

**ALASKA LEGISLATURE COMMITTEE FILES 1999-2000**

**9860 HOUSE JUDICIARY**

87

**HB**

**221**

## HB 221

• split

Sec 1 old Bill  $\Rightarrow$  new compromise  
on notification  
 $\rightarrow$  talk to Shechtel / Manly

Sec 2  $\Rightarrow$  notification

Sec 3  $\Rightarrow$  see 4 of old modification/revocation  
of irrevocable trusts

13.36.370 - removed.

Sec 5  $\Rightarrow$  spendthrift trust language  
has been taken out.

RAR

Dana Olson  $\rightarrow$  DNR's reasons easements  
saying they work together  
she'll lose other property

# Alaska State Legislature



## House of Representatives House Judiciary Committee

### Talking Points HB 221

- This legislation seeks to amend two areas of the Alaska Trust Act.
- The first area HB 221 addresses is a trustee's duty to inform and account to beneficiaries. The current law does not specify which beneficiaries must be notified with respect to income or principle he/she may be entitled to receive.
- Some trusts name as many as a dozen discretionary beneficiaries that a trustee may have to notify on account of the statute's vague language. HB 221 would clarify that the trustee only has to notify a beneficiary who is entitled to mandatory distribution of income or principal. This mandatory beneficiary will be referred to as a "current beneficiary" throughout the statute.
- The second area HB 221 addresses is the modification or termination of an irrevocable trust.
- Both revocable and irrevocable trusts are frequently used for estate planning purposes. Trusts are often made irrevocable to obtain certain tax advantageous tax treatment or to ensure that the settlor's purpose is achieved. Irrevocable trusts are currently prohibited from modification or termination under Alaska law.
- Accordingly, when circumstance arise under which a modification or termination of an irrevocable trust would be prudent, the movant is required to take the matter to court and face unpredictable results.
- HB 221 would amend Alaska law to permit irrevocable trusts to be amended or terminated by a trustee, settlor, or beneficiary unless the trust is expressly made irrevocable.
- The proposed legislation follows a statutory pattern that has been adopted by the drafters of the Uniform Trust Act. Comments to Section 3-102 of the Uniform Trust Act provide: Revocation or Modification of Revocable Trust. Subsection (a) of this section, following the lead of California, Montana, and Texas, provides that a trust is revocable unless the terms of the trust provide

# Alaska State Legislature



## House of Representatives

### House Judiciary Committee

otherwise. The common law rule and the law of the other states is the opposite, that is, a trust is irrevocable absent contrary intent. At least one member of the drafting committee is of the view that the Act should follow the common law rule.

## HOUSE BILL NO. 221

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FIRST LEGISLATURE - FIRST SESSION

BY THE HOUSE JUDICIARY COMMITTEE BY REQUEST

Introduced: 5/4/99

Referred: Judiciary

## A BILL

## FOR AN ACT ENTITLED

1 "An Act relating to a trustee's duties to inform and account to beneficiaries;  
 2 relating to the revocation, modification, termination, reformation, construction, and  
 3 trustees of trusts; and relating to transfer restrictions in trusts."

4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

5 \* Section 1. AS 13.16.595(a) is amended to read:

6 (a) Before distributing to a trustee, the personal representative may require that  
 7 the trust be registered if the state in which it is to be administered provides for  
 8 registration and that the trustee inform the current beneficiaries as provided in  
 9 AS 13.36.080.

10 \* Sec. 2. AS 13.36.080 is amended to read:

11 Sec. 13.36.080. **Duty to inform and account to current beneficiaries.** The  
 12 trustee shall keep the current beneficiaries of the trust reasonably informed of the trust  
 13 and its administration. In addition, [:]

14 (1) within 30 days after acceptance of the trust, the trustee shall inform

1 in writing the current beneficiaries and, if possible, one or more persons who under  
2 AS 13.06.120 may represent current beneficiaries [WITH FUTURE INTERESTS], of  
3 the court in which the trust is registered and of the trustee's name and address;

4 (2) upon reasonable request, the trustee shall provide the current  
5 beneficiary with a copy of the terms of the trust that [WHICH] describe or affect the  
6 beneficiary's interest and with relevant information about the assets of the trust and the  
7 particulars relating to the administration;

8 (3) upon reasonable request, a current beneficiary is entitled to a  
9 statement of the accounts of the trust annually and on termination of the trust or  
10 change of the trustee.

11 \* **Sec. 3.** AS 13.36.080 is amended by adding new subsections to read:

12 (b) The trust agreement may modify the trustee's duties under this section and  
13 may prohibit the trustee from providing any notification or information to a current  
14 beneficiary regarding the trust unless that beneficiary receives a distribution from the  
15 trust, and then the notification or information may be limited to the accounting period  
16 during which the distribution was made.

*Why?*

17 (c) In this section, "current beneficiary" means a beneficiary who is entitled  
18 to a mandatory distribution of income or principal from the trust on an annual or more  
19 frequent basis.

20 \* **Sec. 4.** AS 13.36 is amended by adding new sections to read:

21 **Sec. 13.36.335. Presumption of revocability.** (a) Unless a trust is expressly  
22 made irrevocable, a trust executed on or after the effective date of this Act is revocable  
23 by the settlor.

revocability

24 (b) Notwithstanding AS 13.36.035 - 13.36.050, this section applies only if the  
25 settlor is domiciled in this state when the trust is created, the trust instrument is  
26 executed in this state, or the trust provides that the law of this state governs the trust.

27 **Sec. 13.36.340. Modification and revocation of revocable trusts.** (a) A  
28 trust that is revocable by the settlor may be modified or revoked in whole or in part  
29 by

30 (1) substantial compliance with a method of modification or revocation  
31 provided in the trust instrument; or

1 (2) a writing, other than a will, signed by the settlor and delivered to  
 2 the trustee during the lifetime of the settlor, except that, if the trust instrument  
 3 expressly makes the method of revocation provided in the trust instrument the  
 4 exclusive method of revocation, the trust may not be revoked under this paragraph.

5 (b) Unless otherwise provided in the trust instrument, if a trust that is  
 6 revocable by the settlor is created or funded by more than one settlor,

7 (1) the trust may be modified or revoked as provided in AS 34.77.100  
 8 to the extent the trust consists of community property under AS 34.77 (Alaska  
 9 Community Property Act);

10 (2) each settlor may modify or revoke the trust as to the portion of the  
 11 trust property contributed by that settlor that is not community property under  
 12 AS 34.77.

13 (c) A revocable trust may not be modified or revoked by an attorney-in-fact  
 14 under a power of attorney unless the modification or revocation is expressly permitted  
 15 by the trust instrument.

16 **Sec. 13.36.345. Modification or termination of irrevocable trusts because**  
 17 **of unanticipated circumstances.** (a) On petition by a trustee, settlor, or beneficiary,  
 18 a court may modify the administrative or dispositive terms of an irrevocable trust or  
 19 terminate an irrevocable trust if, because of circumstances not anticipated by the  
 20 settlor, modification or termination would substantially further the settlor's purposes  
 21 in creating the trust.

22 (b) Upon termination of a trust under this section, the trust property shall be  
 23 distributed in accordance with the settlor's probable intention.

24 **Sec. 13.36.350. Reformation to correct mistakes in irrevocable trusts.** (a)  
 25 On petition by a trustee, settlor, or beneficiary, a court may reform the terms of an  
 26 irrevocable trust, even if the trust instrument is not ambiguous, to conform to the  
 27 settlor's intention if the failure to conform was due to a mistake of fact or law,  
 28 whether in expression in the trust or inducement to create the trust, and if the settlor's  
 29 intent can be established by clear and convincing evidence.

30 (b) A court may consider evidence, including direct evidence contradicting the  
 31 plain meaning of the text, when determining the settlor's intent or for any other

1 purpose under this section.

2 **Sec. 13.36.355. Construction of trust to achieve settlor's tax objectives. (a)**

3 The terms of a trust shall be construed to achieve the settlor's tax objectives.

4 (b) On petition by a trustee, settlor, or beneficiary, a court may modify the  
5 terms of an irrevocable trust to achieve the settlor's tax objectives in a manner that  
6 does not violate the settlor's probable intent. The court may order that the  
7 modification operate retroactively.

8 **Sec. 13.36.360. Modification or termination of irrevocable trust by consent.**

9 (a) Except as otherwise provided by this section, on petition by a trustee, settlor, or  
10 beneficiary, a court may modify or terminate an irrevocable trust if all of the  
11 beneficiaries consent and if continuation of the trust on the existing terms of the trust  
12 is not necessary to further a material purpose of the trust. The inclusion of a  
13 restriction on the voluntary or involuntary transfer of trust interests under  
14 AS 34.40.110 may constitute a material purpose of the trust under this subsection, but  
15 is not presumed to constitute a material purpose of the trust under this subsection.

16 (b) Unless otherwise provided in the trust instrument, an irrevocable trust may  
17 not be modified or terminated under this section while a settlor is also a discretionary  
18 beneficiary of the trust.

19 (c) If a beneficiary other than a qualified beneficiary does not consent to a  
20 modification or termination of an irrevocable trust that is proposed by the trustee,  
21 settlor, or other beneficiaries, a court may approve the proposed modification or  
22 termination if the court determines

23 (1) if all the beneficiaries had consented, the trust could have been  
24 modified or terminated under this section; and

25 (2) the rights of a beneficiary who does not consent will be adequately  
26 protected or not significantly impaired.

27 (d) In (c) of this section, "qualified beneficiary" means a beneficiary who

28 (1) on the date the beneficiary's qualification is determined, is entitled  
29 or eligible to receive a distribution of trust income or principal; or

30 (2) would be entitled to receive a distribution of trust income or  
31 principal if the event causing the trust's termination occurs.

1           **Sec. 13.36.365. Uneconomical irrevocable trust.** (a) Notwithstanding the  
 2 other provisions of AS 13.36.335 - 13.36.370, if the value of the property of an  
 3 irrevocable trust is less than \$50,000, the trustee may terminate the trust unless the  
 4 trust instrument provides otherwise.

5           (b) Notwithstanding the other provisions of AS 13.36.335 - 13.36.370 and the  
 6 terms of the trust, on petition to the superior court by a trustee, settlor, or beneficiary,  
 7 the court may modify or terminate an irrevocable noncharitable trust, or remove the  
 8 trustee and appoint a different trustee, if the court determines that the value of the trust  
 9 property is insufficient to justify the cost of administration.

10           (c) Upon termination of a trust under this section, the trustee shall distribute  
 11 the trust property in accordance with the settlor's probable intent.

12           **Sec. 13.36.370. Exclusive procedure.** Unless otherwise provided in the trust  
 13 instrument, except as provided by AS 13.12.212(c), 13.12.803, 13.12.804, 13.12.907,  
 14 AS 13.33.205, AS 13.36.130, and AS 13.60.010, AS 13.36.335 - 13.36.365 provide the  
 15 exclusive procedures for modifying, terminating, or revoking trusts.

16 \* **Sec. 5.** AS 34.40.110 is amended by adding a new subsection to read:

17           (g) If a trust contains a transfer restriction allowed under (a) and effective  
 18 under (b) of this section, a beneficiary may not transfer an interest in the trust, and a  
 19 creditor or assignee of a beneficiary may not attach an interest in or a distribution from  
 20 the trust by the trustee before receipt of the interest or distribution by the beneficiary.  
 21 In this subsection, "receipt of the interest or distribution by the beneficiary" does not  
 22 include

23                   (1) direct payment of a beneficiary's health, medical, or educational  
 24 expenses to the provider of the health, medical, or educational goods or services;

25                   (2) the use or occupancy of property owned by the trust; or

26                   (3) expenditures made for the maintenance or preservation of property  
 27 owned by the trust.

28 \* **Sec. 6. APPLICABILITY.** AS 34.40.110(g), added by sec. 5 of this Act, applies to trusts  
 29 regardless of whether the trusts were created before, on, or after the effective date of this Act.

SB 163 - Analyze concerns w/ notification  
Have Shattel → notification - compromise notice is provided

## SPONSOR STATEMENT

### HB 221

"An act relating to a Trustee's duties to inform and account to beneficiaries; relating to the revocation, modification, termination, reformation, construction, and trustees of trusts; and providing for an effective date."

This legislation defines a current beneficiary as a person who receives a mandatory distribution of income or principal from a trust. Current law does not ~~not~~ who is a current beneficiary. Some trusts name as many as dozens of discretionary beneficiaries who may not be entitled to receive any income or principal for years. Under current law the trustees of such trusts do not know whether they have to notify these discretionary beneficiaries. The new legislation would clarify that the trustee only has to notify a beneficiary who is entitled to a mandatory distribution of income or principal from the trust.

Policy  
administrative  
costs

Both revocable and irrevocable trusts are frequently used for estate planning purposes. Trusts are often made irrevocable in order to obtain certain advantageous tax treatment and to ensure obtainment of the settlor's purposes. However, changed circumstances or errors involved in the formation of the trust may require modification or termination of a trust. For example, modification or termination of an irrevocable trust may be desirable for one or more of the following reasons.

- To make a distribution to a beneficiary which is not clearly within the "health, support, maintenance or education" standard otherwise required by the trust;
- To be able to hold "S" corporation stock in the trust;
- To divide one trust into two trusts, one of which is exempt and one of which is non-exempt from the Federal Generation-Skipping Transfer Tax;
- To authorize the trustees to engage in transactions not authorized by the existing trust agreement;
- To authorize an individual trustee in a trust that presently requires a corporate trustee;
- To divide one trust with multiple beneficiaries into two or more trusts because the beneficiaries wish to pursue separate investment policies;
- To try to achieve a Federal Gift or Estate Tax goal;
- To make changes to restrictions on the disposition of property in light of the maturity of children beneficiaries;
- To accommodate new, unanticipated beneficiaries;
- To consolidate several trusts which are for the benefit of a single beneficiary;
- To terminate a trust which is no longer economical to continue.

Alaska does not presently have statutes which allow for the modification or termination of trusts. Therefore, whenever such modification or termination is desired, the individuals involved and the court hearing the matter, have to rely upon general trust principles. If there is opposition to the modification or termination, then the results become unpredictable.

The proposed legislation follows the statutory pattern which has been adopted and in place in California for a number of years and recently adopted in South Dakota. It is also consistent with the pattern of the Uniform Trust Act. The legislation adopts methods for modifying and terminating irrevocable trusts, and procedures which are fair to all parties involved.

# FISCAL NOTE

**STATE OF ALASKA  
2000 LEGISLATIVE SESSION**

**BILL NO. HB 221**

Revision Date/Time (Note if correction) 1/13/00, 8:25 AM Dept. Affected Law  
 Title "... relating to a trustee's duties to inform and BRU Civil Division  
account to beneficiaries; ... revocation, modification ... of trusts ... Component Commercial  
 Sponsor House Judiciary Committee by Request  
 Requester House Judiciary Committee Component Serial No. 2211

**Expenditures/Revenues (Thousands of Dollars)**

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
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<b>CHANGE IN REVENUES ( )</b>						
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**FUND SOURCE (Thousands of Dollars)**

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2000) cost: \_\_\_\_\_

**POSITIONS**

Full-time						
Part-time						
Temporary						

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

HB 221 requires a trustee to give current beneficiaries notice of the registration of a trust and to keep the beneficiaries informed about its administration. Under this bill, trusts are presumed revocable unless expressly made irrevocable. It further defines how trusts can be revoked, whether they are revocable or not, modified and reformed to correct mistakes not intended by the person creating the trust.

This bill will have no fiscal impact on the Department of Law.

Prepared by: Joan M. Kasson *Joan M. Kasson*  
 Division Attorney General's Office  
 Approved by Commissioner *Rodger* Bruce M. Botelho, Attorney General  
 Agency Department of Law

Phone 465-5370  
 Date/Time 1/13/00, 8:25 AM  
 Date 1/13/00

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**HB**

**222**

# Alaska State Legislature



## House of Representatives House Judiciary Committee

### SPONSOR STATEMENT HB 222

#### **Explanation of Proposed Amendments to Alaska Revised Limited Partnership Act and Alaska Revised Limited Liability Act**

Limited partnerships and limited liability companies are often used for closely-held businesses or investment activities. They are frequently used by families. One of the key advantages of these business entities is that the partners or members can choose who will be their business associates, and can be secure that the venture will continue until an agreed time or event.

If a creditor obtains a judgement against a partner or member, the statutes provide that the creditor can obtain a "charging order" against the debtor's partnership or limited liability company interest. This allows the creditor to receive the distributions to which the partner or member would be entitled.

On its face, these statutes do not expressly allow for any other creditor remedies. This is consistent with the concept that the other partners of a partnership or members of a limited liability company should not have their business or investment actively disrupted, nor should they be forced to take in a substitute partner or member (e.g., the judgement creditor). This was the generally understood position taken by the Uniform Limited Partnership Act and many limited liability acts.

However, recently a Connecticut court held that a judgement creditor of a limited partnership could foreclose on the partnership interest. This holding was in conflict with a prior Florida court decision which held that foreclosure was not an available remedy for a judgement creditor of a limited partner. Such foreclosure would allow the judgement creditor to become a partner of the limited partnership, or a member of the limited liability company. Depending on the provisions of the partnership agreement or operating agreement, this could result in a forced dissolution of the entity and sale of its assets. Such a result could be very harmful to the other partners or members.

The proposed amendments make it clear that a judgement creditor of an Alaska limited partnership or limited liability company has only the remedy of a charging order. Thus, the

# Alaska State Legislature



## House of Representatives

### House Judiciary Committee

creditor will receive all distributions made to the debtor or debtor partner or member. However, the right to receive such distribution is the judgement creditor's only remedy. No other remedies are available to the judgement creditor or to a court implementing a creditor's collection request.

The Alaska Revised Limited Partnership Act is amended by changes to AS 32.11.170, .340, and .890. The Alaska Revised Limited Liability Act is amended by changes to AS 10.50.380. This amendment will be effective immediately.

**HB**

**225**

## Sponsor Statement for House Bill 225

Section 1 of House Bill 225 is crafted to address an issue raised by the Supreme Court's recent decision regarding campaign contributions in *State v. AkCLU*. The legislature had the foresight to provide sec. 12, ch. 48, SLA 1996 to become law in the event of a court's invalidation of the fund raising limitations established in AS 15.13.074 (c). However, in 1998, Senate Bill 105 amended the now invalid portion of AS 15.13.074 (c) and neglected to similarly amend the session law which would take effect in the case of a court ruling the law unconstitutional. Thus, when the *State v. AkCLU* decision becomes final, sec. 12, ch. 48, SLA will self-execute and have the effect of repealing a portion of the legislature's actions last year in SB 105. HB 225 redresses this unintended consequence.

Section 2 of HB 225 further clarifies the relationship between subsections (2) and (5)(A) and subsections (2) and (5) (B-E) of AS 24.60.030(a). Furthermore HB 225 seeks to more clearly define the lines of acceptable conduct by legislators and legislative employees. It specifically addresses gray areas regarding use of the legislators' personal office space, greeting card preparation, Internet use, personal equipment used for state purposes and gifts from non-partisan charities. I believe that it is better to openly state our exact intent with regards to these troublesome gray areas so that legislators and staff can work with certainty and confidence. Current law leaves these questions hanging and leads to nebulous interpretations which invite suspicion on us all.

Sections 3 and 4 simply implements the bright guidelines immediately while allowing Section 1 to be implemented pending the finalization of the court's action in *State v. AkCLU*.

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AMENDMENT

#1, or amended

OFFERED IN THE HOUSE  
TO: HB 225

Page 2, line 31:  
Delete "Internet."

Page 3, line 26 & Page 5, line 7  
Delete: "unlimited use by a legislator of the Internet; or"  
*limited*

Insert: "unlimited use of the Internet, except for election campaign purposes, by a legislator or a legislative employee if the use does not carry a special charge"

"or long as . . . ."

adopted

5/6

2

AMENDMENT #2

OFFERED IN THE HOUSE  
TO: HB 225

- 1 Page 4, line 19:
- 2 Delete "unlimited,"

*adopted*

5/6

#3 A

adopted,  
as amended  
CM

5

Page 5, line 8

Delete I

Replace with new I:

use of state property and resources, including staff time, by a legislator to support or oppose a constitutional amendment, except that staff may not be used to raise funds with regard to the amendment.

<sup>2</sup> Page ~~X~~, following line 13, insert new bill section:

"sec 2. AS 15.13.145(a) is amended to read:

(a) Except as provided in (b) and (c) of this section or in A.S.24.60.030 (a)(5) <sup>I</sup> ~~OK~~ <sub>OK</sub>

# 3B

adopted  
conceptual

5/6

I-I.S0931W.1 ✓  
Cramer  
5/6/99

A M E N D M E N T

OFFERED IN THE HOUSE

TO: HB 225

1 Page 2, line 31:

2 Delete "Internet."

3 Page 3, line 26:

4 Delete "unlimited use by a legislator of the Internet"

5 Insert "unlimited use of the Internet by

6 (i) a legislator; or

7 (ii) a legislative employee if the use does not carry

8 a special charge"

WORK DRAFT

WORK DRAFT

WORK DRAFT

5/7

I-LS0931NC+  
Cramer  
5/7/99

*adopted*

**CS FOR HOUSE BILL NO. 225(JUD)**  
**IN THE LEGISLATURE OF THE STATE OF ALASKA**  
**TWENTY-FIRST LEGISLATURE - FIRST SESSION**

**BY THE HOUSE JUDICIARY COMMITTEE**

Offered:  
Referred:

Sponsor(s): **REPRESENTATIVE COWDERY**

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act relating to election campaigns and legislative ethics; and providing for  
2 an effective date."

3 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

4 \* **Section 1.** AS 15.13.074(c), as repealed and reenacted by sec. 12, ch. 48, SLA 1996, is  
5 amended to read:

6 (c) A person or group may not make a contribution

7 (1) to a candidate or an individual who files with the commission the  
8 document necessary to permit that individual to incur certain election-related expenses  
9 as authorized by AS 15.13.100 when the office is to be filled at a general election  
10 before the date that is 18 months before the general election;

11 (2) to a candidate or an individual who files with the commission the  
12 document necessary to permit that individual to incur certain election-related expenses  
13 as authorized by AS 15.13.100 for an office that is to be filled at a special election or  
14 municipal election before the date that is 18 months before the date of the regular

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1 municipal election or that is before the date of the proclamation of the special election  
 2 at which the candidate or individual seeks election to public office; or

3 (3) to any candidate after the earlier of December 31 of the year of  
 4 the election or the 60th [LATER THAN THE 45TH] day

5 (A) after the date of a primary election if the candidate

6 (i) has been nominated at the primary election or is  
 7 running as a write-in candidate; and

8 (ii) is not opposed at the general election;

9 (B) after the date of the primary election if the candidate was  
 10 not nominated at the primary election; or

11 (C) after the date of the general election, or after the date of a  
 12 municipal or municipal runoff election, if the candidate was opposed at the  
 13 general, municipal, or municipal runoff election.

14 \* Sec. 2. AS 15.13.145(b) is amended to read:

15 (b) Money held by an entity identified in (a)(1) - (3) of this section may be  
 16 used to influence the outcome of an election concerning a ballot proposition or  
 17 question if the use is permitted under AS 24.60.030(a)(5)(H) or [ BUT ONLY ] if  
 18 the funds have been specifically appropriated for that purpose by a state law or a  
 19 municipal ordinance.

20 \* Sec. 3. AS 24.60.030(a) is amended to read:

21 (a) A legislator or legislative employcc may not

22 (1) solicit, agree to accept, or accept a benefit other than official  
 23 compensation for the performance of public duties; this paragraph may not be  
 24 construed to prohibit lawful solicitation for and acceptance of campaign contributions  
 25 or the acceptance of a lawful gratuity under AS 24.60.080;

26 (2) use public funds, facilities, equipment, services, or another  
 27 government asset or resource for a nonlegislative purpose, for involvement in or  
 28 support of or opposition to partisan political activity, or for the private benefit of either  
 29 the legislator, legislative employee, or another person; this paragraph does not prohibit

30 (A) limited use of state property and resources for personal  
 31 purposes if the use does not interfere with the performance of public duties and

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either the cost or value related to the use is nominal or the legislator or legislative employee reimburses the state for the cost of the use:

(B) the unlimited use of mailing lists, computer data, or other information lawfully obtained from a government agency and available to the general public for nonlegislative purposes;

(C) unlimited telephone or facsimile use that does not carry a special charge;

(D) the legislative council, notwithstanding AS 24.05.190, from designating a public facility for use by legislators and legislative employees for health or fitness purposes; when the council designates a facility to be used by legislators and legislative employees for health or fitness purposes, it shall adopt guidelines governing access to and use of the facility; the guidelines may establish times in which use of the facility is limited to specific groups; [OR]

(E) a legislator from using the legislator's private office in the capital city during a legislative session, and for the 10 [FIVE] days immediately before and the 10 [FIVE] days immediately after a legislative session, for nonlegislative purposes if the use does not interfere with the performance of public duties and if there is no cost to the state for the use of the space and equipment, other than utility costs and minimal wear and tear, or the legislator promptly reimburses the state for the cost; an office is considered a legislator's private office under this subparagraph if it is the primary space in the capital city reserved for use by the legislator, whether or not it is shared with others;

(F) a legislator from unlimited use of legislative employees to prepare and send out seasonal greeting cards;

(G) a legislator from using state resources to transport computers or other office equipment owned by the legislator but primarily used for a state function;

(H) unlimited use by a legislator of photographs of that legislator;

(I) reasonable use of the Internet by a legislator or a

WORK DRAFT

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1 legislative employee except if the use is for election campaign purposes: or  
 2 (D) a legislator from soliciting, accepting, or receiving a gift  
 3 on behalf of a recognized, nonpolitical charitable organization in a state  
 4 facility:

5 (3) knowingly seek, accept, use, allocate, grant, or award public funds  
 6 for a purpose other than that approved by law, or make a false statement in connection  
 7 with a claim, request, or application for compensation, reimbursement, or travel  
 8 allowances from public funds;

9 (4) require a legislative employee to perform services for the private  
 10 benefit of the legislator or employee at any time, or allow a legislative employee to  
 11 perform services for the private benefit of a legislator or employee on government  
 12 time; it is not a violation of this paragraph if the services were performed in an  
 13 unusual or infrequent situation and the person's services were reasonably necessary to  
 14 permit the legislator or legislative employee to perform official duties;

15 (5) use or authorize the use of state funds, facilities, equipment,  
 16 services, or another government asset or resource for the purpose of political fund  
 17 raising or campaigning; this paragraph does not prohibit

18 (A) limited use of state property and resources for personal  
 19 purposes if the use does not interfere with the performance of public duties and  
 20 either the cost or value related to the use is nominal or the legislator or  
 21 legislative employee reimburses the state for the cost of the use;

22 (B) the unlimited use of mailing lists, computer data, or other  
 23 information lawfully obtained from a government agency and available to the  
 24 general public for nonlegislative purposes;

25 (C) telephone or facsimile use that does not carry a special  
 26 charge;

27 (D) unlimited storage or maintenance [STORING OR  
 28 MAINTAINING], consistent with (b) of this section, of election campaign  
 29 records in a legislator's office; [OR]

30 (E) a legislator from using the legislator's private office in the  
 31 capital city during a legislative session, and for the 10 [FIVE] days

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1 immediately before and the 10 [FIVE] days immediately after a legislative  
 2 session, for nonlegislative purposes if the use does not interfere with the  
 3 performance of public duties and if there is no cost to the state for the use of  
 4 the space and equipment, other than utility costs and minimal wear and tear,  
 5 or the legislator promptly reimburses the state for the cost; an office is  
 6 considered a legislator's private office under this subparagraph if it is the  
 7 primary space in the capital city reserved for use by the legislator, whether or  
 8 not it is shared with others;

9 (I) unlimited use by a legislator of photographs of that  
 10 legislator;

11 (G) reasonable use of the Internet by a legislator or a  
 12 legislative employee except if the use is for election campaign purposes; or

13 (H) use of governmental resources, including paid staff time,  
 14 to support or oppose a proposed initiative or an amendment to the state  
 15 or federal constitution; a legislator or legislative employee may support or  
 16 oppose a proposed initiative or constitutional amendment; [however, a  
 17 legislator or legislative employee may not use governmental resources to  
 18 solicit contributions for or [gather signatures on] an initiative petition; a  
 19 legislative employee may not, on government time, accept or receive  
 20 contributions relating to a proposed constitutional amendment or initiative.

21 \* Sec. 4. Except as provided in sec. 5 of this Act, this Act takes effect immediately under  
 22 AS 01.10.070(c). 14 1 / 99

23 \* Sec. 5. Section 1 of this Act takes effect on the effective date of sec. 4 of this Act or on  
 24 the date that, under sec. 34, ch. 48, SLA 1996, sec. 12, ch. 48, SLA 1996 takes effect,  
 25 whichever is later.

1

2 b 3 - 12/1

**Alaska State Legislature**  
**Select Committee on**  
**Legislative Ethics**

Rep.  
Kott

716 W. 4th, Suite 230  
Anchorage, AK  
(907) 258-8172  
FAX: 258-2106

Mailing Address:  
P.O. Box 101468  
Anchorage, AK  
99510

July 22, 1997

**Advisory Opinion 97-02**

RE: Participation in the initiative process under AS 15.45.

**Statement of Facts**

You are a legislator and therefore covered by the legislative ethics code. You have requested an advisory opinion concerning whether a legislator or a legislative employee may be a sponsor of an initiative petition under AS 15.45 and to what extent activities related to an initiative petition can take place, consistent with the requirements of the legislative ethics code, in a legislative office and on legislative time. You have expressly waived your right to confidentiality under AS 24.60.160.

**Discussion**

**A. The initiative is a process undertaken by private citizens rather than the institutions of government but is an adjunct to the legislative process.**

Under Article XI of the state constitution, the people may propose and enact laws by the initiative process. The constitution sets out requirements for sponsorship by 100 qualified voters (sec. 2), signing of the petition by qualified voters (sec. 3) and the initiative election (sec. 4). If a majority of the votes cast favor the adoption of the initiative, it is enacted (sec. 6). These provisions give the voters in the state the power to enact an initiative, not the elected representatives that make up the legislature. Under sec. 4, if, before the election, "substantially the same measure has been enacted" by the legislature, the initiative petition is void. A law enacted through the initiative process has the same force and effect as a law enacted through the legislative process, except that it is not subject to veto by the governor and may not be repealed by the legislature within two years after its effective date. (sec. 6) While the legislature is not part of the initiative process, initiatives may be used as an adjunct to the legislative process, both as a means of enacting law directly by the people and to encourage the legislature to act on legislation on topics of concern to the voters. The committee finds that even though activity concerning an initiative may be undertaken by any voter, initiatives are related to the duties of the legislature.

**B. The ethics code permits a legislator or a legislative employee to participate in the initiative process while acting in a private capacity.**

The restrictions on political activity by a legislator or legislative employee imposed by the legislative ethics code prohibit activities that take place on government time or that use government resources. See AS 24.60.030(a)(2), (a)(5), (b), (c), and (d). Except for restrictions imposed on the public members and staff of the ethics committee, the ethics code does not prohibit legislators or legislative employees from engaging in partisan political activity on their own time and without the use of public resources.<sup>1</sup> Therefore, the committee holds that a legislator or legislative employee may, consistent with the ethics code, sponsor or otherwise support or oppose an initiative petition. In reaching this holding, the committee is not addressing restrictions on political activity that may be imposed by employment policies or other statutes outside the ethics code. Legislative employees should consult their supervisors about restrictions that apply to a particular office before engaging in political activity.<sup>2</sup>

**C. Application to local initiative petitions.**

Under AS 29.26.100 - 29.26.190, municipal voters have the power to adopt a municipal initiative that parallels the power of state voters with respect to a state initiative petition. The role of a legislator in representing the people he or she represents on public policy issues is not limited to issues directly before state government. Legislators are expected to respond to local issues as well. Furthermore, municipalities are established by state statute and their powers and duties are governed by those statutes. Issues that affect one or more municipalities are likely to raise issues that will affect the state as a whole. Therefore, the committee finds that a legislator or legislative employee may use state resources (including paid staff time) with respect to a municipal initiative petition to the same extent that state resources may be used with respect to a state initiative petition.

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<sup>1</sup> Since you have not asked specifically about whether public members and staff of the ethics committee may engage in activities supporting or opposing an initiative, this opinion will not address whether AS 24.60.134(a)(1), prohibiting public members and staff of the committee from participating in a political campaign, would apply to activities concerning an initiative.

<sup>2</sup> For example, under AS 24.55.030(b), staff of the office of the ombudsman are prohibited from joining, supporting, or otherwise participating in a partisan political organization, faction, or activity. They are allowed to make political contributions and to express private opinions.

**D. Action relating to an initiative petition is governmental action for purposes of the legislative ethics code and, with certain exceptions, may be taken using governmental resources.**

The last part of your inquiry requires the committee to consider whether the ethics code permits action in support of (or in opposition to) an initiative petition to be undertaken using governmental resources -- the space, supplies, and paid staff time of the legislature. The committee discussed this issue at some length before reaching a decision.

The committee has already found, under the conclusions of Part A of this opinion, that action to support or oppose an initiative petition is related to duties of the legislature. Legislators are frequently called on to comment on public issues, whether or not legislation has been proposed relating to that issue, and to take stands on those issues. Similarly, legislators need to hear from their constituents and others concerning public issues. In carrying out this dialogue, a legislator may use state resources, including paid staff time, state facilities and equipment, and reimbursement for travel expenses. Legislators may attend public functions or direct staff to attend on their behalf to both gather and present information to the public concerning the initiative, including the legislator's recommendation to support or oppose its passage. Legislators may direct staff to research issues raised by the initiative, to prepare draft legislation for possible introduction in the Legislature, and to prepare communications concerning the initiative and the legislator's position on its adoption. A legislator may make the results of research or bill drafting available to others, including individuals who are supporting or opposing an initiative. Communications may take any form including individual letters, mass mailings, brochures or handouts, and any other written or electronic communication as well as personal appearances in the media and at events and gatherings, including state fairs. While the information provided to the public at state expense may include copies of the text of the initiative and the name and address of groups and individuals supporting or opposing it, as discussed below, it is not appropriate to use state resources, including paid staff time, state-paid transportation, and state facilities and equipment, to circulate the official petitions (which are prepared and numbered by the Lieutenant Governor) for signature or to solicit contributions for the adoption or rejection of the initiative.

There is a limit on the appropriate use of state resources to support or oppose an initiative. In this respect, there is a distinction between activities that a legislator may appropriately engage in and activities that are appropriate for an employee to engage in on government time or that should take place in a legislative office or other state facilities.

Legislators serve for 24 hours a day, so restrictions on the use of state resources does not apply to a legislator's own time: it is permissible for a legislator to gather signatures on an initiative petition and to ask for contributions to a campaign related to the initiative so long

as that activity does not take place in a state facility.<sup>3</sup> At activities like state fairs, a booth or other area rented by a legislator using the legislator's personal funds or the unaccountable form of the office allowance account (on which the legislator has paid personal income taxes) is not considered to be a state facility and could be used to gather petition signatures. As explained in Part B of this opinion, legislative employees who were not on government time could participate in gathering signatures there. However, if the rental fee was paid from state funds or from an accountable office allowance, then the space is treated as a state facility and it would be impermissible for either legislators or legislative employees, whether paid or unpaid, to gather signatures on an initiative petition at that location.

In contrast to permitted activity of legislators, the committee finds that it is not appropriate for legislative employees during working hours to raise money for the support of or opposition to an initiative, to participate in the collection of signatures, or to prepare the actual documents necessary for filing the initiative petition.

It is also not appropriate to use state facilities or equipment in these activities unless the general public has equal access to them for a similar purpose. In this regard, it is not appropriate to offer an initiative petition for signature in legislative office space. Meetings of petition organizers or signature gatherers may not be organized by legislative employees on government time and may not be conducted in a state facility unless the facility is equally available for such a purpose to the general public. All of these prohibited activities are focused on the election campaign relating to the initiative and are less directly related to the discussion of policy issues raised by the initiative.

In reaching this decision, the committee is mindful that this result may place the resources of state government on one side or the other of an initiative effort, which is, in many ways the action of voters rather than an action of the legislature. However, initiatives are sufficiently close to legislation as to be treated as a governmental action rather than a private action by legislators and legislative employees who are involved in an initiative campaign as part of their legislative duties. The use of public facilities and resources in support of or opposition to the initiative as described above and as limited by the restriction on initiative campaign activities, is therefore a governmental use and is permitted under the ethics code.

### Conclusion

For the reasons stated above and as described in more detail above, the committee finds that a legislator or legislative employee may engage in action in support of or opposition to an initiative and may use governmental resources, including paid staff time, to support or

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<sup>3</sup> Note that there are restrictions on the solicitation of gifts in AS 24.60.080. So long as the contributions requested are in compliance with campaign financing laws and regulations of the Alaska Public Offices Commission, the ethics code gift restrictions do not apply. See AS 24.60.080(e).

oppose an initiative. However, a legislative employee may not, on government time, engage in fund raising or offer an initiative petition for signature and neither a legislator nor a legislative employee may use legislative space to gather signatures on an initiative petition or to solicit contributions in support of or opposition to an initiative.

Adopted by the Select Committee on Legislative Ethics on July 22, 1997. Senator Jim Duncan abstained from voting on this opinion.

Members present and concurring in this opinion were:

Margie Mac Neille, Chair  
 Ed Granger  
 Shirley McCoy  
 Representative Con Bunde  
 Representative Kim Elton  
 Senator Drue Pearce

Members dissenting from this opinion were:

Joe Donahue

Members absent were:

Edith Vorderstrasse

TC:glc  
 97-338.glc

# Alaska State Legislature

## Select Committee on Legislative Ethics

716 W. 4th, Suite 230  
Anchorage, AK  
(907) 258-8172  
FAX: 258-2106

Mailing Address:  
P.O. Box 101468  
Anchorage, AK  
99510

March 24, 1998

### Advisory Opinion 98-02

RE: Use of legislative resources and staff relating to a proposed constitutional amendment.

You are a legislator and therefore covered by the legislative ethics code. You have requested an advisory opinion concerning facts and circumstances that you have related. The committee relies on these facts in answering your questions. You have waived your right to confidentiality under AS 24.60.160.

#### Statement of Facts

You have asked what activities a legislator or legislative employee may engage in to support or oppose a proposed amendment to the state constitution without violating the legislative code of ethics. You note that the constitution limits the ways that an amendment may be adopted. The people may not propose an amendment through the initiative process. Only the legislature may pass a resolution proposing an amendment which then must be approved by the voters. You distinguish this process from the initiative process, in which voters are able to both propose and enact legislation. You state that the success of a proposed constitutional amendment depends on legislators informing the public and their constituents about the merits of the proposed change.

#### Discussion

This committee recently considered whether the ethics code limited or prohibited legislative activity relating to the adoption of an initiative. Advisory Opinion 97-02, July 22, 1997. In that opinion, we said

The committee has already found . . . that action to support or oppose an initiative petition is related to duties of the legislature. Legislators are frequently called on to comment on public issues, whether or not legislation has been proposed relating to that issue, and to take stands on those issues. Similarly, legislators need to hear from their constituents and others concerning public issues. In carrying out this dialogue, a legislator may use state resources, including paid staff time, state facilities and equipment, and reimbursement for travel expenses. Legislators may attend public functions or direct staff to attend on their behalf to both gather and present information to the public concerning the initiative, including the legislator's

recommendation to support or oppose its passage. Legislators may direct staff to research issues raised by the initiative, to prepare draft legislation for possible introduction in the Legislature, and to prepare communications concerning the initiative and the legislator's position on its adoption. A legislator may make the results of research or bill drafting available to others, including individuals who are supporting or opposing an initiative. Communications may take any form including individual letters, mass mailings, brochures or handouts, and any other written or electronic communication as well as personal appearances in the media and at events and gatherings, including state fairs. While the information provided to the public at state expense may include copies of the text of the initiative and the name and address of groups and individuals supporting or opposing it, as discussed below, it is not appropriate to use state resources, including paid staff time, state-paid transportation, and state facilities and equipment, to circulate the official petitions . . . or to solicit contributions for the adoption or rejection of the initiative.

There is a limit on the appropriate use of state resources to support or oppose an initiative. In this respect, there is a distinction between activities that a legislator may appropriately engage in and activities that are appropriate for an employee to engage in on government time or that should take place in a legislative office or other state facilities.

Legislators serve for 24 hours a day, so restrictions on the use of state resources do not apply to a legislator's own time: it is permissible for a legislator to gather signatures on an initiative petition and to ask for contributions to a campaign related to the initiative so long as that activity does not take place in a state facility. At activities like state fairs, a booth or other area rented by a legislator using the legislator's personal funds or the unaccountable form of the office allowance account (on which the legislator has paid personal income taxes) is not considered to be a state facility . . . . However, if the rental fee was paid from state funds or from an accountable office allowance, then the space is treated as a state facility . . . .

In contrast to permitted activity of legislators, the committee finds that it is not appropriate for legislative employees during working hours to raise money for the support of or opposition to an initiative, to participate in the collection of signatures, or to prepare the actual documents necessary for filing the initiative petition.

It is also not appropriate to use state facilities or equipment in these activities unless the general public has equal access to them for a similar purpose. . . . Meetings of petition organizers or signature gatherers may not be organized by legislative employees on government time and may not be conducted in a state facility unless the facility is equally available for such a purpose to the

general public. All of these prohibited activities are focused on the election campaign relating to the initiative and are less directly related to the discussion of policy issues raised by the initiative.

In reaching this decision, the committee is mindful that this result may place the resources of state government on one side or the other of an initiative effort, which is, in many ways the action of voters rather than an action of the legislature. However, initiatives are sufficiently close to legislation as to be treated as a governmental action rather than a private action . . . . The use of public facilities and resources in support of or opposition to the initiative as described above and as limited by the restriction on initiative campaign activities, is therefore a governmental use and is permitted under the ethics code.

Id., pages 3-4 (footnote omitted). There is a difference between the process of amending the state constitution and the process of enacting laws. Under Article XIII, sec. 1, the legislature may not act alone to amend the state constitution: the proposed amendment must be ratified by vote of the people. In contrast, under the provisions of Article II, the legislature can enact laws without the involvement of any other entity, although the governor does have an opportunity to veto a measure if he or she wishes to do so, and under Article XI, the people acting alone may initiate a law, so long as the legislature does not enact similar legislation.

The role of the voters in the context of a proposed amendment to the constitution is thus different from their role in voting on an initiative: in the former, they serve as a partner of the legislature. In the latter, they are a substitute for the legislature. However, in either case, the issues involved are public issues, the expectations that the public has about leadership from legislators on issues that confront the state is similar, and the committee believes that the appropriate use of state staff time and resources is the same: state resources may be used for presenting information and urging support or opposition to a proposed constitutional amendment but may not be used to solicit, accept, or receive campaign funds relating to the proposed amendment. However, a legislator may solicit contributions so long as the legislator does not use staff time or public resources, including legislative office space, to do so.

The committee cautions that this opinion does not address whether a use of legislative resources might constitute an expenditure or contribution for purposes of the election campaign finance laws. Legislators and legislative employees who are planning to engage in activity in support of or opposition to a proposed constitutional amendment should consult with the Alaska Public Offices Commission (APOC) to determine their obligations, if any, under AS 15.13. In particular, legislators and legislative employees should be aware of AS 15.13.145(b), which provides that money held by the state or a state agency may only be used to influence the outcome of an election concerning a proposed constitutional amendment if the money was specifically appropriated for that purpose. It is the obligation of APOC to interpret and apply this provision. The ethics committee cannot offer advice about what activity might be permitted under it and what activity would be prohibited by it.

**Conclusion**

For the reasons stated above and as described in more detail above, the committee finds that under the legislative ethics code a legislator or legislative employee may engage in activity in support of or opposition to a proposed amendment to the state constitution and may use governmental resources, including paid staff time, to support or oppose the proposed amendment. However, state facilities may not be used by legislators or legislative employees for activities related to contributions and a legislative employee may not, on government time, solicit, accept, or receive contributions in support of or opposition to a proposed constitutional amendment. Further, the committee encourages a legislator or legislative employee who is considering activity to support or oppose a constitutional amendment to request advice from APOC on the application of campaign finance laws to the use of legislative resources.

Adopted by the Select Committee on Legislative Ethics on March 24, 1998.

Members present and concurring in this opinion were:

Shirley McCoy, committee chair  
Senator Jim Duncan  
Senator Drue Pearce  
Representative Con Bunde  
Representative Kim Elton  
Dennis Cook, public member  
Joseph P. Donahue, public member  
Ed Granger, public member

Members absent were:

Edith Vorderstrasse, public member

TC:jdr:lmb  
98-175:jdr

**HB**

**233**



**Jermain Dunnagan & Owens, P.C.**  
LAW OFFICES

WILLIAM K. JERMAIN  
CHARLES A. DUNNAGAN  
BRADLEY D. OWENS  
RANDALL G. SIMPSON  
HOWARD S. TRICKEY  
GREGORY C. TAYLOR


GARY C. SLEEPER  
SAUL F. FRIEDMAN  
DIANE F. VALLENTINE

JAMES A. CASPER  
W. MICHAEL STEPHENSON

ANDRENA L. STONE  
EUGENIA G. RICHARDSON  
MIKE L. DISHMAN  
NATASHA M. SUMMIT  
ERIC J. BROWN  
JOHN A. BIOFF

3000 A STREET, SUITE 300  
ANCHORAGE, ALASKA 99503-4087  
TELEPHONE (907) 563-8844  
FAX (907) 563-7322  
E-MAIL info@jdoalaw.com

**M E M O R A N D U M**

**DATE:** February 28, 2000  
**TO:** John Walsh  
**FROM:** Saul R. Friedman   
**RE:** **RESPONSES TO QUESTIONS POSED BY THE  
HJUD COMMITTEE STAFF**

Overview

Chapter 9 of the Bankruptcy Code, 11 U.S.C. §§ 901-46 (1982), allows a municipality to seek a restructuring of its debt under the jurisdiction of the bankruptcy court. The provisions governing municipal bankruptcy represent a balance between competing constitutional considerations. Because the United States Constitution prohibits states from impairing the contractual rights of creditors, and requires uniformity in bankruptcy laws, only federal legislation may relieve a municipality of its obligations without the consent of the affected creditors. See U.S. Const., art. I, §§ 8, 10. However, because the exercise of federal control over municipalities implicates the Tenth Amendment, the legislation must be "sufficiently narrow in scope to avoid intrusion by the federal courts on the sovereign power of the states." *In re: Richmond Unified Sch. Dist.*, 133 B.R. 221, 224 (Bankr. N.D. Cal. 1991)(reviewing school district's Chapter 9 petition where district owed approximately \$9 million to each of three creditors.)

Chapter 9 strikes such a balance "by providing the debtor with an array of bankruptcy powers to enable it to achieve financial rehabilitation with very few, if any, corresponding limitations and duties of the type to which a Chapter 11 debtor is subject." *Id.* at 224. 11 U.S.C. § 904 imposes restrictions on the bankruptcy court's control over a municipal debtor. That section provides:

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.

In short, as the legislative history of the Bankruptcy Act explains, "Therefore, the primary purpose of Chapter 9 is to allow the municipal unit to continue operating while it adjusts or refinances its creditor claims." H.R. Rep. No. 95-595 at 263 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6221.

*Question: Why is it necessary for Alaska municipalities to file bankruptcy?*

Answer: The purpose of Chapter 9 relates to the burden of debt service on the municipality. The burden of a debt service that cannot be paid by the revenues generated by the municipality affects the residents of that municipality in the same way as it would affect a debt-ridden individual: It saps initiative, and depresses money-generating activity. The residents of a city will cease to pay taxes (or seek tax cap legislation) if rates are too high and the residents get none of the benefit of the higher taxes because those funds do not result in better municipal services. A downward spiral can result. Bankruptcy is premised on the idea that the debtor will become more productive if freed from the burden of debt.

*Question: What would be the effect on bond ratings/bonding capacity of municipalities if this power were given?*

Answer: The 1994 Bankruptcy Reform Act requires that municipalities be specifically authorized by state law to seek the protections of Chapter 9. Prior to those amendments, there is absolutely no evidence that municipalities had difficulty authorizing or selling bonds. Now that a majority of states have provided the specific authorization required by the 1994 Bankruptcy Reform Act, there is no evidence that those municipalities have experienced any such negative affects on bond ratings/bonding capacity.

Bond ratings are essentially based upon the overall financial strength of a municipality considering, among other things, its tax base, infrastructure, population projections, etc. Bond ratings are premised on the belief that a municipality will not need to seek Chapter 9 protection. We do not believe that bond ratings are affected by the fact that Chapter 9 may be available as a remedy in the event of insolvency of the municipality.

In fact, a review of two resource documents (attached) which discuss municipal bond ratings, indicates that the mere authority to file Chapter 9 is not even an issue. It is not even discussed.

*Question: If the power to file might negatively impact bond ratings, should the power to file be expressly prohibited instead?*

Answer: We do not believe that the power to file negatively impacts bond ratings.

*Question: If state law already prohibits execution on local government's property, is this enough protection from creditors?*

Answer: Alaska Statute 09.30.040 provides that a creditor may not execute a judgment against a "borough, city, or other public corporation." Instead, the creditor is required to present the judgment within ten years to the entity's authorized treasury officer, after which the officer "shall draw an order on the treasurer for the amount of the judgment in favor of the party for whom the judgment was given[.]" AS 09.30.040(2) (emphasis added). Additionally, AS 09.40.030 provides that "[a]ll property in the state not exempt from execution may be attached." AS 09.38.015 sets forth property that is exempt from attachment. Subsection (c) exempts all "[p]roperty of the state, a municipality, and of the Alaska Municipal Bond Bank Authority or another state public corporation."

Therefore, the fact that municipal property is exempt does not alter the fact that a judgment is to be paid out of the municipality's treasury. The Bankruptcy Act protects a municipality from having to pay a judgment when the funds in its treasury are insufficient to pay existing debts, or to continue essential municipal services, etc.

*Question: Is it good public policy to permit a local government to file bankruptcy in order to delay its creditors or negotiate discounts from them? What might this do to the ability of other local governments to obtain goods or services on credit?*

Answer: Chapter 9 is essentially a last resort. As indicated in the overview above, the purpose of the municipal bankruptcy laws is to allow the municipality a fresh start. Without Chapter 9 protection, a municipality would be mired in insolvency. Insolvency would have a greater detrimental impact on the municipality's ability to obtain goods or services, than the fact that the municipality has the authority to file for bankruptcy if it ever becomes necessary.

*Question: Under Alaska law, if a municipal government wants to dissolve, it must provide for payment of its creditors under AS 29.06.470(a). Under Chapter 9, however, the bankruptcy court can confirm a plan which does not provide payment in full. Which is the better policy for Alaska's municipalities?*

Answer: The better policy for Alaska's municipalities is to have the municipal government continue in existence. It is the municipal government that provides essential services to the residents such as police and fire protection. The better public policy is for the municipality to survive its insolvency, and continue in existence.

*Question: The Bankruptcy Court for Alaska is part of the federal court system and appeals go to the Court of Appeals for the Ninth Circuit in San Francisco. Is it good policy for Alaska to permit its municipal governments to adjust their debts through the federal court system?*

Answer: As set forth in the overview above, the United States Constitution prohibits states from impairing the contractual rights of creditors. In other words, there is no corresponding bankruptcy jurisdiction in the state courts.

*Question: The state Superior Court, as a court of general jurisdiction, may have the power to require a municipality to sell non-productive assets surplus to public needs. The Alaska Supreme Court reviews Superior Court orders by appeal or petition for review. It is better to require Alaska's local governments to work out payment plans through the state's court system so local judges, subject to retention election, will have authority?*

Answer: As set forth in the prior answer, there is no state court jurisdiction which allows the Chapter 9 remedies to be available in state court. The primary advantages of a Chapter 9 proceeding reflect the bankruptcy court's ability to develop "an equitable composition of the claims and rights of all classes of creditors which no state court proceeding or receivership has constitutional authority to affect." *Pleasant View*, 24 B.R. at 637, n. 4.

*Question: If Alaska municipalities are authorized to file bankruptcy, should they be required to pay their debts in full over time as a condition of bankruptcy relief?*

Answer: No. Such a requirement, if legal, would interfere with the jurisdiction of the bankruptcy court. Eligibility for Chapter 9 relief is only available if the municipality "is insolvent," "desires to effect a plan to adjust . . . debts," "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 . . .," "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 . . .," "is unable to negotiate with creditors because such negotiation is impractical," or "reasonably believes that a creditor may attempt to obtain a transfer that is avoidable" under the bankruptcy laws. See 11 U.S.C. § 109(c).

Furthermore, even though the heart of Chapter 9 is the plan for the adjustment of the municipality's debts, the bankruptcy court is required to determine that the plan is in the "best interest of creditors and is feasible." 11 U.S.C. § 943(b)(7). A proper balance has been struck.

# The Investment FAQ



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## Subject: Bonds - Moody Bond Ratings

Last-Revised: 7 Nov 1995 Contributed-By: Bill Rini (bill at moneypages.com)

Moody's Bond Ratings are intended to characterize the risk of holding a bond. These ratings, or risk assessments, in part determine the interest that an issuer must pay to attract purchasers to the bonds. All information herein was obtained from Moody's Bond Record.

### Aaa

Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edged." Interest payments are protected by a large or an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.

### Aa

Bonds which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long-term risk appear somewhat larger than the Aaa securities.

### A

Bonds which are rated A possess many favorable investment attributes and are considered as upper-medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment some time in the future.

### Baa

Bonds which are rated Baa are considered as medium-grade obligations (i.e., they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

### Ba

Bonds which are rated Ba are judged to have speculative elements; their future cannot be considered as well-assured. Often the protection of interest and principal payments may be very moderate, and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

### B

Bonds which are rated B generally lack characteristics of the desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.

### Caa

Bonds which are rated Caa are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.

Ca

Bonds which are rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.

C

Bonds which are rated C are the lowest rated class of bonds, and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.

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Another way to evaluate an issuer is to examine its credit rating. Many bonds are graded by ratings agencies such as Moody's Investors Service, Standard & Poor's Corporation and Fitch Investors Service, Inc. A number of banks and brokerage firms have their own research departments which also analyze municipal securities. Bond ratings are important benchmarks because they reflect a professional assessment of the issuer's ability to repay the bond's face-value at maturity.

Generally, bonds rated BBB or Baa, or better, by Standard & Poor's and Fitch, or Moody's, respectively, are considered "Investment Grade," suitable for preservation of investment capital.

CREDIT RATINGS			
CREDIT RISK	MOODY'S	STANDARD & POOR'S	FITCH
PRIME	Aaa	AAA	AAA
EXCELLENT	Aa	AA	AA
UPPER MEDIUM	A	A	A
LOWER MEDIUM	Baa	BBB	BBB
SPECULATIVE	Ba	BB	BB
VERY SPECULATIVE	B, Caa	B, CCC, CC	B, CCC, CC, C
DEFAULT	Ca, C	D	DDD, DD, D

Credit ratings, however, should not be the sole basis for any investment decision. For example, the ratings do not take into account market trends. Before purchasing bonds with lower ratings, talk with your financial advisor or broker to make sure they're suited for you.

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FAX (907) 465-2418  
1-800-465-4939

INTERIM  
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ANCHORAGE, AK 99501  
(907) 269-0244  
FAX (907) 269-0248

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REPRESENTATIVE ANDREW HALCRO

District 12

TO: Rep. Pete Kott  
Chair, House Judiciary Committee  
FROM: Rep. Andrew Halcro  
RE: HB 233 - Municipal Bankruptcy  
DATE: February 29, 2000

---

1. *Why is it necessary for Alaska municipalities to file bankruptcy?*

Smaller communities are often in tenuous financial situations. Some have strong city manager forms of government and mismanagement, intentional or not, could create a situation where a community may have to file for protection in bankruptcy court to prevent creditors from cherry picking assets.

2. *What could be the effect on bond ratings/bonding capacity of municipalities if this power were given?*

Bonding agencies are generally more willing to issue bonds for communities that have the power to reorganize under Chapter 9 of the Federal Bankruptcy Code. Bankruptcy protection contemplates the taxing capability, both statutory and practically, of a community. Reorganization only occurs when a local government cannot further tax its residents based on state law or because of the effect on the local economy. Bonds are usually general obligation bonds in local communities. As such, bankruptcy protects the bonding authority's ability to recover on the general tax obligation associated with the bond issuance.

3., *If the power to file might negatively impact bond ratings, should the power to file be expressly prohibited instead?*

Bond ratings will not be negatively affected. A local government cannot seek bankruptcy protection without passage of HB 233. As such, no prohibition would be necessary to prevent seeking bankruptcy protection, without the specific authority contemplated in HB 233, no local government can seek protection under Chapter 9.

4. *If state law already prohibits execution on local governments' property, is this enough protection from creditors?*

No, the law creates a stalemate where a local government would not be able to get out from under its debts. The debts would never be reorganized resulting in an ongoing bad debt for a creditor, and an ongoing obligation for the borrower and no way to resolve the matter.

5. *Is it good public policy to permit a local government to file bankruptcy in order to delay its creditors or negotiate discounts from them? What might this do to the ability of other local governments to obtain goods or services on credit?*

It is good public policy to allow local governments to seek reorganization in bankruptcy. It should only be utilized as a last resort, when increasing taxes, cutting other expenses, or liquidating assets is not an option. The bankruptcy code assures these requirements be met by a local government before they approve a bankruptcy reorganization.

The ability for a local government to obtain credit is a similar criterion to that of an individual or corporation. The credit is based on income, obligations, and history of payment. Most other states allow for municipal bankruptcy. There has not been any reduction in ability for them to obtain credit.

6. *Under Alaska law, if a municipal government wants to dissolve, it must provide for payment of its creditors under AS 29.06.470(a). Under Chapter 9, however, the bankruptcy court can confirm a plan, which does not provide payment in full. Which is a better policy for Alaska's municipalities?*

The question presumes the two laws work in a mutually exclusive manner. They do not. To dissolve under state law, a local government must make payment in full. To reorganize under chapter 9, the court only will require a creditor to take a discounted payment if one of four things happen: 1) Agreement of creditors, 2) Negotiated in good faith but failed to obtain consent of creditors, 3) Negotiations are impracticable, and 4) Preventing creditors from obtaining preferences. (*See Collier on Bankruptcy*, pp 109-32, 109-33 (rev. ed.1998).)

7. *The Bankruptcy Court for Alaska is part of the federal court system and appeals go up to the Court of Appeals for the Ninth Circuit in San Francisco. Is it good public policy for Alaska to permit its municipal governments to adjust their debts through the federal court system?*

Article I, section 8 of the United States Constitution provides:

The Congress shall have the power . . . to establish . . . uniform laws on the subject of bankruptcies throughout the United States;

In implementing this section of the United States Constitution, the Congress has granted exclusive bankruptcy jurisdiction to the federal bankruptcy courts. State courts cannot discharge, order the reorganization, or delay payment of debts for reorganization. State courts only have the ability to determine if a debt exists, and then enforce payment of the debt. Additionally, many creditors for local governments will not be incorporated in Alaska. As such, even if federal law did not create exclusive jurisdiction in the federal bankruptcy courts, the creditors would likely be entitled to diversity jurisdiction in federal courts anyway.

*8. The state Superior Court, as a court of general jurisdiction, may have the power to require a municipality to sell non-productive assets surplus to public needs. The Alaska Supreme Court reviews Superior Court orders by appeal or petition for review. Is it better to require Alaska's local governments to work out payment plans through the state court system so local judges, subject to retention elections, will have authority?*

The problem with utilizing the Alaska court system is that its rules do not require all creditors be notified of an action; as is the case in federal bankruptcy court. A creditor with a lower priority could seek recovery in Superior Court and other creditors might not be made aware of the action. Federal bankruptcy court provides for notification of all creditors.

The framers of the United States Constitution contemplated a simple system of bankruptcy that would prevent multiple actions over assets in different courts throughout the nation for one debtor. The bankruptcy court resolves this problem by establishing jurisdiction in the federal bankruptcy court for the district in which the debtor resides.

*9. If Alaska municipalities are authorized to file bankruptcy, should they be required to pay their debts in full over time as a condition of bankruptcy relief?*

The question is moot. Federal law does not permit Alaska to make that requirement. The bankruptcy court has exclusive jurisdiction to make that decision. Alaska only has the ability to determine if a local government can take advantage of Chapter 9, not to determine how it takes advantage of that protection.

From: David H. Bundy  
Bundy & Christianson

Re: Proposed HB 233 (Municipal Bankruptcy)

Date: February 18, 2000

---

House Bill 233, introduced 5/12/99, authorizes any municipality to file a bankruptcy petition. Bankruptcy relief for municipalities is granted under Chapter 9 of the Bankruptcy Code. Section 109 (c) of the Bankruptcy Code provides, among other things, that to be eligible under Chapter 9 a municipality must be "specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law." Alaska law does not currently contain this specific authorization.

Chapter 9 bankruptcy is quite different from bankruptcy for an individual or a business (Chapters 7, 11, and 13). Under 11 and 13, the court can require a particular percentage of assets and/or income to be paid to creditors. In Chapter 7, the debtor's non-exempt property is liquidated for creditors. In all three cases the Bankruptcy Court has substantial authority and the Debtor either loses control, or might lose control, of its economic life. Chapter 9 on the other hand does not give the court the power to liquidate the debtor's assets or manage its income, as the municipal functions cannot be impaired. Chapter 9 is designed to provide a forum in which the debtor and its creditors can negotiate; it prevents creditor collection actions while the case is pending, which puts pressure on creditors to negotiate. In addition, it allows the bankruptcy court to confirm (that is approve) a plan for payment that a municipality proposes which does not provide for full payment of creditors. But the court cannot impose a payment plan on an unwilling municipality.

Without a bankruptcy filing, municipalities are protected by AS 09.30.040 which prohibits executions on the property of boroughs and cities, but requires the governing body to pay judgments. The statute does not say what happens if payment is not made.

Questions that come up in connection with HB 233 include:

1. Why is it necessary for Alaska municipalities to file bankruptcy?
2. What could be the effect on bond ratings/bonding capacity of municipalities if this power were given?

3. If the power to file might negatively impact bond ratings, should the power to file be expressly prohibited instead?
4. If state law already prohibits execution on local governments' property, is this enough protection from creditors?
5. Is it good public policy to permit a local government to file bankruptcy in order to delay its creditors or negotiate discounts from them? What might this do to the ability of other local governments to obtain goods or services on credit?
6. Under Alaska law, if a municipal government wants to dissolve, it must provide for payment of its creditors under AS 29.06.470 (a). Under Chapter 9, however, the bankruptcy court can confirm a plan which does not provide payment in full. Which is the better policy for Alaska's municipalities?
7. The Bankruptcy Court for Alaska is part of the federal court system and appeals go up to the Court of Appeals for the Ninth Circuit in San Francisco. Is it good policy for Alaska to permit its municipal governments to adjust their debts through the federal court system?
8. The state Superior Court, as a court of general jurisdiction, may have the power to require a municipality to sell non-productive assets surplus to public needs. The Alaska Supreme Court reviews Superior Court orders by appeal or petition for review. Is it better to require Alaska's local governments to work out payment plans through the state court system so local judges, subject to retention elections, will have authority?
9. If Alaska municipalities are authorized to file bankruptcy, should they be required to pay their debts in full over time as a condition of bankruptcy relief?

# ALASKA STATE LEGISLATURE

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**REPRESENTATIVE ANDREW HALCRO**

District 12

STATE CAPITOL, SUITE 418  
JUNEAU, AK 99801-1182  
(907) 465-4939  
FAX (907) 465-2418  
1-800-465-4939

*INTERIM*  
716 WEST 4TH, SUITE 620  
ANCHORAGE, AK 99501  
(907) 269-0244  
FAX (907) 269-0248

## 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.

# FISCAL NOTE

STATE OF ALASKA  
2000 LEGISLATIVE SESSION

BILL NO. HB 233 (CRA)

Revision Date/Time (Note if correction) \_\_\_\_\_ Dept. Affected DCED  
 Title \_\_\_\_\_ BRU \_\_\_\_\_  
 An Act granting authority to each municipality or other political ... Component \_\_\_\_\_  
 Sponsor House Community & Regional Affairs Committee  
 Requester HOUSE Judiciary Committee Component No. \_\_\_\_\_

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
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<b>CHANGE IN REVENUES ( )</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
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**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (specify type)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2000) cost: \_\_\_\_\_

**POSITIONS**

Full-time	0	0	0	0	0	0
Part-time						
Temporary						

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

This legislation would bring Alaska in line with changed federal bankruptcy law as applied to municipalities. It would have no fiscal impact on this department.

Prepared by: Pat Poland, Director Phone 269-4580  
 Division Municipal and Regional Assistance Division  
 Approved by Commissioner Deborah B. Sedwick Date 02/15/00  
 Agency Department of Community and Economic Development

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## MEMORANDUM

January 24, 2000

**SUBJECT:** Municipal bankruptcy (HB 233)

**TO:** Representative Andrew Halcro  
Attn: Jonathan H. Lack

**FROM:** Tamara Brandt Cook  
Director *TBC*

You ask whether HB 233 currently applies to regional educational attendance areas. The bill applies only to municipalities, which includes cities, boroughs and unified municipalities. (See AS 01.10.060(4) and AS 29.71.800(13))

You also ask whether federal bankruptcy law could apply to an REAA and whether the state would have to authorize that application. The word "municipality" is defined broadly in federal law to include a "political subdivision or public agency or instrumentality of a State." (11 U.S.C. 101(40)) Under 11 U.S.C. 109(c)(2), a municipality may be a debtor under chapter 9 only if it "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."

Consequently, if it is the intent of the legislature to include REAAs within the coverage of chapter 9 of the federal bankruptcy law, HB 233 would have to be amended to include REAAs. Alternatively, if it is the intent of the legislature to include all state political subdivisions and instrumentalities, including REAAs and municipalities, the amendment could be worded broadly. Please let me know if you would like changes made to HB 233 to address this or other issues.

TBC:jdr  
00-030.jdr



**U.S. Department of Justice**

*Office of the United States Trustee*  
605 West 4<sup>th</sup> 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.

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- ¶ 109.07. Who May Be a Debtor Under Chapter 12
- ¶ 109.08. Prior Dismissal May Make Debtor Ineligible
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- ¶ 109.II. History of Section 109

## ¶ 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.<sup>1</sup> 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).<sup>2</sup> Each of these chapters limits availability of relief

## ¶ 109.01.

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

<sup>2</sup> 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.<sup>3</sup> 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,<sup>4</sup> confirmation of a plan is normally res judicata with respect to the issue of jurisdiction.<sup>5</sup> However, in some types of cases, such as those of financial institutions or insurance companies, other statutes may make clear that exclusive jurisdiction over

<sup>3</sup> *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).

<sup>4</sup> 11 U.S.C. §§ 1129(a), 1225(a)(1), 1325(a)(1).

<sup>5</sup> *In re Lochamy*, 197 B.R. 384 (Bankr. N.D. Ga. 1995).

liquidation or reorganization proceedings lies elsewhere, thereby preempting bankruptcy court jurisdiction<sup>6</sup>

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."<sup>1</sup> 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.<sup>2</sup>

<sup>6</sup> See ¶ 109.03[3] *infra*.

#### ¶ 109.02.

<sup>1</sup> 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).

<sup>2</sup> 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 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" (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 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.<sup>1</sup> 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.<sup>2</sup> 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<sup>3</sup> to provide the maximum access to chapter 9 consistent with the

#### ¶ 109.04.

<sup>1</sup> *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).

<sup>2</sup> *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 case was not in bad faith but debtor did not meet eligibility requirements).

<sup>3</sup> 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.<sup>4</sup> 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,<sup>5</sup> nor did it require the debtor to engage in prepetition negotiations with respect to a specific plan of adjustment.<sup>6</sup> To broaden access to chapter 9, these requirements, found in chapter 9's predecessor, were intentionally not carried over into chapter 9.<sup>7</sup> 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,"<sup>8</sup> 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.<sup>9</sup> 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),<sup>10</sup> 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).<sup>11</sup> 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.").

<sup>4</sup> *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).

<sup>5</sup> 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).

<sup>6</sup> *See Bankruptcy Act Section 84(2)*, former 11 U.S.C. § 404 (1976).

<sup>7</sup> *See* ¶ 900.02 *infra*.

<sup>8</sup> *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).

<sup>9</sup> *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).

<sup>10</sup> *See* ch. 903 *infra*.

<sup>11</sup> *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.<sup>12</sup> “Municipality” is defined to mean “political subdivision or public agency or instrumentality of a State.”<sup>13</sup> This definition is identical to the language in section 84 of the 1976 municipal bankruptcy legislation.<sup>14</sup> 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.”<sup>15</sup> 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.<sup>16</sup> The suggestion that the three categories

<sup>12</sup> 11 U.S.C. § 109(c).

<sup>13</sup> 11 U.S.C. § 101.

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

<sup>15</sup> *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).

<sup>16</sup> 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,

“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<sup>17</sup> 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.<sup>18</sup> 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.<sup>19</sup>

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”].

<sup>17</sup> 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).

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

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

### [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.<sup>20</sup> This reading is incorrect.<sup>21</sup> 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.<sup>22</sup>

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

The Bankruptcy Reform Act of 1994<sup>23</sup> 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."<sup>24</sup> The 1994 Act modified the preexisting law, which required only general

<sup>20</sup> 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.

<sup>21</sup> See ch. 903 *supra*.

<sup>22</sup> *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)).

<sup>23</sup> 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*.

<sup>24</sup> 11 U.S.C. § 109(c)(2).

authorization.<sup>25</sup> 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."<sup>26</sup>

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.<sup>27</sup>

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

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

"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

<sup>25</sup> See ¶ 900.LH[6] *infra*.

<sup>26</sup> *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.

<sup>27</sup> 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*.

<sup>28</sup> 11 U.S.C. § 109(c)(3).

<sup>29</sup> Pub. L. No. 100-597, § 11(1988), reprinted in App. Pt. 41(g)(ii) *infra*.

over nonexempt assets at fair market value.<sup>30</sup> 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.<sup>31</sup> 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.<sup>32</sup> 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.<sup>33</sup> 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.<sup>34</sup> 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.<sup>35</sup> 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

<sup>30</sup> See ch. 101 *supra*.

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

<sup>32</sup> 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).

<sup>33</sup> *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).

<sup>34</sup> See ¶ 900.01[1] *infra*.

<sup>35</sup> *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.<sup>36</sup>

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.<sup>37</sup> 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.<sup>38</sup>

**[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.<sup>39</sup> Reliance on this portion

<sup>36</sup> See ¶ 900.LII *infra*.

<sup>37</sup> 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.

<sup>38</sup> *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*.

<sup>39</sup> 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").

f 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."<sup>40</sup> For purposes of the "unable to pay" test, qualifying unpaid debt must be "unconditionally owing and presently enforceable."<sup>41</sup> 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.<sup>42</sup> 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.<sup>43</sup> 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)<sup>44</sup> 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

<sup>40</sup> *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 do not, by definition, render a debtor insolvent.")

<sup>41</sup> *In re Hamilton Creek Metropolitan Dist.*, 143 F.3d 1381, 1385 (10th Cir. 1998).

<sup>42</sup> *In re Hamilton Creek Metropolitan Dist.*, 143 F.3d 1381, 1385 (10th Cir. 1998).

<sup>43</sup> 11 U.S.C. § 921(c). See ch. 921 *infra*.

<sup>44</sup> 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 unable 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."<sup>45</sup> 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."<sup>46</sup> 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.<sup>47</sup> 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.<sup>48</sup> A municipality cannot deliberately budget or spend itself into insolvency when other scenarios are possible.<sup>49</sup>

<sup>45</sup> *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).

<sup>46</sup> *Id.*, 129 B.R. 332, 338.

<sup>47</sup> *Id.*, 129 B.R. 332, 337.

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

<sup>49</sup> *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.”<sup>50</sup> This language was also found in the 1937 Act<sup>51</sup> and the 1976 Act.<sup>52</sup> It is an element of the “good faith” requirement of section 921(c).<sup>53</sup> 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;<sup>54</sup> 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.<sup>55</sup> This same court also concluded that the debtor’s pre-filing 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).<sup>56</sup> The desire to effectuate a plan of adjustment does not necessarily mean that the municipality must yield to creditor pressures.<sup>57</sup>

#### [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.<sup>58</sup> It supplements and reinforces the last

<sup>50</sup> 11 U.S.C. § 109(c)(4).

<sup>51</sup> Bankruptcy Act § 83(a), former 11 U.S.C. § 403(a).

<sup>52</sup> Bankruptcy Act § 84, former 11 U.S.C. § 404.

<sup>53</sup> 11 U.S.C. § 921(c).

<sup>54</sup> See *In re Town of Westlake, Texas*, 38 C.B.C.2d 1046, 1053-54, 211 B.R. 860, 867 (Bankr. v.D. Tex. 1997).

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

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

<sup>57</sup> *In re Ellicott Schapter Bldg. Auth.*, 150 B.R. 261, 265 (Bankr. D. Colo. 1992).

<sup>58</sup> See *In re Town of Westlake, Texas*, 38 C.B.C.2d 1046, 1054, 211 B.R. 860, 867-68 (Bankr. v.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,<sup>59</sup> 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,<sup>60</sup> 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.<sup>61</sup> As early as 1973, the requirement that an accepted plan be filed with the petition was recognized as anachronistic and unsuitable.<sup>62</sup> House and Senate versions of the 1976 legislation both attempted to do away with this requirement entirely.<sup>63</sup> 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.<sup>64</sup> However, the skittishness of the municipal bond community about a municipal bankruptcy law with “virtually limitless” access<sup>65</sup> 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.<sup>66</sup> It failed to recognize, however, what became of that opposition by 1946,<sup>67</sup> and shortsightedly imposed a cumbersome and unnecessary procedure on distressed municipalities.

<sup>59</sup> Bankruptcy Act § 84, former 11 U.S.C. § 404.

<sup>60</sup> Bankruptcy Act § 83(a), former 11 U.S.C. § 403(a).

<sup>61</sup> See ¶ 900.LII *infra*.

<sup>62</sup> 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*.

<sup>63</sup> 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).

<sup>64</sup> See ¶ 109.04[3][e][iii] *infra*.

<sup>65</sup> 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).

<sup>66</sup> See ¶ 900.LII *infra*.

<sup>67</sup> See ¶ 900.LII *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]."<sup>69</sup> This requirement is the same as that contained in the 1937 Act,<sup>69</sup> with the exception of the use of the word "impair," which is a concept new to the Bankruptcy Code.<sup>70</sup> 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."<sup>71</sup> 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.<sup>72</sup> 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.<sup>73</sup> 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

<sup>69</sup> 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.

<sup>69</sup> Bankruptcy Act § 83(a), former 11 U.S.C. § 403(a).

<sup>70</sup> See ch. 1124 *infra*.

<sup>71</sup> 11 U.S.C. § 109(c)(5)(B).

<sup>72</sup> 11 U.S.C. § 1129(b). See chs. 943 and 1129 *infra*.

<sup>73</sup> *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.<sup>74</sup>

Just how yielding a debtor must be in its prepetition negotiations will be subject to judicial review based upon the specific facts.<sup>75</sup>

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

The third alternative is that the municipality "is unable to negotiate with creditors because such negotiation is impracticable."<sup>76</sup> 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 be impossible.<sup>77</sup> 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.<sup>78</sup>

<sup>74</sup> 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).

<sup>75</sup> 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).

<sup>76</sup> 11 U.S.C. § 109(c)(5)(C).

<sup>77</sup> *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 prelifting negotiations impracticable" (citing *Trentise*)).

<sup>78</sup> *In re Orange County*, 183 B.R. 594, 60 (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 creditor may attempt to obtain a preference."<sup>79</sup> This provision is derived from the second paragraph of Section 83(c) of the 1937 Act, which permitted the debtor to obtain from the bankruptcy court a stay against aggressive creditor action while it was attempting to negotiate a plan of adjustment. Rather than requiring a municipality to seek stays piecemeal as did the 1937 Act, chapter 9 of the Code permits the municipality to file its petition and obtain the benefits of the Code's automatic stay<sup>80</sup> while it negotiates its plan with creditors, when aggressive creditor action may result in a preferential payment, which by its nature is unfair to other creditors. One court has suggested, without analysis, that a debtor cannot reasonably believe that a justifiable prebankruptcy termination of an executory contract constitutes an avoidable transfer under section 547.<sup>81</sup> It perhaps, under certain circumstances, a termination of an executory contract can constitute a transfer that is potentially avoidable under section 7.<sup>82</sup>

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

The criteria for eligibility for relief under the provisions of chapter 11 are set forth in section 109(d), which provides that "[o]nly 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." As under chapter 7, entities that do not qualify as "persons" under section 101 are not eligible to be chapter 11 debtors.<sup>1</sup> However,

<sup>79</sup> 11 U.S.C. § 109(e)(5)(D).

<sup>80</sup> 11 U.S.C. §§ 362, 922; chs. 362 and 922 *infra*.

<sup>81</sup> *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 at it would be surprising to read transfer to include a justifiable prebankruptcy termination of an executory contract).

<sup>82</sup> See 11 U.S.C. § 101(54) (broad definition of transfer; a property interest of the debtor would have to be found).

#### ¶ 109.05.

<sup>1</sup> See ¶ 109.03 *supra* for a discussion of the eligibility requirements under chapter 7. *In re Constitutional Trust #2-562*, 23 C.B.C.2d 1577, 114 B.R. 627 (Bankr. D. Minn. 1990) (trusts that have 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.<sup>2</sup>

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

The Supreme Court in *Toibb v. Radloff*,<sup>3</sup> 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.<sup>4</sup> While most debtors commencing cases under chapter 11 are corporations,<sup>5</sup> individuals<sup>6</sup> and partnerships may also become debtors under chapter 11. A joint chapter 11 case may be filed, but only by a husband and wife.<sup>7</sup> 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).<sup>8</sup>

### [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.<sup>9</sup> Those subchapters are recognized as business trusts and, therefore, cannot use that statutory category to become eligible as a chapter 11 debtor.

<sup>2</sup> *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).

<sup>3</sup> 501 U.S. 157, 111 S. Ct. 2197, 115 L. Ed. 2d 145, 24 C.B.C.2d 1179 (1991).

<sup>4</sup> *In re Toibb*, 902 F.2d 14, 15 C.B.C.2d 1043 (8th Cir. 1990); *Wamsanz 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).

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

<sup>6</sup> *Toibb v. Radloff*, 501 U.S. 157, 111 S. Ct. 2197, 115 L. Ed. 2d 145, 24 C.B.C.2d 1179 (1991).

<sup>7</sup> 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*.

<sup>8</sup> See ¶ 109.06[2] *infra*.

<sup>9</sup> 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*.



**Jermain Dunnagan & Owens, P.C.**

LAW OFFICES

WILLIAM K. JERMAIN  
CHARLES A. DUNNAGAN  
BRADLEY D. OWENS  
RANDALL G. SIMPSON  
HOWARD S. TRICKEY  
GREGORY C. TAYLOR

GARY C. SLEEPER  
SAUL R. FRIEDMAN  
DIANE F. VALLENTINE

JAMES A. GASPER  
W. MICHAEL STEPHENSON

ANDRENA L. STONE  
EUGENIA G. RICHARDSON  
MIKE L. DISHMAN  
GEOFFREY J. McGRATH  
NATASHA M. SUMMIT  
ERIC J. BROWN

3000 A STREET, SUITE 300  
ANCHORAGE, ALASKA 99503-4097

TELEPHONE (907) 563-8844  
FAX (907) 683-7322  
E-MAIL info@jdoibw.com

December 6, 1999

Representative Andrew Halcro, Co-Chair  
Community and Regional Affairs Committee  
716 W. 4<sup>th</sup> 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

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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. Steeper

# RHONDA LEE FEHLEN

Attorney-At-Law  
400 D Street, Suite 212  
Anchorage, Alaska 99501

Telephone (907) 272-2212  
Facsimile (907) 272-2214

December 3, 1999  
Via Facsimile 269-0248

Andrew Halcro  
State Representative  
716 West 4<sup>th</sup> 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.

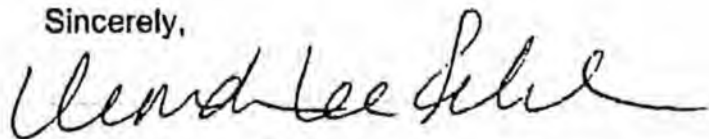
As you probably already know, municipalities already have the right to file for protection from creditors under federal law. See enclosed copy of 11 U.S.C. §109(c). A separate chapter of the Bankruptcy Code, Chapter 9, provides bankruptcy relief for any municipality, including those in the state of Alaska.

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)

TELEPHONE  
(907) 274-5631

*Law Office*  
**THOMAS J. YERBICH**

329 "F" STREET, SUITE 210  
ANCHORAGE, ALASKA 99501-2202  
e-mail: yerblaw@alaska.net

TELEFAX  
(907) 274-5794

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.

Rep. Andrew Halcro  
December 8, 1999  
Page 2

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.

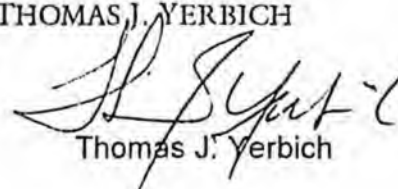
The only change I would recommend would be to add a provision waiving the Eleventh Amendment immunity of the State in bankruptcy cases filed by municipalities. It makes little sense to require resolution of disputes between the municipality and the State be resolved in the State courts, a process that 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 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

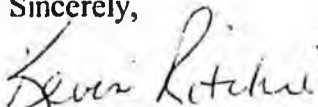
Dear Representative Halcro:

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

DISTRICT OFFICE • P.O. BOX 225 • UNALAKLEET, ALASKA 99684-0225 • (907) 624-3611 • FAX 624-3099

BREVIG MISSION • DIOMEDE • ELIM • GAMBELL  
SHAKTOOLIK • SHISHMAREF • STEBBINS TELLER



GOLOVIN • KOYUK • SAINT MICHAEL • SAVOONGA  
UNALAKLEET • WALES • WHITE MOUNTAIN

24 January, 2000

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

Dear Representative Halcro,

Thank you for scheduling time to meet 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,

A handwritten signature in black ink, appearing to be "John A. Davis", written over a large, stylized cursive flourish.

Dr. John A. Davis  
Superintendent

cc. J. Walsh

---

## "OUR MISSION"

The Mission of the Bering Strait School District is to educate students to become self-sufficient productive citizens in a changing world, recognized for their social, academic, and marketable skills, by providing standards of excellence, quality programs, and a supportive environment for both traditional Native and Western styles of learning.

# BERING STRAIT SCHOOL DISTRICT

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UNALAKLEET • WALES • WHITE MOUNTAIN

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,

A handwritten signature in black ink, appearing to read "John A. Davis".

Dr. John A. Davis  
Superintendent

cc: S. Friedman, Atty.  
J. Walsh

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## "OUR MISSION"

The Mission of the Bering Strait School District is to educate students to become self-sufficient productive citizens in a changing world, recognized for their social, academic, and marketable skills, by providing standards of excellence, quality programs, and a supportive environment for both traditional Native and Western styles of learning.

# LEGAL SERVICES

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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 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 [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

Senator Al Adams  
March 15, 1999  
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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-USE~~ ~~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.

Ohio Northern University Law Review  
1997

## 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

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## 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 [an 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

23 OHNULR 1001

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(Cite as: 23 Ohio N.U. L. Rev. 1001, \*1002)

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 feasible 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, \*1006 [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 sovereignty. [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 Chapter 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 affirmatively 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 refused 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.

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#### IV. State Approaches to Municipal Bankruptcy [FN65]

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 review 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  
[FN 66]

#### 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 California, [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 Emergencies 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 requirements, 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,