Y.S.2d at 328 (quoting United States Trust Co. v. New Jersey, 431 U.S. 1, 25 (1977)).

36. 23 Cal. 3d 296, 591 P.2d 1, 152 Cal. Rptr. 903 (1979).

37. *Id.* at 313-14, 591 P.2d at 10, 152 Cal. Rptr. at 912-13.

38. *See, e.g.*, United Faculty of Florida v. Board of Regents, 365 So. 2d 1073 (Fla. Dist. Ct. App. 1979).

39. Accountants' report, *supra* note 18.

avoid costly litigation with an uncertain outcome and a lengthy appeals process. Chapter 9 appeared to be the school district's best option.

Copper River School District operated under the jurisdiction of the United States bankruptcy court from December 1986 until April 1988.[40] At that time, a reorganization plan was approved by the bankrkuptcy court which permitted the school district to pay salaries at reduced levels.[41] The reorganization plan included a stipulation by the teachers that all litigation and grievances would be dismissed and that no salary increases of any kind would be required unless agreed to in a new collective bargaining agreement.[42] The school district's bankruptcy petition caused considerable furor. Members of NEA-Alaska, the state's largest teachers' union, picketed the federal bankruptcy court on the day of a critical hearing, and a number of local NEA-Alaska affiliates took out advertisements in a state newspaper protesting the school district's action.[43] Moreover, the teachers' union vigorously challenged, unsuccessfully, the school district's bankruptcy petition at every turn. The teachers' union was the only creditor group to challenge the school district's right to file the petition under chapter 9.[44]

Nevertheless, the school district's decision did not adversely affect the quality of education. During the 1986-87 school year, the first year the school district was in bankruptcy, the school district's standardized test scores rose significantly to be among the highest in the state.[45] By reallocating resources from salaries to other areas of the school budget, under the jurisdiction of the bankruptcy court, the school district's per pupil expenditures actually increased.[46]

40. *In re* Copper River School Dist., No. 3-86-00830 (Bankr. D. Alaska filed Dec. 22, 1986).

41. Consent Order Modifying Plan, *supra* note 8, and Order Confirming Plan, *supra* note 7.

42. Waiver, *supra* note 8.

43. Anchorage Daily News, May 26, 1987.

44. The chapter 9 petition filed by the San Jose Unified School District was also vigorously opposed by the teachers' union. As an indication of the extent of the opposition, the San Jose Unified School District pleading index alone is nine pages long. *In re* San Jose Unified School Dist., No. 583-02387-A (Bankr. N.D. Cal. filed June 30, 1983).

45. COPPER RIVER SCHOOL DISTRICT SUPERINTENDENT'S REPORT (Mar. 5, 1988) (copy on file at offices of Alaska Law Review).

46. COPPER RIVER SCHOOL DISTRICT, COMPARISON OF STUDENT EXPENDITURES TO TOTAL REVENUES FY 1984-FY 1988 (unpublished graph) (copy on file at offices of Alaska Law Review).

III. LEGAL IMPLICATIONS OF A CHAPTER 9 PETITION

In some ways, a chapter 9 petition is the municipal equivalent of a private party's petition to reorganize under chapter 11 of the United States Bankruptcy Code.[47] Reorganization, however, is the only option under chapter 9.[48] There are no provisions for liquidating a local political subdivision.

Nevertheless, there are important distinctions between chapter 9 and chapter 11. First, all chapter 9 proceedings are voluntary.[49] A governmental entity may not be forced into a chapter 9 proceeding involuntarily.[50] Second, in chapter 9, only the debtor has the power to propose a reorganization plan.[51] Third, no trustee is appointed in a chapter 9 proceeding.[52]

Finally, and perhaps most importantly, the bankruptcy court has limited authority to interfere with the political responsibilities of a municipality that has elected to reorganize under chapter 9. Section 904 of the United States Bankruptcy Code states:

> Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—
>
> (1) any of the political or governmental powers of the debtor;
>
> (2) any of the property or revenues of the debtor; or
>
> (3) the debtor's use or enjoyment of any income-producing property.[53]

This restriction is in direct contrast to the long shadow of control a court's statutory authority casts over the right of a chapter 11 debtor to operate while under the jurisdiction of the bankruptcy court.[54] Thus, a school board's authority to make decisions, including decisions to hire and fire staff members, to employ attorneys and accountants, and to undertake any other governmental act, is undiminished by the fact that the municipality is under the jurisdiction of the bankruptcy court.

Under United States bankruptcy law, most school districts would qualify to avail themselves of chapter 9 protection. The Code only permits insolvent municipalities to file a chapter 9 petition if they are

47. *Compare* 11 U.S.C. §§ 901-946 (1982) *with id.* §§ 1101-1174.

48. *See id.* §§ 901-946.

49. *Id.* §§ 301, 921.

50. *Id.* § 921. *Cf. id.* § 303 (creditors have ability to begin an involuntary chapter 7 or chapter 11 proceeding against a private entity).

51. *Id.* § 941.

52. *Id.* § 901 (sections 1104 through 1106 of the Bankruptcy Code regarding trustees are not incorporated into chapter 9).

53. *Id.* § 904.

54. *See, e.g., id.* § 363.

generally authorized to be a debtor under state law.[55] "Municipality" is defined broadly as a "political subdivision or public agency or instrumentality of a State."[56] In several cases, bankruptcy courts have held that a municipality's broad grant of statutory authority under state law provides sufficient state authorization for a municipality to file for bankruptcy even though no specific statute grants a municipality the power to file a chapter 9 petition.[57] A municipality's general authority over its financial affairs is often sufficient state authorization to allow the municipality the protection offered by the Bankruptcy Code.[58] For example, the Copper River School District's school board, although given broad powers to manage and control the school district, is not specifically authorized by state law to file a chapter 9 petition.[59] Nevertheless, the teachers' union's motion to dismiss the school district's bankruptcy petition was denied.[60]

Once under the jurisdiction of the bankruptcy court, a school district may alter its relationship with its public employees' unions under chapter 9. Municipal debtors are specifically granted the right to reject executory contracts.[61] An unexpired collective bargaining agreement is an executory contract.[62]

Prior to 1984, the standard a debtor must meet in order to have a collective bargaining agreement rejected was unclear. Rejection of executory contracts other than collective bargaining agreements was governed by the "business judgment" rule.[63]

Although collective bargaining agreements are considered executory contracts under section 365 of the Code, traditionally a standard higher than the "business judgment" rule has been used to determine whether a collective bargaining agreement may be rejected.[64] Some controversy remained regarding the standard to be applied, however, because of its significant reverberations throughout the management/labor relationship. One line of reasoning required that the debtor

55. *Id.* § 109(c).
56. *Id.* § 101(29).
57. *See, e.g., In re* Pleasant View Util. Dist., 24 Bankr. 632 (M.D. Tenn. 1982).
58. *In re* Drainage Dist. No. 7, 21 F. Supp. 798, 805 (E.D. Ark. 1937).
59. Copper River School District is a regional education attendance area organized pursuant to title 14, chapter 8, of the Alaska Statutes. ALASKA STAT. §§ 14.08.010-14.08.011 (1988). The powers and duties of a regional school board are listed in sections 14.08.101 and 14.08.111. *Id.* §§ 14.08.101, 14.08.111 (1988).
60. Order signed July 27, 1987, *In re* Copper River School District, No. 3-86-00830 (Bankr. D. Alaska filed Dec. 22, 1986).
61. 11 U.S.C. § 901 (1982).
62. NLRB v. Bildisco, 465 U.S. 513 (1984).
63. *In re* Minges, 602 F.2d 38 (2d Cir. 1979).
64. *Bildisco*, 465 U.S. at 523-24.

show that economic collapse would be virtually inevitable absent rejection of the contract.[65] Alternatively, courts required only a showing that the collective bargaining agreement was burdensome to the estate and that the balance of equities was in favor of rejection.[66]

The United States Supreme Court affirmed a higher standard for the rejection of a collective bargaining agreement in *National Labor Relations Board v. Bildisco & Bildisco*.[67] The Court did not, however, adopt the test urged by the labor union that in order to reject a collective bargaining contract, the debtor must demonstrate that the reorganization would fail absent rejection of the contract.[68] This is the strict standard which had previously been adopted by the Second Circuit in *Brotherhood of Railway and Airline Clerks v. REA Express, Inc.*[69] Instead, the Court opted for a more lenient standard permitting collective bargaining agreements to be rejected in bankruptcy proceedings where the agreement is shown to burden the bankruptcy estate and, after careful scrutiny, the equities are in favor of rejection of the labor contract.[70] The equities to be considered are only those equities which relate to the success of the reorganization.[71] The Court also encouraged bankruptcy judges to insure themselves that "reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution."[72]

The legislative history of the Code, as expressed by a 1978 United States Senate Report, indicates that the power to reject a collective bargaining agreement was included specifically to allow a municipal debtor to deal with its collective bargaining agreements.

> Within the definition of executory contracts are collective bargaining agreements between the city and its employees. Such contracts may be rejected despite contrary State laws. Courts should readily allow the rejection of such contracts where they are burdensome. the rejection will aid the municipality's reorganization and in consideration of the equities of each case. On the last point, "[e]quities in favor of the city in chapter 9 will be far more compelling than the equities in favor of the employer in chapter 11. Onerous employment obligations may prevent a city from balancing its budget for some time. The prospect of an unbalanced budget may preclude

65. Brotherhood of Railway, Airline and Steam Clerks v. REA Express, Inc., 523 F.2d 164 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975).
66. Shopmen's Union No. 455 v. Kevin Steel Prod., Inc., 519 F.2d 698 (2d Cir. 1975); *see also In re* Brada-Miller Freight Sys., Inc., 702 F.2d 890 (11th Cir. 1983); NLRB v. Bildisco, 682 F.2d 72 (3d Cir. 1982).
67. 465 U.S. 513 (1984).
68. *Id.* at 525.
69. 523 F.2d 164, 167-69 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975).
70. *Bildisco*, 475 U.S. at 525-26.
71. *Id.* at 527.
72. *Id.* at 526.

> judicial confirmation of the plan. Unless the city can reject its labor contracts, lack of funds may force cutbacks in police, fire, sanitation, and welfare services, imposing hardships on many citizens. In addition, because cities in the past have often seemed immune to the constraint of "profitability" faced by private businesses, the wage contracts may be relatively more onerous than those in the private sector." *Executory Contracts and Municipal Bankruptcy*, 85 Yale L.J. 957, 965 (1976) (footnote omitted). Rejection of the contracts may require the municipalities to renegotiate such contracts by state collective bargaining laws. It is intended that the power to reject collective bargaining agreements will pre-empt state termination provisions, but not state collective bargaining laws. Thus, a city would not be required to maintain existing employment terms during the renegotiation period.[73]

Bildisco prompted Congress to adopt section 1113 of the Code as part of the 1984 bankruptcy legislation.[74] Section 1113 modifies both the substantive standard and the procedure necessary to reject a collective bargaining agreement. In order to reject the collectively bargained contract, the debtor must first propose those modifications to the union representative which are "necessary to permit the reorganization of the debtor" and which treat all affected parties "fairly and equitably."[75] In addition, the court must find that the union refused to propose modifications without good cause and that the balance of the equities "clearly favors rejection."[76] This is a higher standard than that set forth in *Bildisco*, but it probably does not rise to the economic survival standard required in *Brotherhood of Railway, Airline and Steam Clerks v. REA Express, Inc.*[77]

Due to the location of section 1113 in the Bankruptcy Code, however, the statutory standard of section 1113 does not apply to petitions under chapter 9. The standard outlined in *Bildisco*, therefore, remains good law with regard to proceedings under chapter 9.[78] Thus, it appears that a municipal debtor has an easier burden than a private debtor when persuading a court to permit the rejection of a collective bargaining agreement.

The law is not developed in this area. Prior to In re *Copper River School District*, only one school district utilized chapter 9 to reject collective bargaining agreements. In 1983, the San Jose Unified School District, a California school district with enrollment of approximately

73. S. REP. No. 989, 95th Cong., 2d Sess. 112 (1978), *reprinted in* App. 3 L. KING, COLLIER ON BANKRUPTCY § V at 112 (15th ed. 1988).
74. Pub. L. No. 98-353 (1984).
75. 11 U.S.C.A. § 1113(b)(a)(A) (Supp. 1988)
76. *Id.* § 1113(c).
77. *See* L. KING, COLLIER ON BANKRUPTCY § 365.03[1] (15th ed. 1988)
78. *Id.*

30,000 students, filed a chapter 9 petition.[79] That school district's financial crisis arose from an enrollment decline, with a consequent reduction in revenues, as well as property tax limits contained in California Proposition 13.[80]

Prior to filing its chapter 9 petition, an arbitrator had ordered the San Jose Unified School District to restore wages withheld when the school board voted to defer a wage increase. The school district's fiscal impossibility defense was rejected by the arbitrator. The bankruptcy court granted the school district's request to reject its collective bargaining agreements approximately two months after the school district filed its chapter 9 petition. Nearly a year after the bankruptcy petition was filed, the school district reached a comprehensive settlement with its unions, and the bankruptcy proceedings were dismissed prior to the approval of a reorganization plan.[81]

In contrast to In re *San Jose Unified School District*, the Copper River School District was formally discharged from bankruptcy in April 1988 under a reorganization plan which reduced teachers' salaries.[82] The teachers' union waived claims for higher salaries and accepted salary freezes and reductions during a hearing on the school district's motion to reject its collective bargaining agreement with the teachers.[83] The court indicated that absent the significant concessions made by the teachers' union, rejection of the collective bargaining agreement could have been appropriate.[84] Further, the court noted that the standards set forth in *Bildisco* would have been the test for determining whether the collective bargaining agreement could have been rejected by the school district.[85] A reorganization plan was then approved which included the teachers' union's waiver of salary claims pending the execution of a new collective bargaining agreement and the dismissal of all grievances and litigation.[86]

A school district considering chapter 9 as a vehicle for adjusting collective bargaining agreements should consider not only the legal implications, but the political implications of such action as well. Shortly after the Copper River School District was discharged from bankruptcy, legislation was introduced in the Alaska Legislature prohibiting an Alaska regional school board from filing a petition as a

79. Winograd, *supra* note 5, at 232.
80. CAL. CONST. art. XIII-A.
81. Winograd, *supra* note 5, at 237-99.
82. Order Confirming Plan, *supra* note 7, and Consent Order Modifying Plan, *supra* note 8.
83. Waiver, *supra* note 8.
84. Transcript of confirmation hearing on March 24, 1988, *In re* Copper River School Dist., No. 3-86-00830 (Bankr. D. Alaska filed Dec. 22, 1986).
85. *Id.*
86. Consent Order Modifying Plan, *supra* note 8.

debtor under chapter 9 of the United Sates Bankruptcy Code.[87] NEA-Alaska listed bankruptcy restrictions as a legislative priority for the 1987 Alaska legislative session.[88] The organization supported legislation requiring a school district declaring bankruptcy to be placed under state receivership.[89]

Although no legislation restricting a school district's right to file a chapter 9 petition was passed by the Alaska Legislature,[90] the fact that legislation was introduced and supported by Alaska's largest teachers' organization is an indication of the political response which could take place if a school district avails itself of the jurisdiction of a United States bankruptcy court.

Indeed, there appears to be a growing trend toward state intervention into the affairs of financially troubled school districts. According to a recent article in *The American School Board Journal*, New Jersey, Texas, Kentucky, New Mexico, and West Virginia have developed procedures for state intervention in local school districts.[91] For example, Kentucky law permits the state superintendent for public instruction, with the concurrence of the state board of education, to intervene in the operations of an educationally "deficient" school district if it fails to implement and approve education improvement plans adopted by the state.[92]

If a school district maintains a sound educational program and is simply overwhelmed by economic factors beyond its control, state intervention hardly seems justified. State intervention or takeover would merely add an additional layer of bureaucracy by removing control of the district to the state level. Such removal would thereby eliminate the flexibility afforded by local control. Moreover, there is no indication that state control would be more effective than local school boards in dealing with financial concerns. Thus, chapter 9, which allows a school board to adjust its debts while maintaining local control of the schools, is preferable to state takeover legislation in cases involving purely financial difficulties.

87. H.B. 562, 15th Leg., 2d Sess., 1988 Alaska Sess. Laws.

88. NEA-ALASKA, NEA-AKTIVIST 1 (Mar. 1987).

89. *Id.*; H.B. 562, 15th Leg., 2d Sess., 1988 Alaska Sess. Laws.

90. H.B. 562 was sent to the House Health, Education and Social Services Committee. The Committee took no action with regard to the bill during the session.

91. Reecer, *Jersey City Stands Firm Against Charges of Academic Bankruptcy*, 21 AM. SCHOOL BOARD J. 21 (Nov. 1988).

92. KY. REV. STAT. ANN. § 158.690(4) (Baldwin 1987). *See also* W. VA. CODE § 18-2E-5 (1988) (pertaining to West Virginia "takeover" legislation).

IV. CONCLUSION

Chapter 9 of the United States Bankruptcy Code is a reasonable option for insolvent school districts to reorganize their financial affairs. Federal bankruptcy law permits municipal debtors to reject burdensome collective bargaining agreements if necessary and stays litigation and administrative proceedings which may hinder a school district's reorganization. In the absence of clear state law remedies, chapter 9 is an effective means for an insolvent school district to reduce salaries and balance its budget.

A school district should consider the political implications of relief under chapter 9. Public employees' unions may attempt to close the door to bankruptcy court by supporting state legislation prohibiting a school district from filing a chapter 9 petition or providing for the takeover of a school district by the state if the school district does take such action. Unless adequate state remedies are provided for responding to a school district's financial crisis, such developments would be unfortunate. Local school boards, like private corporations and individuals, should be afforded an opportunity to adjust their debts under the United States Bankruptcy Code. To the extent chapter 9 gives a school district the means to reorganize its financial affairs and start afresh, the municipal bankruptcy statutes enhance and protect the local control of school districts by popularly elected school boards.

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HB 233

SPONSOR STATEMENT

In 1994, the United States Congress changed the bankruptcy code to require states to give local governments specific authority to seek protection in the bankruptcy courts. Most states have granted their local governments this authority. Alaska has not. HB 233 would allow local governments in Alaska to seek bankruptcy protection.

Smaller communities are often in a tenuous financial condition, often only meeting expenses on a month-to-month basis. Should a financial situation arise where a community would not be able to meet its obligations because of an unexpected natural disaster or tort liability, that community's assets could be placed at risk. HB 233 would allow a local government to seek protection in bankruptcy court allowing them to reorganize their debts and protect public assets.

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MEMORANDUM March 15, 1999

SUBJECT: Application of federal bankruptcy law to municipalities (Work Order No. 21-LS0675)

TO: Senator Al Adams
Attn: Marla Berg

FROM: Tamara Brandt Cook
Director TBC

You have asked whether a municipality in this state may file for bankruptcy and directed my attention to 11 U.S.C.109(c)(2). That federal provision states:

> (c) An entity may be a debtor under chapter 9 of this title [11 U.S.C. 901 et seq.] if and only if such entity--
>
> (1) **is a municipality;**
>
> (2) **is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;**
>
> (3) is insolvent;
>
> (4) desires to effect a plant to adjust such debts; and
>
> (5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;
>
> (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;
>
> (C) is unable to negotiate with creditors because such negotiation is impracticable; or
>
> (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title [11 U.S.C. 547].

(Emphasis added)

Note that under this provision a municipality must meet several criteria before it can be a debtor under chapter 9, one of which is state law authorization. I have found no provision under state law that authorizes municipalities to become debtors under this federal provision or that grants the power to a governmental officer or organization to authorize municipalities

to become debtors. So, it appears to be correct that a municipality in this state cannot file for bankruptcy.

There is another provision, 11 U.S.C. 109(b), that generally permits a "person" to "be a debtor under chapter 7 of this title [11 U.S.C. 701 et seq.]..." However, for almost all purposes 11 U.S.C. 101(41) defines "person" not to include a "government unit." A "government unit" is, among other things, a "municipality." (11 U.S.C. 101(27)) Therefore, a municipality cannot file for bankruptcy under chapter 7.

TBC:glc
99-093.glc

...

11 USC § 109. Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not—

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, *a small business investment company licensed by the Small Business Administration under subsection (c) or (d) of section 301 of the Small Business Investment Act of 1958*, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act ~~(12 USC 1813(h))~~; or

(3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such business in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity—

(1) is a municipality;

(2) is ~~generally authorized~~ *specifically authorized, in its capacity as a municipality or by name,* to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

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Comment

*1001 MUNICIPAL BANKRUPTCY AND EXPRESS STATE AUTHORIZATION TO BE A CHAPTER 9 DEBTOR: CURRENT STATE APPROACHES TO MUNICIPAL INSOLVENCY-AND WHAT WILL STATES DO NOW?

Daniel J. Freyberg

I. Introduction

Municipal bankruptcy has been controversial since its inception in the 1930s, largely due to constitutional conflicts between state and federal powers. [FN1] The effort to balance powers reserved to states under the Tenth Amendment [FN2] with the Bankruptcy Clause [FN3] resulted in significantly limited powers for bankruptcy courts in the context of municipal bankruptcy. [FN4] In addition to limiting judicial powers in court cases, [FN5] the Bankruptcy Code [FN6] imposes tight restrictions on who may qualify as a debtor under this section. [FN7]

Congress left the provisions for municipal bankruptcy under Chapter 9 [FN8] virtually undisturbed in the Bankruptcy Reform Act of 1994. [FN9] However, a significant change made to section 109(c)(2) [FN10] alters the manner of determining who may be a Chapter 9 debtor. The statute now requires a municipality to be "specifically authorized, in its capacity as a municipality or by name, to be a debtor under. . . State law, or by a[n authorized] governmental officer or organization. . . ." [FN11] Prior to the 1994 change an entity was only required to have general authorization by state law to become a debtor under Chapter 9. [FN12]

*1002 This comment surveys the approaches taken by states to authorize or prohibit municipal bankruptcy. The author concludes that states have a duty to enact statutes regarding the resolution of municipal fiscal distress, whether or not such statutes include authorization for filing under federal bankruptcy law. This conclusion derives from multiple factors, including the ever-present threat of municipal insolvency, the need for stability in the municipal bond market, a political climate which favors state based problem-solving, and an analysis of effective approaches to resolving municipal insolvency. The author also proposes development of uniform laws, modeled after currently existing state laws, designed to avert bankruptcy under Chapter 9 before it occurs.

Part II is a brief summary of the history of municipal bankruptcy in the United States. Part III analyzes access issues under section 109(c) of Chapter 9. Included are brief legislative and judicial histories leading up to the 1994 amendments. Part IV surveys the wide variety of state approaches to municipal bankruptcy to date, divided into categories ranging from express authorization to absolute prohibition. Part V discusses the continuing threat of insolvency faced by municipalities, including factors which can lead to bankruptcy and some potential future dangers. Finally, Part VI recommends affirmative state action on this issue, and encourages continued development of uniform laws. This section also suggests a framework for a proposed uniform law, modeled after current state statutory provisions.

II. A Brief History of Municipal Bankruptcy

Thousands of municipalities defaulted on their debts during the Great Depression of the 1930s. [FN13] As a result, Congress determined a need for public sector bankruptcy legislation, and enacted the Municipal Bankruptcy Act in 1934, [FN14] which became Chapter IX (Chapter 9) of the Bankruptcy Act of 1898. [FN15] But within two years, the Supreme Court, in Ashton v. Cameron County Water Improvement District No. 1, [FN16] found the Act unconstitutional. [FN17] While the Supreme Court did not directly cite the Tenth *1003 Amendment to invalidate the Act, the Court's focus on the state's right to control its municipalities supports such an analysis of the Court's reasoning. [FN18]

Congress responded to the Court's decision by revising the Act in 1937 (1937 Act). [FN19] The revision added several sections and provided a modified composition procedure, which required the approval of a majority of creditors. [FN20] Only a month after the 1937 Act was enacted, a California irrigation district filed a bankruptcy petition under the new Act, and the issue ultimately found its way back to the Supreme Court. [FN21] The 1937 Act survived constitutional challenge, possibly due to a change in the makeup of the Court, since the substantive changes made in the 1937 Act were modest. [FN22] While numerous refining amendments were made throughout the *1004 next decade, [FN23] from 1946 until 1975 Chapter 9 remained undisturbed and virtually un-used. [FN24]

Municipal bankruptcies had typically involved small special function entities, defaulting on bond obligations due to shrinking tax revenues. [FN25] Readjustment plans generally provided for extending debt payments, or paying from other revenue-producing sources. [FN26] But in 1975, New York City's financial difficulties demonstrated that use of Chapter 9 was not fea-sible for a large municipality, inspiring Congress to make major changes to the Act in 1976. [FN27] Significant changes included authority to issue certificates of indebtedness as an aid to refinancing, [FN28] authority to reject executory contracts [FN29] and elimination of various pre-filing requirements. [FN30] The current Chapter 9 is derived primarily from the April, 1976 changes to the Act. [FN31]

III. Access to Chapter 9 under Section 109(c)

Section 109(c) provides five requirements a municipality must satisfy to be a debtor for purposes of Chapter 9. [FN32] First, a debtor must be a municipality,*1005 [FN33] defined as a "political subdivision or public agency or instrumentality of a State." [FN34] Next, a municipality must be "specifically authorized, in its capacity as a municipality or by name" by state law to be a debtor under this chapter. [FN35]

The third requirement is that the municipality be "insolvent," [FN36] or "generally not paying its debts as they become due. . . or unable to pay its debts as they become due." [FN37] Courts have broadly construed this section, and municipalities are not required to raise taxes to the maximum allowed by law to be deemed insolvent. [FN38] Fourth, the municipality must show that it "desires to effect a plan to adjust such debts." [FN39] Implicit in this language is a demand for "good faith" filing, not attempted as an effort to buy time or evade creditors. [FN40]

Finally, the fifth requirement may be met by satisfying one of four alternatives: (1) obtain agreement from creditors holding a majority in amount of claims from each impaired class; [FN41] (2) negotiate in good faith for *1006 such agreement, but fail to gain agreement; [FN42] (3) be unable to negotiate for such agreement because it is impracticable to do so; [FN43] or (4) reasonably believe a creditor may attempt an avoidable transfer under Section 547. [FN44]

A. History of Section 109(c)(2)

Disagreement over the correct language to characterize a state's authorization for a municipality to become a debtor under Chapter 9 was evident in the hearings leading up to the adoption of the

Bankruptcy Code. [FN45] The House version of the bill permitted only a municipality "not prohibited by State law from proceeding under Chapter 9" to be a debtor. [FN46] The House Committee Report (House Report) indicated that the members felt the "generally authorized" language from the Bankruptcy Act section 84 [FN47] was unclear, and perhaps not protective enough of state sovereign-ty. [FN48] The Senate proposal mirrored the language of the Bankruptcy Act, requiring general authorization by the state legislature, a government officer, or a government agency given power by the state to authorize filing. [FN49] The Senate version was ultimately adopted, and from 1978 until the 1994 Amendments, municipalities were required to be "generally authorized" under state law to be a debtor in order to qualify for Chapter 9. [FN50]

B. Judicial Interpretations of Section 109(c)(2) Before 1994

Just as the House Report predicted, [FN51] courts were divided in their interpretation of "generally authorized," absent specific statutory authorization. *1007 [FN52] Some courts did not require express statutory authorization, and inferred the right to file bankruptcy from the municipality's general powers, such as the power to borrow money and the power to sue and be sued. [FN53] For example, in In re City of Wellston, [FN54] the court found power to file Chap-ter 9 bankruptcy within the general powers of the mayor and council of a Missouri city to manage the city and its finances, enact "any and all ordinances not repugnant to the constitution and laws of this state," as they deem good for the city, commerce and the inhabitants therein. [FN55] In another widely reported case, In re City of Bridgeport, [FN56] the court held that a state must affirmative-ly authorize municipal bankruptcy, but continued by stating that authorization did not require specific language referring to bankruptcy or reorganization. [FN57] Thus, as in City of Wellston, the court found general authorization through the municipality's authority over its own finances. [FN58]

Other courts refused to imply or infer such power and insisted upon express authorization. [FN59] In the case of In re Carroll Township Authority, the *1008 court relied on its own reading of the legislative history of section 109(c)(2) to determine that only affirmative action from the state would suffice to demonstrate such power. [FN60] The court re-fused any liberal interpretation of the Pennsylvania statute in question, relying on precedent that the law did not allow municipal authorities to become Chapter 9 debtors. [FN61] The court also refused to follow In re City of Wellston, In re City of Bridgeport, or any of the other more recent cases from other states which had broadly interpreted general authority. [FN62]

Congress responded to the division in the courts by amending section 109(c)(2) to require specific authorization. [FN63] Now courts cannot find authorization by implication, but must find express authority within the state's statutes. [FN64] While this change certainly clarifies the nature of state authority necessary to be a debtor under Chapter 9, there has not been a reciprocal effort at clarity on the part of the states.

1994

IV. State Approaches to Municipal Bankruptcy [FN66]

Many states have adopted measures which expressly enable municipalities to file bankruptcy under federal law, without further restriction. [FN66] Other states require approval by designated re- view agencies, commissions, or other *1009 authority, or otherwise restrict and oversee a municipality's fiscal distress. [FN67] A few states even have elaborate internal systems designed to resolve serious debt crises without resort to the federal system. [FN68] Still others clearly intend that no municipal bankruptcies will arise in that state. [FN69] The largest group of states have no enabling statutes or other provision within their law for dealing with municipal financial distress. [FN70]

List of States [FN66]

A. Plain Authorization

Fourteen states have enacted straightforward legislation granting their political subdivisions authority to file bankruptcy under Chapter 9. [FN71] A few of these states, notably Califor- nia, [FN72] Colorado, [FN73] and Montana, [FN74] have also granted specific authority to some special water, irrigation, or school districts. The scope of authorization in these statutes is broad, often including any county, city, or town, any taxing district, any municipality, or political subdivisions in general. [FN75] While there is considerable variety in style between states, Missouri's recently enacted section 427.100 is typical:

*1010 The consent of the state is hereby granted to, and all appropriate powers are hereby conferred upon, any municipality or political subdivision organized under the laws of the state to institute any appropriate action authorized by any act of the Congress of the United States relating to bankruptcy on the part of any municipality or political subdivision. [FN76]

B. Restricted Authorization [FN77]

A number of states have enabling legislation, but require some form of preliminary review or other restriction before a petition may go forward. [FN78] At a minimum, these states require a commission, agency of state government, or a particular official or officials to review and give their approval. For example, North Carolina requires approval of the Local Government Commission before filing. [FN79] Kentucky carves out an exception to its general enabling legislation for counties, which must have proposed plans approved by the local debt officer and local finance officer before filing Chapter 9. [FN80] Iowa limits filings to municipalities whose insolvency was the result of debt involuntarily incurred. [FN81] Iowa appears to have aimed its statute at liability judgments, since bond debt and collective bargaining agreements are specifically excluded, and the municipality must certify that: (1) an increase in taxes will be needed to cover the debt or portion of the debt not covered by insurance; (2) the tax increase will have a severe adverse impact; (3) as a result the municipality is unable to pay debts as they become due; and (4) the debt is not owed to another political subdivision. [FN82]

Other states also grant authority to file for bankruptcy while following a heightened level of scrutiny of local finances. [FN83] In Ohio, for instance, *1011 approval of the state tax commissioner is required. [FN84] In addition, the Local Fiscal Emergen-cies Law, [FN85] which was recently amended and expanded, allows considerable state intervention prior to a Chapter 9 filing. [FN86]

Similarly, Louisiana [FN87] and Connecticut [FN88] have challenging approval require-ments, specifically prohibiting Chapter 9 filings unless certain conditions are met. Connecticut requires express, written permission of the Governor. [FN89] If the Governor consents, he must report to the State Treasurer and the Joint Standing Committee on Finances of the General Assembly to explain his action. [FN90] Unsurprisingly, these statutes were amended following In re City of Bridgeport, where the state had argued that the city was not even generally authorized to be a debtor under state law. [FN91] Louisiana requires a municipality's plan to be submitted to the State Bond Commission for written approval, and also requires written approval of the Governor and Attorney General. [FN92]

C. State Recomposition Plans

A number of states have complex "prebankruptcy" statutes. [FN93] These statutes create a vehicle for a municipality to readjust its debts within the supervision of the state court system or with oversight by a commission or agency. The effect of these statutes is similar to what is available in bankruptcy court, with provisions for creating a plan, eligibility requirements, stay of claims during pendency, and reissuing of bonds.

*1012 New Jersey enacted statutes authorizing state control over insolvent municipalities in 1931,

and in 1933 added a provision allowing creditors to be bound by the state's adjustment plan. [FN94] These laws were constitutionally challenged soon thereafter in Faitoute Iron & Steel Co. v. City of Asbury Park, N.J. [FN95] The plaintiffs were holders of defaulted bonds issued prior to the enactment of the New Jersey statutes. [FN96] Under the readjustment plan, the plaintiff's bonds were converted to new bonds, bearing reduced interest from the original bonds. [FN97] The plaintiffs claimed that since the New Jersey laws constituted municipal bankruptcy legislation, enactment of federal Chapter 9 had preempted New Jersey's statutes, making their enforcement unconstitutional. [FN98] Alternatively, they asserted that their rights under the Contracts Clause [FN99] had been violat-ed. [FN100]

The Supreme Court upheld the New Jersey statutes on broad grounds. [FN101] Citing United States v. Bekins, [FN102] the Court emphasized the care with which the federal statutes had been drawn, specifically in order to avoid restricting states' control over their fiscal af-fairs. [FN103] Finding significance in the fact that the New Jersey statutes expressly forbid resort to Chapter 9 without approval of the Municipal Finance Commission, the Court refused to find that state power to manage financial problems of state subdivisions could be absorbed into the federal statutes. [FN104]

Congress, however, disagreed with the Supreme Court and enacted what is now section 903. [FN105] Section 903 prevents state authorization of compositions of indebtedness which are binding on non-consenting creditors. [FN106] Congress' stated purpose in enacting this section was to ensure equal treatment of municipal bondholders throughout the nation. [FN107]

*1013 While it is generally accepted that states cannot exercise bankruptcy powers, [FN108] there may be reason to believe the principle survives. [FN109] In 1975, the New York legislature enact-ed emergency legislation in an effort to deal with New York City's fiscal crisis. [FN110] As part of the plan, the time for payment on municipal notes was extended, with additional interest for those who exchanged their old notes for new ones. [FN111]

Noteholders challenged the practice as a violation of the Contracts Clause and of the Bankruptcy Act. [FN112] The court rejected the Contracts Clause challenge, [FN113] relying on the reason-ing of Faitoute Iron & Steel. [FN114] The plaintiffs' Bankruptcy Act challenge [FN115] was reject-ed as well, because the New York legislation involved 'extension' rather than 'composition', which the court ruled was not precluded under the Act. [FN116] Thus, it may be that federal courts will still allow some involuntary aspects in state debt composition plans, a power usually assumed to be reserved to the federal bankruptcy court. [FN117]

Michigan, Pennsylvania, Illinois, and Nevada have enacted detailed plans for addressing municipal fiscal distress which differ from the New York and New Jersey plans because they do not include the supervision of reorganization plans by state courts. [FN118] All of the plans contain statutory authority to appoint a financial management team to review the entity's *1014 finances, then create and implement a plan of action. [FN119] The Michigan and Pennsylvania plans specifically allow the review team or its chairperson to authorize a Chapter 9 filing, although for some entities approval of the Governor is required as well. [FN120]

In Illinois, on the other hand, the statutes are silent about a municipality's authority to file Chapter 9 proceedings. The financial planning and supervision commission, and its financial advisor, have powers and duties similar to the financial management teams in Pennsylvania and Michigan, including the authority to recommend that the unit of local government file a petition under Chapter 9. [FN121] However, nebulous language like 'authority to recommend' is not the same as specific power to authorize, and it is unlikely that courts will be willing to construe such language as expressed state authority under the amended section 109(c)(2). [FN122] Nevada's plan is also si-lent on bankruptcy, omitting any reference even to recommending Chapter 9 filing within the allotted

powers of the review team or its members. [FN123]

*1015 D. Statutory Provisions Which Preclude Municipal Bankruptcy

Only Georgia has a statute which specifically prohibits municipalities from filing Chapter 9 without exception. [FN124] Other states, however, have designed their governmental structure in such a way that bankruptcy filing is essentially impossible, even though not prohibited. [FN125] In addition, since Congress amended section 109(c)(2) to require specific enabling legislation, the many states which are entirely silent on the matter, for all practical purposes, preclude it.

Kansas has a unique set of laws which require all political subdivisions to operate on a cash-only basis. [FN126] Some debt is permitted, but strictly limited. [FN127] Since it is unlawful to incur debt beyond the rigid parameters allowed by the state, circumstances which might lead to bankruptcy are virtually impossible.

Another state with a unique statutory design is Massachusetts. [FN128] First, Massachusetts, like many other states, has carefully limited amounts and types of debt which entities are permitted to incur. [FN129] But, before a municipality can assume a financial liability, a two-thirds approval vote of its citizens is required. [FN130] If a municipality determines that it is unable to pay its' debts, the Commissioner of Revenue must be notified. [FN131] If the Commissioner concurs with the municipality's conclusion following a separate investigation, the State Treasurer must pay what is owed on the debt. [FN132] The money owed by the municipality will then be recovered, plus costs and interest, from money otherwise payable from the state to the local entity. [FN133] No provision enabling entities to file under Chapter 9 is included in the Massachusetts Code.

*1016 Finally, twenty-one states simply have not enacted any enabling legislation, nor developed statutory plans for dealing with municipal fiscal distress. [FN134] A number of these states had Chapter 9 filings prior to the 1994 Amendments, and where courts found authorization for those filings, it was under the general powers. [FN135] In these states, political subdivisions which continue to suffer financial stress will no longer have the protection of the federal bankruptcy court unless the state passes authorizing legislation. [FN136]

V. The Continuing Threat of Insolvency

When municipalities incur debt, it is generally in the form of bonds, issued for the purpose of financing revenue-producing projects, such as roads, utilities, swimming pools, and school buildings. [FN137] Society has determined that local governments need the flexibility to finance neces-sary improvements through municipal bonds, with the consent of the citizens. [FN138] Unfortunately, all municipalities continue to face economic hardships, and those hardships, without stable guidance from the state, can lead to uncertainty in the bond market. [FN139]

A number of factors can cause a municipality to default on its bonds. [FN140] First, a serious recession can result in a reduction in revenues so that the municipality cannot pay on its debts while maintaining necessary services. [FN141] Bridgeport, Connecticut's experience is illustrative. [FN142] The combined effects of a large poor population, a declining tax base and political battles pushed Bridgeport into filing bankruptcy. [FN143] Many other *1017 cities have problems which mirror Bridgeport's, and perhaps it is only a matter of time until others follow into default. [FN144]

Of course, our system includes the ability of local governments to raise taxes to meet the community's needs, but taxpayers are increasingly hostile to higher taxes without visible bene- fits. [FN145] Perhaps the clearest manifestations of that hostility are measures such as Proposi-tion 13 [FN146] in California, where taxpayers amended the state constitution to limit the ability of

government to raise taxes. [FN147] Taxpayers are also attracted to "flat tax" proposals, with widely disputed effects on available revenues. [FN148] Municipal bankruptcy commentator James E. Spiotto said this, regarding the tension between limits on taxation and necessary public spending:

> The difficulty with an artificial and unrealistic tax cap and similar constitutional limits on taxation is that there are certain municipal services that are required and expected by the citizenry. If revenues available to municipalities are capped in an unrealistic and artificial way, obviously the ability of municipalities to supply those services is significantly curtailed. That is not to say that there should not be limits on the spending of public dollars or that taxation should be allowed to become an unlimited resource in the hands of a misguided or misdirected governmental body. It is merely to state the obvious fact that, when there is a ceiling on revenues unrelated to costs and expenses, there will be a tension. [FN149]

One of the largest sources of revenue to the states is the federal government. [FN150] When a recession hits, demand for federal programs such as food stamps, unemployment and Medicaid increase dramatically, and the federal government responds by increasing the states' allotments. [FN151]

However, Congress has threatened to enact a balanced budget amendment to the Constitution, a move which appears to have considerable *1018 popular support. [FN152] Under any amendment proposal, increases in federal aid to states would depend on either a federal tax increase or cuts in other programs. [FN153] Some proposals require a "super-majority" of all members in both the House and the Senate for any tax increase. [FN154] It is, of course, uncertain what effect an amendment would have on municipal finances, but it undoubtedly could threaten a city's ability to survive recessionary times.

Other possible causes of default are negligent or fraudulent mismanagement by the governing body or by particular officials. [FN155] This can include such things as incompetent budgeting, imprudent investments and even misuse of funds for political or personal gain. [FN156] The Orange County [FN157] case in California is demonstrative, where risky investments, inspired in part by efforts to offset the effects of Proposition 13, led to bankruptcy. [FN158]

Orange County is apparently not the last major American urban entity to face a fiscal crisis brought on by financial mismanagement. On November 26, 1996, Miami, Florida, Mayor Joe Carollo requested the governor to declare a "financial emergency" in Miami, as a first step toward gaining major state assistance for the city. [FN159] Earlier in the year, both the city finance manager and city manager were forced to resign as the result of a corruption scandal. [FN160] The budget shortfall is estimated to be at least $68 million, and as an immediate result, Miami's bond ratings have dropped precipitously, making it difficult for the city to work its way out of debt through bond sales. [FN161] One idea to resolve the crisis includes abolishing the Miami city government, and absorbing it into surrounding Dade County. [FN162]

Yet another precipitating cause for default, large liability judgments, is particularly applicable to general municipalities (as opposed to special purpose districts). [FN163] Imagine the predica- ment a rural school district or a *1019 small town would face with a judgment equal to or greater than its total budget for an entire year if, for instance, a school bus or a town truck struck a car and permanently injured the car driver. It is inconceivable that the taxpayers of a poor, rural area could shoulder such a debt and keep the schools or the town operating as usual. [FN164] In fact, a number of municipalities have already been pushed into bankruptcy by large tort judgments and environmental claims. [FN165] Furthermore, environmental claims under CERCLA [FN166] are steadily increasing and are likely to threaten municipali- ties, the owners of many former and current industrial sites, long into the future. [FN167]

VI. A Time for State Action

In light of the perpetual need for municipal debt financing and the myriad of potential threats to financial stability, access to the bankruptcy courts continues to be a matter worthy of careful scrutiny by the states. Now that Congress has made specific authorization the law, each state must evaluate to what extent a municipality within its borders may have access to such a remedy. It is no longer enough to leave it to the bankruptcy court to analyze state law, searching for state authorization for subdivisions to enter into bankruptcy.

States have begun the process of evaluating their statutory schemes to determine what their position on municipal bankruptcy will be. Missouri, for instance, has enacted straightforward enabling legislation following the adoption of the 1994 Bankruptcy Reform Act, with its revision of section *1020 109(c)(2). [FN168] This is a state which has had some experience in recent years with municipal bankruptcy filings. [FN169] Evidently, Missouri found compelling value in the bankruptcy process, and has chosen to keep the option available to its political subdivisions.

Illinois is also poised to consider enabling legislation. [FN170] The Illinois State Bar Association has been studying the matter since 1994, and its proposed enabling legislation is expected to be considered by the Illinois General Assembly during the 1996-97 term. [FN171] If enacted, authority to file Chapter 9 would be added to the general powers of state municipalities, a far broader measure than the present Illinois provision allowing the financial planning and supervision committee to recommend filing. [FN172]

*1021 California, on the other hand, which has consistently authorized municipal bankruptcy, has contemplated restrictions on authority to file Chapter 9. [FN173] In the wake of the Orange County bankruptcy filing, [FN174] a bill was introduced into the California State Assembly which would drastically alter access to Chapter 9 for California municipalities. [FN175] The bill required specific authorization by the legislature for each Chapter 9 filing, and required the municipality's debt adjustment plan to be submitted to the legislature before submission to the bankruptcy court. [FN176] The amended statute contained language which purported to preserve specific authorization to be a Chapter 9 debtor, but delay and conflict inherent in the political process may very well make access to Chapter 9 unavailable when it is most needed. [FN177] At least for the present, California municipalities *1022 remain able to become Chapter 9 debtors, since the bill was rejected in committee. [FN178]

Perhaps other states are studying the matter and considering appropriate legislation. Evidence exists as well that some states are unaware of the change in section 109(c)(2), or have not yet considered what approach to take under the amended statute. [FN179] In any event, the inconsistency of state statutes for dealing with municipal bankruptcy, or the lack of any statutory framework, is confusing for the bond market, for municipal authorities and for bankruptcy practitioners. Some consistency is needed to end this confusion, and that consistency could be attained through the development and adoption of uniform laws.

One of the primary criticisms of bankruptcy law concerns uniformity of the law within the meaning of the Bankruptcy Clause. [FN180] Because widely divergent state laws are so thoroughly entwined with the federal Bankruptcy Code, uniformity is far from evident in this context. [FN181] But the Supreme Court, in Hanover National Bank v. Moyses, [FN182] determined that only "geographical uniformity" and not "personal uniformity" is required by the Constitution. [FN183] Debtors within a state must be treated equally, but there is no requirement for the states to deal uniformly with debtors. [FN184] Adoption of uniform laws for managing municipal insolvency might leave considerable divergence between states, but would increase uniformity in a broad sense, reducing confusion for those who deal with municipal finances.

State insolvency laws are sometimes accused of actually being bankruptcy law, and thus preempted by Congress exercising its power under the Bankruptcy Clause. [FN185] Clearly, section 903 [FN186] limits state action short of what is available in bankruptcy court. However, New Jersey's statutory scheme for adjustment or composition of claims of creditors is still good law, and recomposition plans in other states like Pennsylvania, *1023 Michigan and Illinois have not been significantly challenged. [FN187] State-based plans, with a last resort of filing in federal court under Chapter 9, probably would survive constitutional chal-lenge. [FN188]

Some commentators have suggested expanding the powers of the bankruptcy courts under Chapter 9, granting the court broad powers to reorganize, sell city property and raise taxes. [FN189] Simi-lar provisions are available to the court under Chapter 11 of the Bankruptcy Code [FN190] to as-sist in the reorganization of businesses. Making Chapter 9 more like Chapter 11 would permit the bankruptcy court to actively and aggressively restore the financial stability of an insolvent municipality. [FN191]

However, in today's political climate favoring the down-sizing of federal government, block grants to states, and the reduction of federal regulations, such proposals are likely "dead on arrival" at Congress. Moreover, Congress did not change Chapter 9 in the 1994 revisions, it only changed access to it by amending section 109(cX2). Thus, Congress continues to stand behind the provisions in Chapter 9, but it intends for states to actively decide to what extent their political subdivisions can take advantage of it. [FN192]

It has also been advocated that states should be given power to displace federal municipal bankruptcy law with state municipal bankruptcy law. [FN193] Such a move would require repealing section 903, thus reviving the state bankruptcy precedent as enunciated in Faitouto Iron & Steel. [FN194] This action would also be a drastic change from the existing system, and might rekindle arguments about the Contracts Clause and Bankruptcy Clause conflict. [FN195] In addi- tion, new arguments are likely to arise over conflict with full faith and credit for neighboring states' bankruptcy decisions. [FN196] Finally, it might necessitate dual federal and state systems, in order to accommodate states without their own bankruptcy system-a potentially costly alterna-tive. [FN197]

As previously suggested, a preferable improvement to the current system would be the development of uniform laws for state management of *1024 municipal financial problems, which the states could adopt in their entirety, or with modifica- tions. [FN198] The existing Chapter 9 process, while limited in the scope of its powers, has been effective, particularly in assisting special districts. [FN199] Chapter 9 should remain available to those states that wish to utilize it, as a last resort in the event all other efforts to resolve the entity's problems fail.

A number of states have extremely comprehensive statutory plans already in place, which would serve as excellent models for uniform laws. [FN200] As a first step, states should consider requiring balanced budgets for their subdivisions. This will not cure already existing deficits, but will require discipline and push municipalities toward finding solutions. [FN201] In the event the entity can-not solve its financial problems by itself, the uniform law framework should be available to direct the municipal authorities toward a solution. A skeletal framework of what should be included in the uniform laws follows:

1. Definitions-what entities are included, what officials locally and on the state level are responsible, and what kinds and amounts of debts are covered.
2. Preliminary review-specific authority to a particular person (state treasurer, tax commissioner, governor) or agency to make a preliminary review of the fiscal problems; also, a list of events which will trigger the initial review, what persons can initiate; standards for further action.

3. Financial oversight authority/commission-at least a team of state officials and others with professional financial expertise appointed with power to do any or all of the following: appoint a paid temporary manager, analyze the budget, recommend new revenue sources, recommend budget cuts, recommend the sale of municipal property/assets, issue bonds for the benefit of the entity (accompanied by standards and goals for the munici-pality to comply with before receiving funds), authorize filing of Chapter 9, do long- term financial planning, negotiate for a state loan or grant, review and renegotiate labor contracts, and recommend dissolution.

*1025 4. Procedure to end state oversight-who decides and what standards must be met. [FN202]

VII. Conclusion

Municipal bankruptcy remains a controversial issue. However, the lack of revision to Chapter 9 provisions, combined with the change to section 109(c)(2) in the 1994 Bankruptcy Reform Act, indicates that Congress is reasonably satisfied with Chapter 9, but now expects states to indicate to what extent they will allow political subdivisions to take advantage of that process. The states have adopted a wide range of approaches to municipal insolvency, resulting in confusion in the bond market and lack of direction for municipal authorities and financial planners. Municipal finances are threatened from multiple directions and states have a responsibility to give guidance to their political subdivisions.

The time is ripe for the development of uniform laws for the management of municipal insolvency. If adopted by the states, clarity and stability would be attached to a historically murky area of the law. The bond market would have an improved measure of the security attached to municipal bonds. Chapter 9 should remain as a viable ultimate alternative, but careful state supervision and a uniform approach may eliminate its need in the future. *1026 Page 1 Appendix-Cover Letter

[Address]

October __

[Name]

[Title]

[Agency]

[Address]

Dear [Name]:

I am a third year law student at Ohio Northern University College of Law. I am involved in an independent-study research and writing project concerning municipal bankruptcies under Chapter 9 of the Bankruptcy Code. The primary focus of the project concerns access to Chapter 9 since enactment of the 1994 Bankruptcy Code Amendments.

As you may know, access to Chapter 9 under 11 U.S.C. section 109 (c) has always been quite narrow and deferential to state control. However, before the 1994 amendments a municipality could be a debtor in a Chapter 9 case if "generally authorized" by state law to be a Chapter 9 debtor. The majority of courts liberally interpreted this section by ruling a municipality eligible if generally authorized to conduct and transact business and enter into contracts under state law. There may have been some Chapter 9 cases in [State] undertaken through this interpretation of the statute.

Section 109 (c)(2) was amended in 1994 to require that a municipality must be "specifically authorized" to be a debtor in a Chapter 9 case. Part of my article will be a survey of all 50 states, including the various approaches applied by the states to Chapter 9. Because I cannot find enabling legislation in your state, or because what appears to be enabling legislation is not entirely clear, I am requesting further information.

Please take a few minutes to complete the enclosed survey form. I have enclosed a self-addressed,

stamped envelope to facilitate return. Copies of any revelant documents may be attached if you so deire. Thank you in advance for your assistance.

I know that your office is extremely busy, but I am under considerable time restraint. Please attempt to provise answers as soon as feasible, so that I may include reliable information about your state in my article. I will gladly provide you with information which I have collectedonce the article has been completed. Thank you again

Sincerely,

Daniel J. Freyburg

Enclosures

*1027 Page 2 Appendix-Survey Form

1. Please identify your state. _____

2. Is there enabling legislation currently in effect in your state? Yes___ No___

2If so, please identify statue._____

3. Is there any enabling legislation pending or otherwise being considered by your state legislature? Yes___ No___

If so, please identify House or Senate Bill number._____

4. If there is no legislation either in effect or pending, how would your state handle a request by a municipality for permission to file bankruptcy?

5. Is there a specific agency, commission, or other person or persons to whom such a request would be referred for evaluation and/or approval? Yes___ No___

If yes, please identify by title._____

If yes, what role would such agency, commission, person(s) play?

Please provide any other information concerning Chapter 9 as applied in your state which might be helpful to a bankruptcy practitioner in your state.

Preparer:_____

Phone:_____

FN1. Charles Jordan Tabb, The History of the Bankruptcy Laws in the United States, 3 Am. Bankr. Inst. L. Rev. 5, 12-24 (1995); Michael W. McConnell & Randal C. Picker, When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy, 60 U. Chi. L. Rev. 425, 450-55 (1993).

FN2. U.S. Const. amend. X. "The enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people." Id.

FN3. U.S. Const. art. I, § 8, cl. 4. The Congress shall have the power "(t)o establish. . .

uniform laws on the subject of bankruptcies throughout the United States." Id.

FN4. See discussion infra, Part II and III, and accompanying notes.

FN5. Barry Winograd, San Jose Revisited: A Proposal for Negotiated Modification of Public Sector Bargaining Agreements Rejected under Chapter 9 of the Bankruptcy Code, 37 Hastings L.J. 231, 288 (1985). In municipal bankruptcies, unlike those under other chapters of the code, the court has little authority over the debtor's affairs. Id. The court may not interfere with property and revenues, nor with political or governmental powers. Id.

FN6. 11 U.S.C. §§ 101-1330 (1994).

FN7. See Part III infra.

FN8. 11 U.S.C. §§ 901-946 (1994).

FN9. Pub. L. No. 103-394, 108 Stat. 4106 (codified as amended in scattered sections of 11 U.S.C.).

FN10. 11 U.S.C. § 109(c)(2)(1994).

FN11. § 109(c)(2) (emphasis added). The italicized words are new language replacing the former "generally authorized" language.

FN12. 11 U.S.C. § 109(c)(2) (1988).

FN13. 6 William L. Collier, Collier on Bankruptcy 900.LH[1] 900-23 (Lawrence P. King ed., 15th ed. 1991).

FN14. Act of May 24, 1934, ch. 667, 50 Stat. 653 (1937).

FN15. Bankruptcy Act, ch. 541, 30 Stat. 544 (1898) (repealed 1978).

FN16. 298 U.S. 513 (1936).

FN17. Id. In Ashton, a Texas water improvement district filed a bankruptcy petition under the new Act, seeking to adjust its bond indebtedness. Id. at 523. The district court dismissed the petition for lack of jurisdiction, finding that "petitioner is a mere agency or instrumentality of the state. . . . The bonds are contracts of the state, executed through this agency, and secured by taxes levied upon local property. Congress lacks power to authorize a federal court to readjust obligations." Id. at 524. The decision was 5-4, with Justice McReynolds delivering the majority opinion, dissent by Justice Cardozo, joined by Chief Justice Hughes, Justice Brandeis, and Justice Stone. Id. at 513.

FN18. Id. at 531. The Court stated, "If obligations of states or their political subdivisions may be subjected to the interference here attempted, they are no longer free to manage their own affairs; the will of Congress prevails over them. . . the sovereignty of the state. . . does not exist." Id. (citing Farmers' & Mechanics' Sav. Bank v. Minnesota, 232 U.S. 516, 526 (1914); McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 430 (1819)). The Court continued by citing the Contracts Clause (U.S. Const. art. I, § 10), noting that states cannot pass statutes which impair contracts in any form including bankruptcy, nor could Congress enact any statute which might impair contracts. Id. "Neither consent nor submis-sion by the states can enlarge

the powers of Congress; none can exist except those which are granted." Id. (citing United States v. Butler, 297 U.S. 1, 56 (1936)).

FN19. Municipal Bankruptcy Act, 50 Stat. 653 (1937).

FN20. 50 Stat. at 653. The 1937 Act: (1) prohibited interference with fiscal or governmental matters of municipalities; (2) limited the protection of bankruptcy to the taxing agency; (3) barred involuntary proceedings; (4) forbade judicial control or jurisdiction over property and revenues necessary for essential services; and (5) prohibited impairment of contractual obligations by states. James E. Spiotto, Introduction to Municipal Bankruptcy, 378 PLI/Real 611, 614 (Jan.-Feb. 1992).

FN21. United States v. Bekins, 804 U.S. 27 (1938).

FN22. Winograd, supra note 5, at 272-73 (citing Note, Municipal Bankruptcy, the Tenth Amendment and the New Federalism, 89 Harv. L. Rev. 1871(1976) [hereinafter Note]). In Bekins, the Court did not expressly rely upon the changes in the law to distinguish Ashton. Winograd, supra note 5, at 272. Instead, Chief Justice Hughes compared the consensual nature of bankruptcy to the consensual arrangement between federal and state government in social security and unemployment law, concluding that the voluntary nature of the proceeding prevented interference with state sovereignty. Winograd, supra note 5, at 272. See Bekins, 304 U.S. at 27. The Chief Justice was joined by Justices Brandeis, Stone, Roberts, Reed, and Black, with Justices McReynolds and Butler dissenting and Justice Cardozo not participating. Bekins, 304 U.S. at 45, 54. The Ashton majority was depleted by the retirements of Justices Sutherland and VanDevanter, and by Justice Roberts switching sides. Note, supra, at 1897 n.169. The dissenters in Ashton were bolstered by the appointments of Justices Black and Reed. Note, supra, at 1897 n.169.

FN23. Jonathan J. Spitz, Federalism, States, and the Power to Regulate Municipal Bankruptcies: Who May Be A Debtor Under Section 109(c), 9 Bankr. Dev. J. 621, 623 (1993). Of particular interest is the addition in 1946 of § 83(l), partially reversing the Supreme Court's holding in Faitoute Iron & Steel Co. v. Asbury Park, 316 U.S. 502 (1942) (upholding New Jersey law allowing municipalities to recompose debt over objections by creditors). Spitz, supra, at 623. See discussion and notes infra, Part IV.

FN24. Spitz, supra note 23, at 624.

FN25. Winograd, supra note 5, at 273.

FN26. Winograd, supra note 5, at 273.

FN27. Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315 (codified in scattered sections of 11 U.S.C.). These revisions were later enacted in the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. §§ 101-1326 (1982) and scattered sections of U.S.C.). See also Spitz, supra note 23, at 624-25.

FN28. Act of Apr. 8, 1976, Pub. L. No. 94-260, § 82(b)(2), 90 Stat. 315 (1976) (codified at 11 U.S.C. § 402 (1982)); see 11 U.S.C. §§ 364(c)- (c) (incorporated by 11 U.S.C. § 901(a) (1982) after 1978).

FN29. Act of Apr. 8, 1976, Pub. L. No. 94-260, § 82(b)(1), 90 Stat. 315 (1976) (codified at 11 U.S.C. § 402 (1982)); see 11 U.S.C. § 365 (incorporated by 11 U.S.C. § 901(a) (1982) after

1978).

FN30. Winograd, supra note 6, at 275-76.

FN31. Winograd, supra note 5, at 275-76 n.204.

FN32. 11 U.S.C. § 109(c)(1)-(5) (1994). The statute reads:
An entity may be a debtor under chapter 9 of this title if and only if such entity-
(1) is a municipality;
(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organiza-tion empowered by State law to authorize such entity to be a debtor under such chapter;
(3) is insolvent;
(4) desires to effect a plan to adjust such debts; and
(5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (C) is unable to negotiate with creditors because such negotiation is impracticable; or (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.
§ 109(c)(1)-(5).

FN33. § 109(c)(1).

FN34. § 101(40).

FN35. § 109(c)(2). As noted in the Introduction to this comment, this section was changed to the present language in the 1994 Amendments. The states' current approaches to this requirement is the focus of this comment, and will be addressed further infra.

FN36. § 109(c)(3).

FN37. § 101(32)(C)(i)-(ii).

FN38. Spitz, supra note 23, at 628. A good statement to this effect is made in In re Pleasant View Util. Dist., 24 B.R. 632, 639 n.6 (Bankr. M.D. Tenn. 1982):
The creditor intimates that the debtor could possibly receive more cash flow and thereby reduce its debt by increasing the rates charged to its customers. . . . In any event, the mere contingency that the District could improve its financial situation by increasing its rates does not alter the fact that at the present time the District cannot meet its debts as they mature.
Id. But in In re City of Bridgeport, 129 B.R. 332 (Bankr. D. Conn. 1991), the judge dismissed the case for failing to meet the insolvency requirement, primarily because more credit was available to the city. Id. at 337-39.

FN39. 11 U.S.C. § 109(c)(4) (1994).

FN40. Eric S. Pommer & Marc M. Friedman, Municipal Bankruptcy and Its Effect on Government Contractors, 25 Pub. Cont. L.J. 249, 264 (1996).

FN41. § 109(c)(5)(A).

FN42. § 109(c)(5)(B).

FN43. § 109(c)(5)(C).

FN44. § 109(c)(5)(D); § 647.

FN45. Eric W. Lam, Municipal Bankruptcy: The Problem with Chapter 9 Eligibility-A Proposal to Amend 11 U.S.C. § 109 (c)(2) (1988), 22 Ariz. St. L.J. 625, 631-32 (Fall 1990).

FN46. Id. at 631 (citing H.R. 8200, 95th Cong., § 109(c) (1977), reprinted in Legislative History of Bankr. L. Ed. (Law. Co-op.) § 82:24, at 519 (1979)).

FN47. Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315, 317 (codified at 11 U.S.C. §§ 401-418 (Supp. 1976)).

FN48. Lam, supra note 45, at 631 (citing H.R. Rep. No. 95-595, at 319, reprinted in Legislative History of Bankr. L. Ed. (Law. Co-op.) § 82:15, at 326 (1979)).

FN49. Lam, supra note 45, at 631 (citing S. 2266, 95th Cong. § 906 (1978), reprinted in Legislative History of Bankr. L. Ed. (Law. Co-op.) § 83:31, at 510 (1979)).

FN50. Lam, supra note 45, at 631-32. Lam notes that neither the House nor Senate debates and remarks explain why this language was chosen over the more restrictive House version. Lam, supra note 45, at 631-32. Nor was there any guidance in the Legislative History or the Code as to how courts were to interpret "generally authorized." Lam, supra note 45, at 631-32.

FN51. Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315, 317 (codified at 11 U.S.C. §§ 401-418 (Supp. 1976)).

FN52. David S. Kupetz, Municipal Debt Adjustment Under the Bankruptcy Code, 27 Urb. Law. 531, 538 n.21 (1995).

FN53. For cases broadly construing 11 U.S.C. § 109(c)(2) prior to the 1994 Amendments, see: In re Sullivan County Regional Refuse Disposal District, 165 B.R. 60, 73 (Bankr. D. N.H. 1994) ("'[G]enerally authorized' language in 11 U.S.C. § 109(c)(2) should be broadly construed to provide municipalities maximum access to Chapter 9 within the constitutional limitations of the Tenth Amendment."); In re City of Bridgeport, 128 B.R. 688, 696 (Bankr. D. Conn. 1991) ("'generally authorized' should be given a broad construction"); In re Villages at Castle Rock Dist. No. 4, 145 B.R. 76, 82 (Bankr. D. Colo. 1990) ("[B]road general powers are sufficient to constitute general authorization for a chapter 9 filing."); In re Greene County Hosp., 59 B.R. 388, 391 (Bankr. S. D. Miss. 1986) ("[S]tatutes. . . which grant an entity the general power to control its existence, operation and financial affairs, are a sufficient state authorization in spite of the lack of express language authorizing the entity to proceed in bankruptcy."); In re City of Wellston, 43 B.R. 348, 350 (Bankr. E.D. Mo. 1984) ("[A] municipality may be authorized to proceed as a debtor under Chapter 9, notwithstanding the absence of a State statute specifically authorizing such action, if it can be shown that the circumstances require actions which are otherwise permissible under a grant of general authority in the State law."); In re Pleasant View Utility District, 24 B.R. 632, 636 (Bankr. M.D. Tenn.1982) ("[T]he term 'generally authorized' was intended to be given a broad interpretation.")

FN116. Ropico, 425 F. Supp. at 983.

FN117. Winograd, supra note 5, at 307.

FN118. See note 67 supra.

FN119. In Michigan, after preliminary review by the State Treasurer, the Governor appoints the review team, which includes the treasurer as a member. Mich. Comp. Laws Ann. § 141.1213 (West 1992). In Pennsylvania, a complaint alleging severe fiscal distress must be made to the Secretary of the Department of Internal Affairs. 53 Pa. Cons. Stat. Ann. § 6571 (West 1972). That department then makes an evaluation of the financial circumstances faced by the entity, and if the secretary determines a crisis exists, appoints a coordinator to create and implement a resolution of the financial problems. § 11701.221. In Illinois, a detailed request for assistance must be made by the entity to the Governor, who makes a preliminary review of the financial circumstances involved, then may appoint a commission. 50 Ill. Comp. Stat. Ann. § 320/5(b) (West 1993). In Nevada, complaint is made to the Nevada Tax Commission, which itself may take over management of the local government until the fiscal crisis has been resolved. Nev. Rev. Stat. § 354.675-.685 (Michie Supp. 1995).

FN120. Mich. Comp. Laws. Ann. § 141.1222 (West 1992); 53 Pa. Cons. Stat. Ann. §§ 6571 (West 1972) (repealed in part 1987, 53 Pa. Cons. Stat. Ann. § 6571 (West Supp. 1996)); 53 Pa. Cons. Stat. Ann. § 11701.261, 12720.211 (West Supp. 1996). Authority to be a debtor only exists under the Pennsylvania statutes if granted by the Secretary of the Department of Internal Affairs, through his appointed coordinator, with the additional approval of the Governor in the case of larger (first-class) cities. Also, no filings under Chapter 9 will be authorized under any circumstances so long as any bonds are outstanding. 74 Pa. Cons. Stat. Ann. § 1773 and 53 (West Supp. 1996); Pa. Cons. Stat. Ann. § 12720.211 (West Supp. 1996).

FN121. 50 Ill. Comp. Stat. Ann. § 320/9(b)(4) (West 1993).

FN122. See Part VI infra for a discussion of a pending move in Illinois to provide for specific authorization under the state's general powers.

FN123. Nev. Rev. Stat. § 354.695 (Michie Supp. 1995). In fact, in Nevada, the local government has no option but to obey the solution plans of the tax commission, which is backed by the state courts to force compliance. § 345.715.

FN124. Ga. Code Ann. § 36-80-5 (1993).

FN125. See Kan. Stat. Ann. §§ 10-1101 to 1116, §§ 79-2938 to 2942 (1982) (cash only basis for political subdivisions; limits on debt); Mass. Gen. Laws Ann. ch. 44:14 (Law. Co-op. 1993) (no exemptions from liability to pay debts lawfully incurred).

FN126. Kan. Stat. Ann. § 10-1102 (1982).

FN127. §§ 10-1113, 10-1116.

FN128. Mass. Gen. Laws Ann. ch. 44 (Law. Co-op. 1993).

FN129. See id. at ch. 44:2 to :7.

FN130. Id.

FN131. Id. at ch. 44:19A.

FN132. Id.

FN133. Mass. Gen. Laws. Ann. ch. 44:19A (Law. Co-op. 1993). While the local taxing unit is thus relieved from the burden of its immediate problem, the debts it cannot pay, the ordinary flow of money from the state will end under this statutory framework. When state money assumed available and used in planning a budget dries up, the municipality is still going to be in serious financial trouble. Enough money for necessary government services is going to be hard to find.

FN134. See note 69 supra.

FN135. Indiana, Mississippi, New Hampshire, Tennessee, Utah, and West Virginia, all states without any current specific authorization, had filings between 1981 and 1994. Chapter 9 Revisited, Natalie R. Cohen, ed., Fiscal Stress Monitor, National Municipal Research 1-3 (Nov. 1994) (source of statistics:Administrative Office of the U.S. Courts) [hereinafter Fiscal Stress Monitor]. At least in Mississippi (In re Greene County Hospital, 69 B.R. 388, 391 (Bankr. S.D. Miss. 1986)), Tennessee (In re Pleasant View Utility District, 24 B.R. 632, 638-39 (Bankr. M.D. Tenn. 1982)), and New Hampshire (In re Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 75 (D. N.H. 1994)), the bankruptcy court found a municipality authorized through the general powers granted to political subdivisions under the former "generally authorized" language.

FN136. Fiscal Stress Monitor, supra note 135, at 3.

FN137. Spiotto II, supra note 64, at 7.

FN138. Spiotto II, supra note 64, at 18.

FN139. Spiotto II, supra note 64, at 18.

FN140. Spiotto II, supra note 64, at 5.

FN141. Spiotto II, supra note 64, at 5.

FN142. In re City of Bridgeport, 129 B.R. 332 (Bankr. D. Conn. 1991).

FN143. Id. For more information and analysis of the Bridgeport case, see generally Dorothy A. Brown, Fiscal Distress and Politics:The Bankruptcy Filing of Bridgeport as a Case Study in Reclaiming Local Sovereignty, 11 Bankr. Dev. J. 625 (1994-95); Rachael E. Schwartz, This Way to the Egress: Should Bridgeport's Chapter 9 Filing Have Been Dismissed?, 66 Am. Bankr. L.J. 103 (1992).

FN144. Schwartz, supra note 143, at 106-07.

FN145. Spiotto II, supra note 64, at 6.

FN146. Cal. Const., art. XIIIA, § 1.

FN147. See Spiotto II, supra note 64, at 19.

FN148. See Spiotto II, supra note 64, at 18.

FN149. See Spiotto II, supra note 64, at 19. James E. Spiotto has written and lectured on the subject of municipal bankruptcy for the Practicing Law Institute. He contributed a chapter to the treatise State and Local Government Debt Financing (Professor David Gelfand, ed., 1993), and a book, James E. Spiotto, Defaulted Securities: A Prudent Indenture Trustee's Guide (Am. Bankers Ass'n 1990).

FN150. Karen M. Paget, The Balanced Budget Trap, Am. Prospect, Nov.-Dec. 1996, at 22. States receive anywhere from one-fourth to one-third of their revenues from the federal government. Id. at 25.

FN151. Id.

FN152. Id. at 21-22.

FN153. Id. at 25.

FN154. Id. Paget points out the difficulty a legislator from a large urbanized state might have in convincing those from more rural states to vote in favor of a general tax increase, the bulk of which will go to aid the citizens of the larger state. Id.

FN155. Spiotto II, supra note 64, at 6.

FN156. Spiotto II, supra note 64, at 6.

FN157. In re County of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995).

FN158. Id. at 601.

FN159. Will Lester, Reeling Miami Seeking State Aid, Plain Dealer, Nov. 28, 1996, at A19.

FN160. Id.

FN161. Id.

FN162. Id.

FN163. McConnell & Picker, supra note 1, at 470. "Special purpose districts" are entities created for a specific, narrow public purpose, such as irrigation, water, and drainage. See McConnell & Picker, supra note 1, at 470.

FN164. The suggested scenario is not entirely hypothetical. The author is aware of just such a situation developing in Ohio. A rural school district is contemplating bankruptcy after being hit with a large tort judgment from a bus crash. The state has taken the position that the school district is not authorized to be a debtor under Chapter 9, despite the fact that the district has no outstanding bonds, and a tax increase adequate to cover the judgment would devastate taxpayers. The state offered to loan the money to the school district, but such a loan would strap the taxpayers beyond their ability to pay just as surely as the judgment itself. See Buchman v. Board of Educ., 652 N.E.2d 952 (Ohio Sup. Ct. 1995).

FN165. McConnell & Picker, supra note 1, at 470-71. For example, Bay St.Louis, Mississippi

suffered a $370,000 judgment after a youth jumped off a municipal pier and broke his neck; South Tucson, Arizona was hit with a $3.6 million judgment after one police officer shot and paralyzed another officer on the job; and Wapanucka, Oklahoma incurred a $112,000 judgment when its water supply was fouled by an oil tanker crash. McConnell & Picker, supra note 1, at 470-71 (citing Advisory Commission on Intergovernmental Relations, Bankruptcies, Defaults, And Other Local Government Financial Emergencies 8 (1985)). All of these municipalities ultimately filed bankruptcy petitions. McConnell & Picker, supra note 1, at 470-71.

FN166. Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. §§ 9601-9675 (1989 & Supp. 1991).

FN167. McConnell & Picker, supra note 1, at 471.

FN168. Mo. Ann. Stat. § 427.100 (West Supp. 1997).

FN169. Missouri had four Chapter 9 filings between 1981 and 1994. Fiscal Stress Monitor, supra note 135. Published opinions include:In re Chilhowee R-IV School Dist., 145 B.R. 981 (Bankr. W.D. Mo. 1992) (while plaintiff initially challenged school district's authority to be a debtor, challenge was later dropped and court assumed authority existed); In re City of Wellston, 43 B.R. 348 (Bankr. E.D. Mo. 1984) (court's analysis determined city was authorized to be a debtor under general powers granted by the state to municipalities).

FN170. Michael J. Chmiel, Illinois Authorization for Chapter 9 Bankruptcy on Horizon, 33 Ill. St. B. Ass'n. Sec. Loc. Gov't. L. 2 (Sept. 1996).

FN171. Id. The Commercial, Banking and Bankruptcy Law Section Council of the Illinois State Bar Association (ISBA) did the initial study of this issue. Id. That group developed proposed enabling legislation and referred it to the Local Government Law Section Council, which voted to support the proposal. Id. The ISBA as a whole is expected to add its support and push for adopting by the General Assembly. Id. The Illinois Township Attorneys Association has separately endorsed the proposal. Id.

FN172. Id. See also note 116 and accompanying text supra, for discussion of current law in Illinois; the proposal calls for a new act under chapter 5-the "General Provisions" chapter of the Illinois Compiled Statutes, to be designated: Ill. Comp. Stat. Ann. §§ 240/0 to /2. Chmiel, supra note 170. The proposal follows:
Act 240. Bankruptcy Authorization Act
Section 240/0.01 Short title. Section 240/1. Purpose. Section 240/2. Authorization. Section 240/0.01. Short title. Section 240/0.01. Short title. §0.01. Short title. This Act may be cited as the Bankruptcy Authorization Act.

Section 240/1. Purpose
§1. Purpose. The Congress of the United States has enacted certain laws enabling financially distressed persons to seek and obtain certain relief as set forth under Title 11 of the Un'ted States Code. This relief includes certain relief for local government generally set forth under Chapter 9 of said Title 11. And, whereas, it is the public policy of this State to provide for the public health, safety and welfare, and to provide assistance to units of local government in the formulation and implementation of proper financial accounting procedures, budgeting and taxing practices, it is the public policy of this State to support the reorganization of the financial affairs of a politicalsubdivision of this State under the protection and procedures set forth under Chapter 9 of Title 11 of the United States Code.

Section 240/2. Authorization.
§2. Authorization. The consent of this State is hereby granted to, and all appropriate powers are hereby conferred upon, any political subdivision organized under the laws of this State to institute any appropriate action authorized by any act of Congress of the United States relating to bankruptcy on the part of itself. Such political subdivisions are specifically authorized in their respective capacities to be debtors under Chapter 9 of Title 11 of the United States Code.
Chimel, supra note 170.

FN173. Kupetz, supra note 52, at 540 n.24.

FN174. In re County of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995).

FN175. Kupetz, supra note 52, at 540 n.24 (citing G.A. 29, 121 Leg., 2nd Extraordinary Sess. (Cal. 1995)).

FN176. G.A. 29, 121 Leg., 2nd Extraordinary Sess. (Cal. 1995). The bill text follows:
THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:SECTION 1. Section 53760 of the Government Code is amended to read:53760. __k(a)k¢¢ Any __-taxing agency or instrumentality -¢¢__kmunicipalityk¢¢of this __- State-¢¢__kstatek¢¢, as __kthat term isk¢¢defined in Section __-81 of the act of Congress entitled "An act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, as amended-¢¢__k101 of Title 11 of the United States Codek¢¢, __kwith specific statutory approval of the Legislature,k¢¢may file __-the petition mentioned in Section 83 of the act-¢¢__kas a debtor under Chapter 9 (commencing with Section 901) of Title 11 of the United States Codek¢¢and prosecute to completion all proceedings permitted by __-Sections 81, 82, 83, and 84 of the act-¢¢__kthat chapterk¢¢. __kHowever, a plan for the adjustment of the municipality's debts, as provided in Section 941 or Section 942 of Title 11 of the United States Code, shall be submitted to the appropriate policy committee of the Legislature prior to being submitted to the United States Bankruptcy Court.k¢¢__k(b) It is the intent of the Legislature that this section specifically authorizes a munici- pality, subject to the requirement of legislative approval specified in subdivision (a), to be a debtor under Chapter 9 (commencing with Section 901) of Title 11 of the United States Code as required by Section 109 of that title.k¢¢
Id.

FN177. Id.

FN178. Id.

FN179. Survey responses from Attorney General and Legislative Counsel offices in a number of states indicate that the office is still assuming authority can be found from general municipal powers. A majority of the surveyed states without enabling statutes responded that they do not know what the state's response would be if a municipality became insolvent and wished to avail itself of Chapter 9. Some possibilities qualifiedly suggested by those responding were dissolution of the entity and specific legislation for each entity. Survey responses are on file with author.

FN180. Tabb, supra note 1, at 46-47.

FN181. Tabb, supra note 1, at 46-47.

FN182. 186 U.S. 181 (1902).

FN183. Id. at 188.

FN184. Id. at 190.

FN185. Tabb, supra note 1, at 47-9.

FN186. 11 U.S.C. § 903 (1994).

FN187. See Part IV and accompanying notes supra for discussion of the statutes in these states.

FN188. See generally Spiotto II, supra note 64, at 23-24.

FN189. McConnell & Picker, supra note 1, at 472-81.

FN190. 11 U.S.C. §§ 1101-1174 (1994).

FN191. McConnell & Picker, supra note 1, at 472-81.

FN192. See generally Spiotto II, supra note 64, at 22-24.

FN193. McConnell & Picker, supra note 1, at 479.

FN194. 316 U.S. 502 (1942).

FN195. McConnell & Picker, supra note 1, at 480.

FN196. McConnell & Picker, supra note 1, at 480 n.225.

FN197. McConnell & Picker, supra note 1, at 481 n.228.

FN198. Spiotto II, supra note 64, at 23-24.

FN199. Spiotto II, supra note 64, at 25. As an example, in Colorado a few years back, a large number of bonds were issued in anticipation of real estate development and the accompanying taxes, which never occurred. Spiotto II, supra note 64, at 25. Chapter 9 procedures ultimately provided an equitable solution for both the creditors and the special districts. Spiotto II, supra note 64, at 25. See In re City of Colo. Springs Spring Creek Gen. Improvement Dist., 187 B.R. 683 (Bankr. D. Colo. 1995); In re Wolf Creek Valley Metro. Dist. No. IV, 138 B.R. 610 (Bankr. D. Colo. 1992); In re Villages at Castle Rock Metro. Dist. No. 4, 145 B.R. 76 (Bankr. D. Colo. 1990).

FN200. See discussion, Part IV.C. supra.

FN201. Spiotto, supra note 20, at 25-26.

FN202. This suggested framework was created by combining statutory provisions of Michigan (Mich. Comp. Laws Ann. §§ 141.1202-.1226) (West 1992), Pennsylvania (53 Pa. Cons. Stat. Ann. §§ 11701.201-.264) (West 1972), and Illinois (50 Ill. Comp. Stat. Ann. §§ 320/5 to /9) (West 1992), as well as general provisions in other state statutes. See also Spiotto,

supra note 20, at 24-29.

END OF DOCUMENT

U.S. Department of Justice

Office of the United States Trustee
605 West 4th Avenue, Suite 258
Anchorage, Alaska 99501

(907) 271-2600
FAX (907) 271-2610

January 26, 2000

Jonathan Lack
% Rep. Andrew Halcro
State Capitol Building, Rm 418
Juneau, Alaska 99801

Dear Mr. Lack:

You requested in your email a copy of Title 11 USC Section 109 relating to Municipal bankruptcy, that is being considered by the legislature. The highlighted copy of Collier on Bankruptcy is attached for your reference. If you have any questions or would like to see other resources, please let me know and I will provide whatever assistance that I can.

Very truly yours,

JAN SAMUEL OSTROVSKY
UNITED STATES TRUSTEE

Barbara L. Franklin
Assistant United States Trustee

Enc.

Cc: Jan Ostrovsky
ss / blf

Chapter 109

Who May Be a Debtor

BANKRUPTCY CODE, Section 109

(11 U.S.C. § 109)

§ 109. Who may be a debtor.

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not—

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a small business investment company licensed by the Small Business Administration under subsection (c) or (d) of section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act; or

(3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such business in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity—

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust debts; and

(5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a person that may be a debtor under chapter 7 of this title, except a stockbroker or a commodity broker, and a railroad may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than *$269,250** and noncontingent, liquidated, secured debts of less than *$807,750*** , or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than *$269,250** and noncontingent, liquidated, secured debts of less than *$807,750*** may be a debtor under chapter 13 of this title.

(f) Only a family farmer with regular annual income may be a debtor under chapter 12 of this title.

* [*Ed. Note:* Pursuant to 11 U.S.C. § 104(b), this dollar amount became effective for cases filed on or after April 1, 1998. For cases commenced prior to April 1, 1998, the dollar amount is $250,000.]

** [*Ed. Note:* Pursuant to 11 U.S.C. § 104(b), this dollar amount became effective for cases filed on or after April 1, 1998. For cases commenced prior to April 1, 1998, the dollar amount is $750,000.]

* [*Ed. Note:*Pursuant to 11 U.S.C.§ 104(b), this dollar amount became effective for cases filed on or after April 1, 1998. For cases commenced prior to April 1, 1998, the dollar amount is $250,000.]

** [*Ed. Note:* Pursuant to 11 U.S.C. § 104(b), this dollar amount became effective for cases filed on or after April 1, 1998. For cases commenced prior to April 1, 1998, the dollar amount is $750,000.]

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if—

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

Synopsis

¶ 109.01. Overview of Section 109.

[1]—Purpose and Structure of Section 109.

Section 109 defines the eligibility requirements to become a debtor under the Bankruptcy Code.[1] It establishes who may benefit from the Code's provisions by designating "Who may be a debtor." In light of the fundamental purpose of the bankruptcy laws, it is not surprising to find that section 109 is written to make bankruptcy relief widely accessible under various chapters of the Code. Exceptions to the availability of the remedies provided in title 11 are limited and carefully delineated.

Section 109 may be divided into three basic segments. The first is subsection (a), which establishes the criteria that must be met for a person to be eligible for any relief under title 11.

The second segment is made up of subsections (b) through (f), which designate the qualifications for "debtor" status under chapter 7 (liquidation), chapter 9 (municipalities), chapter 11 (reorganization), chapter 13 (individuals with regular income), and chapter 12 (family farmers with regular annual income).[2] Each of these chapters limits availability of relief

¶ 109.01.

[1] The debtor eligibility criteria need not be met in an ancillary proceeding under section 304. *See* ¶ 304.02[3] *infra*.

[2] The Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 (Pub. L. No. 99-554 (1986)), which added chapter 12 to the Bankruptcy Code, also amended section 109 to include references to family farmers and chapter 12. Subsection 109(f) follows the references to the original chapters of title 11 and, therefore, is discussed in that order in this chapter. For a further discussion of chapter 12, *see* chs. 1201-1231 *infra*.

through a definition of "debtor" for each chapter. These definitions are discussed in the following sections.

The third segment is section 109(g), which denies relief to any individual or family farmer who had been a debtor in a previous Code case if the case was pending at any time within 180 days before the ensuing filing and either (1) was dismissed by the court because of the debtor's willful failure to abide by an order of the court or to appear before it, or (2) was dismissed upon the debtor's request after the filing of a motion for relief from section 362's automatic stay.

Section 109 does not speak in terms of who may be "adjudged bankrupt," as did the former Act. Rather, the section uses the phrase "may be a debtor," intended both to tone down negative connotations and to make the general paragraph more easily applied to any case under any chapter of the Code. Subsection (a) expressly includes a "municipality" within the category of eligible entities. A municipality, because it is within the definition of governmental unit, would otherwise be excluded from the operation of section 109, which employs the term "person" for eligibility criteria. "Person" as defined in section 101 does not include a municipality.

[2]—Section 109 Not Jurisdictional.

Section 109 is not characterized in terms of venue or jurisdiction by the statute itself, and it is clear that it is not jurisdictional.[3] Section 109 is a rule governing eligibility for relief. If a debtor ineligible for relief under a particular chapter files a case and no party raises the issue of ineligibility, the relief that the debtor may receive under that chapter may not subsequently be successfully challenged for lack of jurisdiction. Moreover, since lack of eligibility for relief is grounds for denial of confirmation in chapters 11, 12, and 13,[4] confirmation of a plan is normally res judicata with respect to the issue of jurisdiction.[5] However, in some types of cases, such as those of financial institutions or insurance companies, other statutes may make clear that exclusive jurisdiction over

[3] *In re* Wenberg, 902 F.2d 768 (9th Cir. 1990), *aff'g* 94 B.R. 631 (B.A.P. 9th Cir. 1988); Rudd v. Laughlin, 866 F.2d 1040 (8th Cir. 1989); Promenade Nat'l Bank v. Phillips (In the Matter of Phillips), 844 F.2d 230, 18 C.B.C.2d 105 (5th Cir. 1988) (whether or not a debtor is eligible under section 109(g) does not raise an issue of subject matter jurisdiction); *In re* Toronto, 30 C.B.C.2d 2019, 165 B.R. 746 (Bankr. D. Conn. 1994) (section 109(e) relates to the eligibility of a debtor for chapter 13 relief, not to the jurisdiction of the court).

[4] 11 U.S.C. §§ 1129(a), 1225(a)(1), 1325(a)(1).

[5] *In re* Lochamy, 197 B.R. 384 (Bankr. N.D. Ga. 1995).

liquidation or reorganization proceedings lies elsewhere, thereby preempting bankruptcy court jurisdiction.[6]

For a debtor to be eligible for relief under the Code, the debtor must have a domicile, residence, place of business or property in the United States. Thus, a foreign debtor with property in the United States would be eligible for relief under the Code and the court will have proper jurisdiction.

¶ 109.02. Basic Criteria for Eligibility; § 109(a).

[1]—"Persons" That May Be Debtors Under Chapter 7.

Section 109 specifies rules of eligibility to be a debtor under title 11. The fundamental criteria are found in subsection (a), which provides that "Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality may be a debtor under this title." The first phrase of this section reveals the intended overall applicability of these basic criteria to any person that seeks to bring itself within the ambit of a particular chapter of the Code. Petitions filed in accordance with Official Forms 1 and 5 must assert that these basic criteria are met; these basic criteria must be met as well as the additional chapter-specific criteria set by the other subsections of section 109.

The word "person" is used in subsection (a) rather than the broader term "entity."[1] As defined in section 101, "person" includes an individual, a partnership, and a corporation, but in most situations, not a governmental unit. (The express use of the word "municipality" in subsection (a) has the effect of excluding governmental units other than a municipality from the coverage of the Bankruptcy Code.) There are also other provisions of the Code that may place limitations on the filing of petitions for relief under the Code.[2]

[6] *See* ¶ 109.03[3] *infra*.

¶ 109.02.

[1] *See* ch. 101 *supra*. *See also In re* Hunt, 30 C.B.C.2d 139, 160 B.R. 131 (B.A.P. 9th Cir. 1994) (the definition of "person" in section 101(41) fixes eligibility for purposes of section 109(d) and only an entity that is a "person" is eligible to be a debtor).

[2] *E.g.*, 11 U.S.C. §§ 302 (only husband and wife may file a joint case). *See* ch. 302 *infra*; *In re* Funneman, 29 C.B.C.2d 52, 155 B.R. 197 (Bankr. S.D. Ill. 1993) (although a partnership may be a debtor in bankruptcy in its own right, it may not jointly seek relief with any other person, including a partner).

It is noteworthy that the exclusion of banking institutions is stated in encompassing language, covering "domestic insurance company, bank, savings bank, cooperative bank, savings and l an association, building and loan association, homestead association, a small business investment company licensed by the Small Business Administration under subsection (c) or (d) of section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act" (as well as foreign entities of the same nature when engaged in business in the United States). Expansive language was chosen to ensure that the exception would be stated in terms current with banking laws.

¶ 109.04. Who May Be a Debtor Under Chapter 9.

[1]—Statutory Criteria for Chapter 9 Eligibility; § 109(c).

Section 109(c) sets forth the statutory criteria for eligibility as a chapter 9 debtor.

A municipality that is eligible for relief under chapter 9 cannot be a debtor under any other chapter of the Bankruptcy Code.

[2]—Burden of Proving Eligibility for Chapter 9 Relief.

The burden of establishing eligibility for relief under chapter 9 lies with the debtor seeking relief.[1] This burden should be liberally applied in favor of granting relief. However, chapter 9 is not a sanctuary to be employed to escape political disputes.[2] To effectuate the chapter 9 objective of promoting the rehabilitation of financially distressed municipalities, the eligibility requirements for relief under chapter 9 should be construed broadly[3] to provide the maximum access to chapter 9 consistent with the

¶ 109.04.

[1] *In re* Hamilton Creek Metropolitan Dist., 143 F.3d 1381, 1385 (10th Cir. 1998); *In re* Town Of Westlake, Texas, 38 C.B.C.2d 1046, 1047, 211 B.R. 860, 862 (Bankr. N.D. Texas 1997); *In re* County of Orange, 183 B.R. 594, 599 (Bankr. C.D. Cal 1995); *In re* City of Bridgeport, 25 C.B.C.2d 269, 272, 129 B.R. 332, 334 (Bankr. D. Conn. 1991).

[2] *See In re* Town Of Westlake, Texas, 38 C.B.C.2d 1046, 211 B.R. 860 (Bankr. N.D. Texas 1997) (when debtor confronted political dispute over who had authority to sign checks, filing chapter 9 case was not in bad faith but debtor did not meet eligibility requirements).

[3] S. Rep. No. 458, 94th Cong., 2d Sess. 13 (1976) ("The provisions of the chapter [9] should provide ready access to the bankruptcy courts. It is during the first steps of reorganization that

constitutional limitations of the Tenth Amendment.[4] Congress did not include in chapter 9 a requirement that a debtor had to file with its petition a reorganization plan agreed to by at least 51% in amount of its creditors,[5] nor did it require the debtor to engage in prepetition negotiations with respect to a specific plan of adjustment.[6] To broaden access to chapter 9, these requirements, found in chapter 9's predecessor, were intentionally not carried over into chapter 9.[7] The suggestion that the eligibility requirements should be read as "creditor protections" to "require an opportunity to negotiate concerning a plan [to be filed under chapter 9] on a level playing field with the debtor before their rights are further impaired by the provisions of section 362 of the Code,"[8] is at odds with the rehabilitative purposes of chapter 9. Similarly misplaced is the suggestion that constitutional concerns require a limitation on chapter 9 accessibility.[9] The structure of chapter 9 itself sufficiently satisfies constitutional requirements by making chapter 9 voluntary, preserving the state's authority to control a municipality's exercise of political or governmental powers (section 903),[10] and prohibiting the court from interfering with political or governmental powers, property, or revenues of the debtor, or the debtor's use or enjoyment of income-producing property (section 904).[11] Accordingly, it is redundant and illogical to limit application of specific provisions of chapter 9 because of constitutional concerns.

delay could cause the most permanent harm."). *See also In re* City of Bridgeport, 128 B.R. 688, 694 (Bankr. D. Conn. 1991) ("It is noted that generations of decisions have established the place of bankruptcy in federal public policy and have held that in general bankruptcy laws are to be liberally construed and ambiguities are to be resolved in favor of the full measure of relief afforded by Congress.").

[4] *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 73 (Bankr. D.N.H. 1994) *But see In re* Cottonwood Water and Sanitation Dist., 26 C.B.C.2d 1786, 1793, 138 B.R. 973, 974, 979 (Bankr. D. Colo. 1992).

[5] Such a requirement was part of Section 83(a) of the 1937 Municipal Bankruptcy Act. Section 83(a), former 11 U.S.C. § 403(a) (1976).

[6] *See* Bankruptcy Act Section 84(2), former 11 U.S.C. § 404 (1976).

[7] *See* ¶ 900.02 *infra*.

[8] *In re* Cottonwood Water and Sanitation Dist., 26 C.B.C.2d 1786, 1793, 138 B.R. 973, 979 (Bankr. D. Colo. 1992) (interpreting section 109(c)(5)(B) to require prepetition negotiations regarding a plan of adjustment that would be implemented pursuant to section 941).

[9] *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 82 (Bankr. D.N.H. 1994) (suggesting that access to chapter 9 relief is a difficult task).

[10] *See* ch. 903 *infra*.

[11] *See* ch. 904 *infra*.

[3]—Eligibility Requirements for Chapter 9 Relief.

[a]—The Debtor Must Be a "Municipality" to Be Eligible Under Chapter 9.

Only an entity that is a "municipality" is eligible for relief under chapter 9 of the Bankruptcy Code.[12] "Municipality" is defined to mean "political subdivision or public agency or instrumentality of a State."[13] This definition is identical to the language in section 84 of the 1976 municipal bankruptcy legislation.[14] It represented a simplification of the extensive list of kinds of municipalities in section 81 of the 1937 Act, and was intended "to broaden applicability of Chapter IX as much as possible."[15] In fact, section 81 of the 1937 Act did not refer to "political subdivisions" and defined public agencies and instrumentalities collectively, without differentiating between the two.[16] The suggestion that the three categories

[12] 11 U.S.C. § 109(c).

[13] 11 U.S.C. § 101.

[14] Bankruptcy Act § 84, former 11 U.S.C. § 404 (1976); H.R. Rep. No. 686, 94th Cong., 1st Sess. 20 (1975).

[15] *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 73 (Bankr. D.N.H. 1994). *But see In re* Cottonwood Water and Sanitation Dist., 26 C.B.C.2d 1786, 1793, 138 B.R. 973, 974, 979 (Bankr. D. Colo. 1992).

[16] Section 81 of the 1937 Act, as finally amended in 1946, granted jurisdiction to the courts of bankruptcy:

> [F]or the composition of indebtedness of, or authorized by, any of the *agencies or instrumentalities* hereinafter named, payable (a) out of assessments or taxes, or both, levied against and constituting liens upon property in any of said agencies or instrumentalities, or (b) out of property acquired by foreclosure of any such assessments or taxes or both, or (c) out of income derived by such agencies or instrumentalities from any income-producing property, whether or not secured by a lien upon such property: (1) Drainage, drainage and levee, reclamation, water, irrigation, or other similar districts, commonly designated as agricultural improvement districts or local improvement districts, organized or created for the purpose of constructing, improving, maintaining, and operating certain improvements or projects devoted chiefly to the improvement of lands therein for agricultural purposes; or (2) local improvement districts, such as sewer, paving, sanitary, or other similar districts, organized or created for the purposes designated by their respective names; or (3) local improvement districts, such as road, highway, or other similar districts, organized or created for the purpose of grading, paving, or otherwise improving public streets, roads, or highways; or (4) public-school districts or public-school authorities organized or created for the purpose of constructing, maintaining, and operating public schools or public-school facilities; or (5) local improvement districts, such as port, navigation, or other similar districts organized or created for the purpose of constructing, improving, maintaining, and operating ports and port facilities; or (6) incorporated authorities, commissions, or similar public agencies organized for the purpose of constructing, maintaining, and operating revenue-producing enterprises; or (7) any county or parish or any city, town, village, borough, township, or other municipality . . . .

Bankruptcy Act § 81, former 11 U.S.C. § 404 (1976) (emphasis added). Not only did section 81 not differentiate between the "agencies or instrumentalities hereinafter named," but the language used in section 81(6) ["organized for the purpose of constructing, maintaining and operating revenue-producing enterprises"] is strikingly similar to that used in section 81(1)["organized or created for the purpose of constructing, improving, maintaining, and operating certain improvements or projects"], section 81(2)["organized or created for the purposes designated by their respective names"], section 81(3)["organized or created for the purpose of grading, paving, or otherwise improving public streets, roads, or highways"], section 81(4)["organized or created for the purpose of constructing, maintaining, and operating public schools or public-school facilities"], and section 81(5)["organized or created for the purpose of constructing, improving, maintaining, and operating ports and port facilities"].

[17] *See In re* County of Orange, 183 B.R. 594, 600-603 (C.D. Cal. 1995) (arguing that section 81(7) defined political subdivisions, section 81(6) defined public agencies and sections 81(1)-(5) defined instrumentalities).

[18] *See* former Bankruptcy Act § 81(1); *In re* County of Orange, 183 B.R. 594, 601, n.16 (C.D. Cal. 1995).

[19] See *In re* Cottonwood Water and Sanitation Dist., 26 C.B.C.2d 1786, 138 B.R. 973 (Bankr. D. Colo. 1992).

"political subdivision," "public agency" and "instrumentality of a State" should be defined exclusively by the categories of agencies and instrumentalities set forth in section 81 of the 1937 Act[17] is misplaced because the Bankruptcy Code definition of municipality is strikingly dissimilar to the language of section 81 of the 1937 Act; the suggestion fails to give effect to Congress' intention to broaden the definition of "municipality."

[i]—Political Subdivisions.

A political subdivision includes a county, parish, city, town, village, borough, township or other municipality.[18] It does not include the state itself. Accordingly, a state is not an eligible entity.

[ii]—Public Agency or Instrumentality.

A public agency or instrumentality includes, collectively, incorporated authorities, commissions, and the like that are organized for the purpose of constructing, maintaining and operating revenue-producing enterprises. These include entities whose revenues are derived from taxes or assessments or from income-producing property, and all manner of public improvement districts, school districts and revenue-producing bodies that provide services that are paid for by users rather than by general taxes, such as bridge or highway authorities, gas authorities and the like.[19]

[iii]—Instrumentality of a State.

The modifying phrase "of a State" has been read to be limited to an instrumentality of a state, thereby excluding an instrumentality of a municipality.[20] This reading is incorrect.[21] The phrase "of a State" should be read to mean that the political subdivision, public agency or instrumentality must be subject to control by state or municipal authority.[22]

[b]—The Specific Authorization Requirement for Chapter 9 Eligibility.

The Bankruptcy Reform Act of 1994[23] amended section 109(c)(2) to require that a municipality be "specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter."[24] The 1994 Act modified the preexisting law, which required only general

[20] *See In re* County of Orange, 183 B.R. 594, 603 (C.D. Cal. 1995). The bankruptcy court rejected the argument that the Orange County Investment Pool, as an instrumentality of the County of Orange, fell within the meaning of instrumentality of a state on the grounds that the definition of municipality was not drafted in parallel with the definition of governmental unit to specifically include an instrumentality of a municipality, and that including an instrumentality of a municipality within the definition of an instrumentality of a state would raise Constitutional concerns. *Id.* These arguments are misplaced. That Congress could have specifically included instrumentality of a municipality in the definition of municipality does not conclusively mean that Congress specifically intended to exclude an instrumentality of a municipality as an eligible chapter 9 debtor. Congress intended the definition of municipality to be expansive, and the lesser (instrumentality of a municipality) is included within the greater (instrumentality of a state). Further, the suggestion that the Orange County Investment Pool was not an instrumentality of the state is belied by the fact that the "existence" of the Pool depended, as the bankruptcy court recognized, upon enabling state legislation.

[21] *See* ch. 903 *supra*.

[22] *In re* Ellicott Schapter Bldg. Auth., 150 B.R. 261, 264 (Bankr. D. Colo. 1992). *In re* Westport Transit Dist., 30 C.B.C.2d 1786, 1791, 165 B.R. 93, 95 (Bankr. D. Conn. 1994) (Westport Transit District created by the Town of Westport) (*citing In re* Greene County Hosp., 59 B.R. 388, 389 (S.D. Miss. 1986)). *See also In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 73 (Bankr. D.N.H. 1994) (disposal districts formed by member towns and cities pursuant to state law were defined as "body politic and corporate" under applicable state law and thus constituted municipalities within the meaning of section 101(40)).

[23] Pub. L. No. 103-394, 103d Cong., 2d Sess., 108 Stat. 4106 (enacted on October 22, 1994, effective in cases commenced on or after that date) *reprinted in* App. Pt. 9(a) *infra*. *See* ¶ 900.LH[6] *infra*

[24] 11 U.S.C. § 109(c)(2).

authorization.[25] The one court that has addressed section 109(c)(2) concluded that state law must provide express written authority for a municipality to file; the authority must be "exact, plain, and direct with well-defined limits so that nothing is left to inference or implication."[26]

With the passage of the 1994 Act and in light of the *Orange County* decision, states (and governmental officers and organizations with power under state law to so act) are clearly on notice that if a municipality is to have the opportunity to restructure under chapter 9 of the Bankruptcy Code, they must specifically say so in appropriate enabling legislation or action; otherwise, there is a risk that a municipality may not be eligible to be a debtor under chapter 9.[27]

[c]—The Insolvency Requirement for Chapter 9 Eligibility.

To be an eligible chapter 9 debtor, the municipality must be "insolvent."[28] Section 101 of the Bankruptcy Code defines "insolvent" for municipalities:[29]

> "insolvent" means—
>
> * * *
>
> (C) with reference to a municipality, financial condition such that the municipality is—
>
> (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or
>
> (ii) unable to pay its debts as they become due.

This insolvency test is different from a traditional balance sheet or fair value of assets over liabilities test. Under the 1978 Act, however, "insolvency" was defined in the Bankruptcy Code sense of an excess of liabilities

[25] *See* ¶ 900.LH[6] *infra*

[26] *In re* County of Orange, 183 B.R. 594, 604 (C.D. Cal. 1995). The bankruptcy court in *Orange County* concluded that Cal. Gov't Code § 53760, which authorized instrumentalities of the State, as defined in section 81 of the 1937 Act, to file for relief, was not specific authorization for the Orange County Investment Pool to be eligible as a chapter 9 debtor because section 81 of the 1937 Act did not refer to an investment fund

[27] For a listing of states which have passed legislation specifically authorizing a municipality to commence a chapter 9 case see App. Pt. 44 at App. Pt. 44-980 n2431 *infra*.

[28] 11 U.S.C. § 109(c)(3).

[29] Pub. L. No. 100-597, § 1(1988), *reprinted in* App. Pt. 41(g)(ii) *infra*.

over nonexempt assets at fair market value.[30] The use of this concept in chapter 9 was somewhat artificial, since a municipality cannot be liquidated under the Bankruptcy Code with the proceeds being used to pay its creditors.[31] Also, most assets of a municipality are exempt from execution for payment of debts, as a matter either of state constitutional or statutory law or public policy.[32] As a result, nearly all municipalities were "insolvent" under this definition. Congress recognized the anomaly created by using the traditional bankruptcy definition of insolvency in the municipal context when it enacted the 1988 Amendments.

[i]—Insolvency for Chapter 9 Eligibility Purposes Is Determined as of Petition Date.

The determination of insolvency should be made as of the date of the petition.[33] Municipalities need relief under chapter 9 by reason of their inability to raise sufficient revenues through taxes or otherwise to meet their debts as they mature.[34] Under former Chapter IX, a municipality was unable to meet its debts as they mature when it had exercised its taxing authority to the fullest extent permitted by applicable law or by the municipality's economy and was still unable to meet its debts.[35] The latter condition prevails when the imposition of taxes over and above those already imposed has a counterproductive effect of causing more tax defaults and tax foreclosures by reason of the inability of the private

[30] *See* ch. 101 *supra*.

[31] *See* ¶ 900.01[1] *infra*. *But see* Fano v. Newport Heights Irr. Dist., 114 F.2d 563, 565 (9th Cir. 1940) (comparison of assets and liabilities).

[32] S. Rep. No. 100-506, 100th Cong., 2d Sess. 10 (1988), *reprinted in* App. Pt. 41(g)(i) *infra*. *But see In re* City of Wellston, 11 C.B.C. 2d 512, 43 B.R. 348 (Bankr. E.D. Mo. 1984) (municipal debtor sought release of prepetition garnishment of bank account).

[33] *In re* Hamilton Creek Metropolitan Dist., 143 F.3d 1381, 1384 (10th Cir. 1998); *In re* Town of Westlake, Texas, 38 C.B.C.2d 1046, 1050, 211 B.R. 860, 864 (Bankr. N.D. Tex. 1997).

[34] *See* ¶ 900.01[1] *infra*.

[35] Moody v. James Irr. Dist., 114 F.2d 685, 687 (9th Cir. 1940); *In re* Corcoran Irr. Dist., 27 F. Supp. 322, 326-27 (S.D. Cal. 1939), *aff'd sub nom.*, Newhouse v. Corcoran Irr. Dist., 114 F.2d 690 (9th Cir. 1940). It does not matter in determining ability to pay debts whether the municipality's bonds have yet matured. It is sufficient if the municipality is unable to meet current interest payments. Lorber v. Vista Irr. Dist., 127 F.2d 628, 638-39 (9th Cir. 1942). Similarly, the fact that a municipality has partially consummated a plan of adjustment before filing a Chapter IX petition and thereby reduced its obligations by the time the petition is filed "does not have any bearing on the question of insolvency." West Coast Life Ins. v. Merced Irr. Dist., 114 F.2d 654, 677 (9th Cir. 1940). *Cf.* 11 U.S.C. § 946.

property or private activities within the municipality to support the taxes imposed. For example, in an irrigation or drainage district, if farm prices are sufficiently low that the land cannot be farmed profitably and still pay the taxes imposed, the taxes imposed are beyond the maximum that may be economically imposed. This situation frequently occurred during the Great Depression and was the cause of many of the municipal bankruptcies that were filed under the 1937 Act.[36]

Under a more modern view, a municipality need not exercise its taxing or assessment authority to the fullest extent before a court may conclude that it is unable to meet its debts as they mature.[37] The purpose of chapter 9 is to permit debt adjustment. Thus, whenever a municipality is unable to pay its debts, it should have access to the debt adjustment procedure. As one court commented:

> [T]he mere contingency that the District could improve its financial situation by increasing its rates does not alter the fact that at the present time the District cannot meet its debts as they mature.[38]

[ii]—The Chapter 9 Insolvency Standard of Not Generally Paying Debts as They Become Due.

A municipality is insolvent and therefore within this eligibility requirement if it is generally not paying its debts as they become due, unless the debts are the subject of a *bona fide* dispute.[39] Reliance on this portion

[36] *See* ¶ 900.01[1] *infra*.

[37] *See In re* Ellicott Schapter Bldg. Auth., 150 B.R. 261, 265 (Bankr. D. Colo. 1992); *In re* Villages at Castlerock Metro. Dist. No. 4, 145 B.R. 76, 84 (Bankr. D. Colo. 1990). *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 75-76 (Bankr. D.N.H. 1994) (failure to levy a special assessment does not preclude a claim of insolvency); *In re* Pleasant View Util. Dist., 24 B.R. 632, 639 n.6, (Bankr. M.D. Tenn.), *aff'd*., 27 B.R. 552 (M.D. Tenn. 1982). Some courts however, rely upon a debtor's failure to exercise (or consider) tax assessments as a means to solve its financial difficulties as an indicia of bad faith. *See, e.g., In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 76.

[38] *In re* Pleasant View Util. Dist., 24 B.R. 632, 639 n.6, (Bankr. M.D. Tenn.), *aff'd*., 27 B.R. 552 (M.D. Tenn. 1982). This reasoning would not apply equally at plan confirmation, when the fair and equitable rule, if invoked, requires use of the taxation power to the fullest extent. *See* ch. 943 *infra*.

[39] *See In re* Town of Westlake, Texas, 38 C.B.C.2d 1046, 1050, 211 B.R. 860, 864-865 (Bankr. N.D. Tex. 1997) (when debtor was current on 76% of its obligations and was delinquent on 24% due to a "temporary political dispute over authority to sign checks from admittedly ample funds," the debtor was not insolvent by reason of "generally not paying its debts as they become due").

of the definition may obviate the need for litigation over ability to pay, because proof of nonpayment is generally simpler than proof of inability to pay. In most circumstances, proof of nonpayment may amount to proof of inability, for municipalities, invested as they are with the public trust, will generally cease paying only in circumstances in which they are unable to pay or if the debts are in *bona fide* dispute. However, general nonpayment of undisputed amounts may not by itself qualify the municipality as eligible for chapter 9. Similarly, nonpayment of debts which are not yet due does not constitute "not generally paying debts as they come due."[40] For purposes of the "unable to pay" test, qualifying unpaid debt must be "unconditionally owing and presently enforceable."[41] One court has held that debt which accrues, but is only payable if a cash flow availability test is met, is not "due" when the test had not been met and thus the accrued obligation was not payable.[42] If the nonpayment is not in good faith, the case may be dismissed under section 921(c) for failure to meet the requirement that the case be filed in good faith.[43] While nonpayment in bad faith may differ from filing the chapter 9 petition in bad faith, bad faith nonpayment may constitute a strong element of proof of a bad faith filing.

Nonpayment by reason of a dispute will not render a municipality insolvent if the municipality has the ability to pay, because of the exception in the definition. While a similar exception for *bona fide* disputes in section 303(b)(1)[44] protects a commercial debtor from an involuntary petition by a creditor with whom it has the dispute, such an exception in the definition of municipal insolvency has a less important protective effect in chapter 9, since a municipality is not subject to an involuntary petition. The exception should prevent a financially healthy municipality from using a chapter 9 petition to obtain a stay pending appeal of an adverse judgment, since the nonpayment by reason of the dispute will take the nonpayment out of the definition, and the municipality will not be "insolvent" unless it is also unable to pay the debt if the judgment is affirmed. The effect

[40] *In re* Hamilton Creek Metropolitan Dist., 143 F.3d 1381, 1386 (10th Cir. 1998) ("[U]nder a cash flow analysis of insolvency, obligations that are enforceable only if cash flow is available cannot, by definition, render a debtor insolvent.").

[41] *In re* Hamilton Creek Metropolitan Dist., 143 F.3d. 1381, 1385 (10th Cir. 1998).

[42] *In re* Hamilton Creek Metropolitan Dist., 143 F.3d. 1381, 1385 (10th Cir. 1998).

[43] 11 U.S.C. § 921(c). *See* ch. 921 *infra*.

[44] 11 U.S.C. § 303(b)(1). *See* ch. 303 *supra*.

of this provision will be mitigated to the extent that the municipality's assets are exempt from process and the municipality is thereby otherwise able under state law to prevent the payment of the judgment until appeals are exhausted.

[iii]—The Chapter 9 Insolvency Standard of Being Unable to Pay Debts as They Become Due.

The "unable to pay" test is in addition to the "generally not paying" test discussed above. A municipality may actually be paying its debts generally as they mature at the petition date yet still be unable to pay in the future. Thus, the "unable to pay" test "requires a prospective analysis."[45] Otherwise, the two tests would be redundant. However, the application of the unable to pay test should not look too far into the future. One court has held that the test should be applied only to the municipality's "current fiscal year or, based on an adopted budget, in its next fiscal year."[46] The court also concluded that the evaluation "should be judged by a cash flow, not a budget deficiency, analysis," on the ground that it was cash, not budgeted amounts, that is used to pay debts as they mature.[47] The mere fact that a municipality has adopted a budget that reflects a cash flow shortfall is not independently sufficient to meet the requirement of the "unable to pay" test. An adopted budget must be evaluated in light of past and current practices, the practices of similar municipalities, and the extant facts and circumstances. The obligations with respect to which there is a projected shortfall must be inescapably due and the prospect that they will not be paid must be certain, not a mere possibility or a speculative probability.[48] A municipality cannot deliberately budget or spend itself into insolvency when other scenarios are possible.[49]

[45] *In re* Hamilton Creek Metropolitan Dist., 143 F.3d. 1381, 1384 (10th Cir. 1998). *In re* City of Bridgeport, 25 C.B.C.2d 269, 277, 129 B.R. 332, 336 (Bankr. D. Conn. 1991).

[46] *Id.*, 129 B.R. 332, 338.

[47] *Id.* 129 B.R. 332, 337.

[48] *In re* Town of Westlake, Texas, 38 C.B.C.2d 1046, 1052, 211 B.R. 860, 866 (Bankr. N.D. Tex. 1997).

[49] *In re* Town of Westlake, Texas, 38 C.B.C.2d 1046, 1053, 211 B.R. 860, 867 (Bankr. N.D. Tex. 1997). However, the possibility that taxes can be assessed to pay municipal debts does not preclude a finding of insolvency. *In re* Ellicott Schapter Bldg. Auth., 150 B.R. 261, 265 (Bankr. D. Colo. 1992); *In re* City of Columbia Falls, Montana, Special Improvement Dist. Nos. 25, 26 and 28, 1991 Bankr. LEXIS 905 (Bankr. D. Mont. 1991).

[d]—The "Desire to Effect a Plan" Requirement for Chapter 9 Eligibility.

A municipality must "desire to effect a plan to adjust such debts."[50] This language was also found in the 1937 Act[51] and the 1976 Act.[52] It is an element of the "good faith" requirement of section 921(c).[53] It simply requires that the purpose of the filing of the chapter 9 petition not simply be to buy time or to evade creditors. The chapter 9 petition must be designed to result in a plan of adjustment of debts by which creditors' claims will be satisfied or discharged. One court has concluded that the adjustment of debts requires that the debts be impaired or modified;[54] this conclusion is at odds with section 1124 which is incorporated into chapter 9 by section 901. Another court has concluded that this requirement was satisfied by a postfiling submission of a proposed plan of adjustment because it demonstrated a postfiling desire to effectuate a plan of adjustment.[55] This same court also concluded that the debtor's prefiling conduct in refusing to propose a plan of adjustment that could be implemented in chapter 9 and in failing to resort to tax assessment powers evidenced a lack of good faith such that the debtor did not meet the requirements of sections 109(c)(5)(B) or 921(c).[56] The desire to effectuate a plan of adjustment does not necessarily mean that the municipality must yield to creditor pressures.[57]

[e]—The Creditor Negotiation Requirement for Chapter 9 Eligibility.

The final requirement was inserted by Congress to prevent the capricious filing of a chapter 9 petition.[58] It supplements and reinforces the last

[50] 11 U.S.C. § 109(c)(4).

[51] Bankruptcy Act § 83(a), former 11 U.S.C. § 403(a).

[52] Bankruptcy Act § 84, former 11 U.S.C. § 404.

[53] 11 U.S.C. § 921(c).

[54] *See In re* Town of Westlake, Texas, 38 C.B.C.2d 1046, 1053,-54, 211 B.R. 860, 867 (Bankr. N.D. Tex. 1997).

[55] *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 76 (Bankr. D.N.H. 1994).

[56] *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 76-82 (Bankr. D.N.H. 1994).

[57] *In re* Ellicott Schapter Bldg. Auth., 150 B.R. 261, 265 (Bankr. D. Colo. 1992).

[58] *See In re* Town of Westlake, Texas, 38 C.B.C.2d 1046, 1054, 211 B.R. 860, 867-68 (Bankr. N.D. Tex. 1997) (suggesting that section 109(c)(5) requires that a municipality have an intent to negotiate with creditors and not leave them unimpaired).

mentioned requirement that the debtor "desire to effect a plan to adjust [its] debts." It is derived almost verbatim from the 1976 legislation,[59] but represents a departure from the 1937 Act. Under the 1937 Act, a municipality was required to present to the court a reorganization plan that had been agreed to by at least 51% in amount of its creditors.[60] in keeping with the limited purpose of Chapter IX, which contemplated no court interference in the affairs of the municipality, but only court approval or disapproval of the petition and the plan.[61] As early as 1973, the requirement that an accepted plan be filed with the petition was recognized as anachronistic and unsuitable.[62] House and Senate versions of the 1976 legislation both attempted to do away with this requirement entirely.[63] The 1976 amendment was made necessary by the 1975 financial crisis that affected New York and other large cities. It was immediately recognized that the then current Chapter IX would not allow its use because of the impossibility of such a city to meet the plan acceptance requirement. Thus, the 1976 amendment eased the filing requirements to permit the Chapter's use by a sizeable city.[64] However, the skittishness of the municipal bond community about a municipal bankruptcy law with "virtually limitless" access[65] resulted in a compromise, maintaining the prior consent requirement but also recognizing that in certain situations such a procedure was impracticable or could seriously harm the municipality while it was attempting to obtain the necessary consents. The resistance against free access to chapter 9 was reminiscent of the opposition of the bond community to the original Municipal Bankruptcy Act in 1934.[66] It failed to recognize, however, what became of that opposition by 1946,[67] and shortsightedly imposed a cumbersome and unnecessary procedure on distressed municipalities.

[59] Bankruptcy Act § 84, former 11 U.S.C. § 404.

[60] Bankruptcy Act § 83(a), former 11 U.S.C. § 403(a).

[61] *See* ¶ 900.LH *infra*.

[62] 1 Commission on the Bankruptcy Laws of the United States, Report, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. 274 (1973), *reprinted in* App. Pt. 4(c) *infra*.

[63] H.R. Rep. No. 9686, 94th Cong., 1st Sess. 6-7 (1975); H.R. Rep. No. 438, 94th Cong., 2d Sess. 3 (1976) (Conference Report).

[64] *See* ¶ 109.04[3][e][iii] *infra*.

[65] H.R. Rep. No. 686, 94th Cong., 1st Sess. 6-7 (1975); H.R. Rep. No. 938, 94th Cong., 2d Sess. 3 (1976) (Conference Report).

[66] *See* ¶ 900.LH *infra*.

[67] *See* ¶ 900.LH *infra*.

The compromise provides four virtually meaningless alternatives.

[i]—Alternative # 1: Agreement of Creditors Obtained.

The first alternative is that the debtor "obtained the agreement of creditors holding at least a majority in amount of the claims of each class, that [the debtor] intends to impair under a plan in a case under [chapter 9]."[68] This requirement is the same as that contained in the 1937 Act,[69] with the exception of the use of the word "impair," which is a concept new to the Bankruptcy Code.[70] Under the former Bankruptcy Act, the word used was "affected," which had a similar purpose.

[ii]—Alternative # 2: Negotiated in Good Faith but Failed to Obtain Consent of Creditors.

The second alternative is that the debtor "has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that [the debtor] intends to impair."[71] This provision was inserted in recognition of the possibility that the debtor could not obtain the consents it needed by reason of recalcitrance among creditors, but could still confirm a plan of reorganization under chapter 9 by use of the cram down power.[72] This provision has been interpreted to require that a comprehensive, but not formal, workout plan that can be implemented in chapter 9 must be presented to creditors.[73] This is an overly restrictive view of the requirement of section 109(c)(5)(B) which, in contrast to its predecessor provision under the 1976

[68] 11 U.S.C. § 109(c)(5)(A). *See* New Smyrna-DeLand Drainage Dist. v. Thomas, 234 F.2d 338 (5th Cir. 1956). In that case, the district court dismissed the petition for defects in the plan, but granted leave to amend. The debtor filed an "amended plan," but relied on prior consents to the original plan, arguing that the new plan was more favorable to creditors. The court of appeals upheld dismissal of the amended plan and petition on the grounds that the plan was a new plan, not a modification of the original plan, and that the prior consents to one plan could not be counted toward the new plan.

[69] Bankruptcy Act § 83(a), former 11 U.S.C. § 403(a).

[70] *See* ch. 1124 *infra*.

[71] 11 U.S.C. § 109(c)(5)(B).

[72] 11 U.S.C. § 1129(b). *See* chs. 943 and 1129 *infra*.

[73] *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 78 (Bankr. D.N.H. 1994).

Act, does not make reference to negotiations with respect to any specific plan of adjustment.[74]

Just how yielding a debtor must be in its prepetition negotiations will be subject to judicial review based upon the specific facts.[75]

[iii]—Alternative # 3: Negotiations Are Impracticable.

The third alternative is that the municipality "is unable to negotiate with creditors because such negotiation is impracticable."[76] This alternative was inserted in the 1976 Act as a means of dealing with the difficult problems created by major municipalities, such as New York City, whose bonds are exceedingly numerous and are frequently in bearer form: Under these circumstances, negotiation is difficult at best, because of the extreme difficulty in identifying the creditors with whom the municipality must negotiate. Even if the creditors were identified and a committee were formed for purposes of negotiation, obtaining the requisite consent from such a large body in a relatively short period of time could impossible.[77] Further, where it is necessary to file chapter 9 to preserve the assets of a municipality, delaying the filing to negotiate with creditors and risking, in the process, the assets of the municipality makes such negotiations impracticable.[78]

[74] *Compare* Bankruptcy Act Section 84(2), former 11 U.S.C. § 404 (1976) (requiring that prepetition negotiations be with respect to a plan of adjustment) *with* section 109(c)(5)(B) (no reference to negotiations being held with respect to a plan of adjustment).

[75] *Compare In re* Sullivan County Regional Refuse Disposal Dist.,165 B.R. 60, 76-79 (Bankr. D.N.H. 1994) (debtor never set forth a comprehensive workout plan dealing with all of its assets and liabilities in terms comparable to a plan of adjustment, ignored unambiguous contract rights of creditors and failed to exercise tax assessment powers) *with In re* Ellicott Schapter Bldg. Auth., 150 B.R. 261, 266 (Bankr. D. Colo. 1992) (debtor did not negotiate in good faith where it indicated that the economic terms of its proposed plan were nonnegotiable); *and In re* Villages At Castle Rock Metro. Dist. No. 4, 145 B.R. 76, 84-86 (Bankr. D. Colo. 1990) (debtor's meetings with institutional bondholders to develop a financial model and to reach a conceptual agreement held to be sufficient). *See also In re* Cottonwood Water and Sanitation Dist., 26 C.B.C.2d 1786, 1793, 138 B.R. 973, 979 (Bankr. D. Colo. 1992) (requiring an evidentiary hearing on the scope of prepetition negotiations).

[76] 11 U.S.C. § 109(c)(5)(C).

[77] *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 79 n.54 (Bankr. D.N.H. 1994) (section 109(c)(5)(C) is "intended to cover situations in which a very large body of creditors would render prefiling negotiations impractical") (citing *Treatise*).

[78] *In re* Orange County, 183 B.R. 594, 608 (C.D. Cal. 1995) ("The OCIP had no time to enter into negotiations with its participants before acting to protect its portfolio assets.")

[iv]—Alternative # 4: Preventing Creditors from Obtaining Preferences.

The fourth alternative is that the debtor "reasonably believes that a editor may attempt to obtain a preference."[79] This provision is derived om the second paragraph of Section 83(c) of the 1937 Act, which ermitted the debtor to obtain from the bankruptcy court a stay against ggressive creditor action while it was attempting to negotiate a plan of ljustment. Rather than requiring a municipality to seek stays piecemeal , did the 1937 Act, chapter 9 of the Code permits the municipality to le its petition and obtain the benefits of the Code's automatic stay[80] while negotiates its plan with creditors, when aggressive creditor action may sult in a preferential payment, which by its nature is unfair to other editors. One court has suggested, without analysis, that a debtor cannot asonably believe that a justifiable prebankruptcy termination of an xecutory contract constitutes an avoidable transfer under section 547.[81] ut perhaps, under certain circumstances, a termination of an executory ontract can constitute a transfer that is potentially avoidable under section 47.[82]

¶ 109.05. Who May Be a Debtor Under Chapter 11.

The criteria for eligibility for relief under the provisions of chapter 11 re set forth in section 109(d), which provides that "[o]nly a person that ay be a debtor under chapter 7 of this title, except a stockbroker or a ommodity broker, and a railroad may be a debtor under chapter 11 of his title." As under chapter 7, entities that do not qualify as "persons" nder section 101 are not eligible to be chapter 11 debtors.[1] However,

[79] 11 U.S.C. § 109(c)(5)(D).

[80] 11 U.S.C. §§ 362, 922; chs. 362 and 922 *infra*.

[81] *In re* Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 76 n.50 (Bankr. D.N.H. 1994) (*relying on In re* Jermoo's Inc., 38 B.R. 197, 203-04 (Bankr. W.D. Wis. 1984)) (noting hat it would be surprising to read transfer to include a justifiable prebankruptcy termination of n executory contract).

[82] *See* 11 U.S.C. § 101(54) (broad definition of transfer; a property interest of the debtor would ave to be found).

¶ 109.05.

[1] *See* ¶ 109.03 *supra* for a discussion of the eligibility requirements under chapter 7. *In re* Constiutional Trust #2-562, 23 C.B.C.2d 1577, 114 B.R. 627 (Bankr. D. Minn. 1990) (trusts that have s their principal purpose the preservation of property held for the benefit of beneficiaries are not

a decision of the Court of Appeals for the Second Circuit suggests that, notwithstanding the common definition, the analysis may be different in chapter 11 than in chapter 7 because state law may permit an entity in dissolution proceedings to liquidate but not to reorganize.[2]

[1]—Individual Not Engaged in Business May Be Chapter 11 Debtor.

The Supreme Court in *Toibb v. Radloff*,[3] relying on the "plain language" of section 109, held that an individual debtor not engaged in business could reorganize under chapter 11. In holding that the Code contains no ongoing business requirement for reorganization under chapter 11, the Court resolved a split of authority between the Eighth and Eleventh Circuits.[4] While most debtors commencing cases under chapter 11 are corporations,[5] individuals[6] and partnerships may also become debtors under chapter 11. A joint chapter 11 case may be filed, but only by a husband and wife.[7] The most common use of chapter 11 by individuals not engaged in business is by those who wish to reorganize but whose debts exceed the chapter 13 debt limits of section 109(e).[8]

[2]—Stockbroker or Commodity Broker May Not Be Chapter 11 Debtor.

Stockbrokers and commodity brokers may only be liquidated under subchapters III and IV, respectively, of chapter 7.[9] Those subchapters are

recognized as business trusts and, therefore, cannot use that statutory category to become eligible as a chapter 11 debtor).

[2] *In re* C-TC 9th Ave. Partnership, 113 F.3d 1304, 38 C.B.C.2d 115 (2d Cir. 1997) (New York partnership in dissolution not eligible to be debtor in chapter 11 because it was not permitted to have ongoing business under state law).

[3] 501 U.S. 157, 111 S. Ct. 2197, 115 L. Ed. 2d 145, 24 C.B.C.2d 1179 (1991).

[4] *In re* Toibb, 902 F.2d 14, 15 C.B.C.2d 1043 (8th Cir. 1990); Wamsganz v. Boatmen's Bank of DeSoto, 804 F.2d 503, 13 C.B.C.2d 910 (8th Cir. 1986); *In re* Moog, 774 F.2d 1073 (11th Cir. 1985).

[5] For a discussion of debtor eligibility for a dissolved corporation, *see* ¶ 109.02[1][a] *supra*.

[6] Toibb v. Radloff, 501 U.S. 157, 111 S. Ct. 2197, 115 L. Ed. 2d 145, 24 C.B.C.2d 1179 (1991).

[7] 11 U.S.C. § 302. *See In re* Funneman, 29 C.B.C.2d 52, 155 B.R. 197 (Bankr. S.D. Ill. 1993) (although a partnership may be a debtor in bankruptcy in its own right, it may not jointly seek relief with any other person, including a partner); ch. 302, *infra*.

[8] *See* ¶ 109.06[2] *infra*.

[9] *See In re* Co Petro Mktg. Group, 680 F.2d 566, 7 C.B.C.2d 128 (9th Cir. 1982) (discussing definition of "commodity broker"); chs. 741 *et seq.*, *infra*.