

**STATES AS CHAPTER 9 BANKRUPTCY
GATEKEEPERS: FEDERALISM, SPECIFIC
AUTHORIZATION, AND PROTECTION OF
MUNICIPAL ECONOMIC HEALTH**

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INTRODUCTION

Imagine for a moment being a retired Detroit police officer who, because of twenty-six years of service and an advanced rank, receives an annual pension of approximately \$30,000 per year.¹ Now, imagine that because of Detroit's municipal bankruptcy that pension is cut in half,² or even worse, down to sixteen cents on the dollar.³ Due to no personal fault, you are now living just above the poverty line or potentially even far below it.⁴

¹ On average, Detroit general city workers receive much less, approximately \$19,000 per year. See Mary Williams Walsh, *Detroit Spent Billions Extra on Pensions*, N.Y. TIMES (Sept. 25, 2013, 3:08 PM), <http://dealbook.nytimes.com/2013/09/25/undisclosed-payments-cost-detroit-pension-plan-billions/>; see also Bloomberg News, *Orr: Detroit Pensions Should Consider Benefit Cuts*, CRAIN'S DETROIT BUS. (Dec. 11, 2013, 5:14 AM), <http://www.crainsdetroit.com/article/20131211/NEWS01/131219979/orr-detroit-pensions-should-consider-benefit-cuts>.

² Retirement pensions in Central Falls, Rhode Island were cut in half in when that municipality faced bankruptcy in 2011. See Michael Corkery & Matthew Dolan, *Detroit Bankruptcy Likely to Spark a Pension Brawl*, WALL ST. J. (July 19, 2013, 9:09 PM), <http://online.wsj.com/articles/SB10001424127887324263404578616204128866568>.

³ See Joseph Lichterman & Bernie Woodall, *Detroit Pension Cuts 'Function of Mathematics'—Investment Banker*, REUTERS (Oct. 25, 2013, 1:41 PM), <http://www.reuters.com/article/2013/10/25/usa-detroit-bankruptcy-idUSL1N0IF0LG20131025>.

⁴ U.S. DEPT OF HEALTH & HUMAN SERVS., 2013 POVERTY GUIDELINES (2013), available at <http://aspe.hhs.gov/poverty/13poverty.cfm#thresholds>. The 2013 poverty threshold for a single person household was \$11,490 while the threshold for a four person household was just \$23,550. A fifty percent cut in pensions would result in

Also consider the city of Detroit's perspective. Regardless of the anger and confusion the situation presents and what events may have lead the municipality down this financially distressed road, the reality is harsh. Detroit faces the largest municipal bankruptcy in history with an estimated \$18 billion in outstanding debt.⁵ Of this debt, \$3.5 billion is comprised of pensions while another \$6.4 billion encompasses other employee benefits like retiree healthcare.⁶ Despite this incredible debt obligation, municipalities, like Detroit, must continue to function and provide basic services. Without bankruptcy relief through Chapter 9, how else could Detroit, or any similarly situated municipality, ever hope to rise from the ashes?

The reality of municipal bankruptcy is that it is a process with no happy solution. On the one hand, it is important to remember that "creditors" not only represent faceless corporations and investment funds, they also represent individuals such as the retired police officer described above with needs and obligations that states have a vested interest in protecting. On the other hand, municipalities and other financially distressed state government entities must ultimately have some ability to find debt relief under dire circumstances where no other solution can be reached. Because of these competing interests, some sense of dual perspective is necessary when considering municipal bankruptcy and, particularly, when considering the focal point of this piece—specific authorization by states.

Chapter 9 of the U.S. Bankruptcy Code (Code) deals exclusively with financially distressed municipalities such as cities, towns, counties, or school districts. Unlike its more well-known brethren⁷ however, Chapter 9 functions quite differently. This difference exists because bankruptcy is an exclusively federal function and because municipalities, by their very existence, are functions of the individual states. Because of this dichotomy,

retired police and fire workers receiving approximately \$15,000 per year while retired general city workers would receive only \$9,500 per year. *Id.*; see also *supra* note 1 and accompanying text.

⁵ See Corkery & Dolan, *supra* note 2.

⁶ See *id.*

⁷ Such as Chapters 7, 11, and 13 of the U.S. Bankruptcy Code (dealing with individual bankruptcy, corporate bankruptcy, etc.).

constitutional protection of state sovereignty reigned supreme in Chapter 9 construction and resulted in significant reductions from typical bankruptcy court powers as well as systematic advantages for debtor municipalities once they have been declared eligible to access the system.⁸

The Code attempts to counteract these advantages by placing five eligibility requirements—imagined as five hurdles—before potential debtors that must be satisfied before participation in the bankruptcy process is allowed. One of these eligibility requirements is the requirement that a municipality be “specifically authorized” by the state to access Chapter 9.⁹ While many states have chosen to satisfy this requirement through express authorization statutes, approaches to specific authorization varies greatly among the states, with many states having yet to address the issue.

In June 2010, one of the world’s greatest financial minds, Warren Buffett, described municipal finance as facing a “terrible problem” in the coming years.¹⁰ Two years later, Mr. Buffett stated that he believed the stigma associated with filing for Chapter 9 bankruptcy was being lifted and that dramatic economic effects could result should the trend continue.¹¹ Mr. Buffett explained his belief by citing the then-recent Chapter 9 filings of Stockton and San Bernardino, California as evidence to say, “[o]nce people find that the city works the next day, it makes

⁸ Advantages include the automatic stay, the assumption and rejection of executory contracts, limited judicial powers, etc. For a detailed analysis of the advantages and benefits provided to Chapter 9 debtors, see Elizabeth M. Watkins, Note, *In Defense of the Chapter 9 Option: Exploring the Promise of a Municipal Bankruptcy as a Mechanism for Structural Political Reform*, 39 J. LEGIS. 89, 93-96 (2012).

⁹ 11 U.S.C. § 109(c)(2) (2012).

¹⁰ FIN. CRISIS INQUIRY COMM’N, HEARING ON CREDIBILITY OF CREDIT RATINGS, THE INVESTMENT DECISIONS MADE BASED ON THOSE RATINGS, AND THE FINANCIAL CRISIS 337 (2010), *transcript available at* <http://cybercemetery.unt.edu/archive/fcic/20110310180625/http://c0182412.cdn1.cloudfiles.rackspacecloud.com/2010-0602-Transcript.pdf> (on file with author). Mr. Buffett is arguably the world’s most successful investor, having been, at several points, declared to be the world’s richest man. His testimony regarded an investigation into bond rating agencies, one of which, Moody’s, Mr. Buffett’s company Berkshire Hathaway owned thirteen percent. *Id.*

¹¹ See Margaret Collins, *Buffett Says Muni Bankruptcies Set to Climb as Stigma Lifts*, BLOOMBERG BUS. (July 13, 2012, 11:52 AM), <http://www.bloomberg.com/news/2012-07-13/buffett-says-muni-bankruptcies-poised-to-climb-as-stigma-lifts.html>.

it easier for the city counsel . . . just to say, ‘well, we’ll declare bankruptcy.’”¹²

Whether Mr. Buffett is correct and a gradual lifting of the negative stigma associated with Chapter 9 is the catalyst, it is undeniable that Chapter 9 filings reflect an upward trend. From 2000 through 2013, there were 125 Chapter 9 filings.¹³ By comparison, in the sixty-one year period between 1938 and 1999 there were only 519 filings, with a majority of those filings—321—coming in the eleven years surrounding the Great Depression and Chapter 9’s initial enactment.¹⁴ In addition to the increased quantity of filings, the amount of outstanding debt held by financially distressed municipalities filing for Chapter 9 relief has grown to near epic proportions. In the last five years alone, the two largest Chapter 9 filings in United States history have occurred—Jefferson County, Alabama and Detroit, Michigan—which combine to account for an outstanding debt of over \$23 billion.¹⁵

Upon consideration of these facts, this piece attempts to push into the economic realm by considering the resultant economic impact of such filings. For instance, given the increased utilization of the municipal bankruptcy system, will greater publicity and public awareness operate to disincentivize municipal investment? Further, what “specific authorization” system provides the optimal solution for states to balance the economic concerns of all involved parties?

¹² *Id.*

¹³ AM. BANKR. INST., CHAPTER 9 QUARTERLY FILINGS (1980-2014) (2014), available at <http://news.abi.org/sites/default/files/statistics/Chapter9Filings-Thru2Q2014.pdf>; ADMIN. OFFICE OF THE U.S. COURTS, 2012 BANKRUPTCY FILINGS (2013), available at http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2012/1212_f2.pdf; ADMIN. OFFICE OF THE U.S. COURTS, 2013 BANKRUPTCY FILINGS (2014), available at http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2013/1213_f2.pdf. To calculate filing numbers, the several reports and quarterly filings were accumulated.

¹⁴ See *supra* note 13; see also Robert J. Landry III & Keren H. Deal, *More Municipalities Likely to Face Chapter 9: Is a Perfect Storm Brewing?*, AM. BANKR. INST. J., July-Aug. 2008, at 18 (for historical filing numbers dating back to 1938).

¹⁵ See Mary Williams Walsh, *A County in Alabama Strikes a Bankruptcy Deal*, N.Y. TIMES (June 4, 2013, 9:21 PM), <http://dealbook.nytimes.com/2013/06/04/a-county-in-alabama-strikes-a-bankruptcy-deal/>; Monica Davey & Mary Williams Walsh, *Billions in Debt, Detroit Tumbles Into Insolvency*, N.Y. TIMES (July 18, 2013), <http://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html>.

Because the responsibility of balancing the concerns of all interested parties falls squarely on the states, rather than the bankruptcy courts themselves, systems must be implemented with this balance in mind. The optimal system must consider the needs of not only the financially distressed municipalities but also those of other interested parties, such as investors and creditors. Further, because the stakes are so high, once implemented, states must make their best efforts toward ensuring integrity in those systems.

To reach this ultimate end, and to satisfy the “specific authorization” requirement, states should elect to statutorily grant Chapter 9 access because, though the system operates advantageously for debtors, it serves a necessary purpose. Additionally, to ensure its limited use, states should implement a conditional authorization system—more specifically, a Political Model of conditional authorization—that financially distressed municipalities must undertake prior to gaining access to the federal bankruptcy system.

Part I of this Comment examines Chapter 9’s history, including two seminal cases that highlight the constitutional issues faced in construction, as well as two critical revisions that lead to the modern chapter. Part II breaks down into four classifications how each of the fifty states addresses, or does not address, the “specific authorization” requirement as well as a detailed analysis of the three types of conditional authorization models currently in place. Further, for both the Administrative and Hybrid Models of conditional authorization, a thorough illustration of such systems has been provided. In addition, a detailed analysis of all additional Administrative Model states has been provided in the Appendix. Part III provides analysis of the proposed optimal solution for states by utilizing a two-pronged approach to Chapter 9 authorization. This approach begins with states specifically statutorily authorizing access to Chapter 9 and ends with states adopting the Political Model of conditional authorization. Additionally, in an attempt to strike the proper balance between consideration and oversight to find an optimal solution, this Comment provides a comprehensive exploration of the advantages and disadvantages of the three conditional authorization models.

I. THE ECONOMICS & EVOLUTION OF CHAPTER 9 BANKRUPTCY

The goal of this piece is to provide a common sense framework linking the idea that municipal bankruptcy has a detrimental economic impact beyond the individual insolvent municipality with the idea that states bear the responsibility of giving full consideration to these broader Chapter 9 filing effects. While an overarching economic analysis of Chapter 9 filings would certainly contribute to the broader point made by this piece, such a technical analysis is beyond the scope.

A. *The Economic Impact of Chapter 9 Filings*

Municipal bankruptcy can have a dramatic effect on the economic landscape not limited to the individual insolvent municipality.¹⁶ Not only is the individual municipality's ability to utilize debt instruments, such as bonds or notes, affected, but pension holders, taxpayers, and other interested parties are also affected.¹⁷ As Chapter 9 filings continue to trend upward in both frequency and severity, the ripple effect of these filings felt throughout the economic landscape will likely continue to expand as well.

One of the key factors cutting against states allowing access to Chapter 9 is fear that municipal bankruptcy filings may detrimentally impact credit ratings and the ability to borrow.¹⁸

¹⁶ See Watkins, *supra* note 8, at 95-96 ("A Chapter 9 filing may also bring stigma on the locality and the state."); see also Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 382-84 (2010) (discussing how a Chapter 9 filing aggravates a distressed locality's situation); Kirk B. Burkley & Jillian L. Nolan, *Chapter 9 and Act 47: A Light at the End of the Tunnel for Municipalities?*, LAW. J., Jan. 28, 2011, at 4 (noting that Chapter 9 has been "considered a last resort [for municipalities] because of the uncertain results for everyone involved"). See generally Brian S. Fraser, *The Prospect of Municipal or State Defaults on Bond Obligations: Can Bankruptcy Help?*, in THE EMERGENCE OF STATE AND MUNICIPAL BANKRUPTCIES: AN IN-DEPTH LOOK AT THE IMPACT OF RISING FINANCIAL DISTRESS IN STATE AND LOCAL GOVERNMENTS (2011) (discussing generally the effects of Chapter 9 filings as well as analyzing a few historical Chapter 9 cases).

¹⁷ See, e.g., Corkery & Dolan, *supra* note 2; Collins, *supra* note 11; MICH. COMP. LAWS ANN. §141.1543(c) (West 2014) ("[F]iscal stability of local governments is necessary to the health, safety, and welfare of the citizens of this state . . .").

¹⁸ See Claire Zillman, *Bankruptcy Bar? States Aim to Deny Distressed Cities Chapter 9 Option*, AM. LAW. DAILY (July 13, 2011, 12:53 PM), <http://amlawdaily.typepad.com/amlawdaily/2011/07/chapter9.html>.

Furthermore, there are concerns that the ripple effect of a Chapter 9 filing could reverberate beyond the individual municipality and out to other municipalities, states, or beyond.¹⁹

One of the most important factors to consider regarding Chapter 9 is its effect on a municipality's ability to extend debt.²⁰ Debt plays a critical role in finance and economics at the municipal level because it operates as a lifeblood mechanism allowing municipalities to survive and grow the same way credit operates for corporations and individuals. Essentially, the ability to borrow allows municipalities to spread the costs of providing government services or funding public projects over longer periods of time.²¹

A simplistic illustration of how the process of extending municipal debt operates is that municipalities sell debt instruments to investors—which may include anyone from individuals to multi-billion dollar investment funds—with the promise of receiving a modest return on their investment.²² Traditionally, investors have been willing to accept a relatively low rate of return on municipal debt because of benefits such as income tax exemption on municipal bond interest payments and the belief that these investments are incredibly secure and stable.²³

Much of the stability behind municipal debt stems from the structure of municipal bonds. For instance, municipalities have several instruments at their disposal when they wish to extend debt; two of the most commonly used instruments are general

¹⁹ See Watkins, *supra* note 8, at 99.

²⁰ See JAMES E. SPIOTTO, CHAPMAN & CUTLER LLP, PRIMER ON MUNICIPAL DEBT ADJUSTMENT, CHAPTER 9: THE LAST RESORT FOR FINANCIALLY DISTRESSED MUNICIPALITIES 6-7 (2012), available at http://www.afgi.org/resources/Bankruptcy_Primer.pdf.

²¹ See Kevin A. Kordana, *Tax Increases in Municipal Bankruptcies*, 83 VA. L. REV. 1035, 1047 (1997); see also ROBERT S. AMDURSKY & CLAYTON P. GILLETTE, MUNICIPAL DEBT FINANCE LAW: THEORY & PRACTICE 10-11 (1992); Samuel Cameron, *Household Debt Problems: Towards a Micro-Macro Linkage*, 6 REV. POL. ECON. 205, 207 (1994) (“[B]orrowing is a means of adjusting the flow of purchases over time.”).

²² See Kordana, *supra* note 21, at 1056.

²³ Mike Cherney, *Investors Seek Bargains in Battered Munis*, WALL ST. J. (Oct. 13, 2013, 2:57 PM), <http://online.wsj.com/news/articles/SB10001424052702304330904579133331201280554>.

obligation (GO) bonds and revenue bonds.²⁴ GO bonds are particularly attractive to investors because they are “secured by the full faith and credit of an issuer that has taxing power.”²⁵ Revenue bonds, on the other hand, have a specifically designated income source, such as a utility, out of which payments will be made.²⁶ By all accounts, these investments have traditionally been well regarded as safe and secure.

Usually, the transaction between municipalities and investors benefits both parties. The municipality gains funding to do things like build schools or sewer treatment facilities and the investor receives a modest return on the investment through a reliable and secure source. However, when a municipality becomes insolvent and files for bankruptcy, the entire municipal debt transaction is directly impacted because investors are placed in the position of likely receiving only a fraction of their expected return or, worse, nothing at all.²⁷ For instance, though GO bonds are backed by the “full faith and credit” of the issuer, once the municipality is operating within Chapter 9, bondholders are susceptible to the bankruptcy provisions like any typical unsecured creditor.²⁸ Not all that dissimilarly, though revenue bondholders are deemed secured creditors and, thus, are more protected than GO bondholders, they, too, are impaired from necessarily receiving their expected return.²⁹

The direct impact of investors and creditors receiving less than their expected return may detrimentally affect people’s

²⁴ See Kordana, *supra* note 21, at 1047-50.

²⁵ See *id.* at 1047 (citation omitted).

²⁶ See *id.* at 1049.

²⁷ See Corkery & Dolan, *supra* note 2.

²⁸ See Kordana, *supra* note 21, at 1048 (“GO bondholders will, at a minimum, find their ability to enforce their right to payments halted by the automatic stay entered at the beginning of a Chapter 9 proceeding, and may need to await plan confirmation in order to receive any payments on their bonds. GO bondholders are, for Chapter 9 purposes, unsecured creditors.”) (footnotes omitted).

²⁹ See *id.* at 1049 (“Revenue bonds are secured by collateral—namely, the net value of the income stream generated by the facility in question. Section 928 of the Bankruptcy Code specifies that this lien survives bankruptcy. Revenue bondholders thus have a secured claim against the municipality. This claim, however, is only for an amount up to the value of the income stream secured by the bondholders’ lien. To the extent the value of this collateral is less than the amount due on the revenue bonds, the revenue bondholders are deprived of any unsecured bankruptcy claim by Section 927.”) (footnote omitted).

willingness to engage in these essential transactions with the municipality. Though the issue has long been debated as to whether Chapter 9 filings actually have long-term economic effects on a municipality's ability to secure future funding,³⁰ the fact remains that filing quantities, as well as amounts of debt outstanding, continue to increase.³¹ One must wonder, as investor awareness increases, eroding the perceived security and stability in municipal investment, will municipal investment dwindle or, more likely, will municipalities be able to handle the increased return on investment investors will demand in exchange for securing the funds they need? No doubt, whichever outcome, everyday citizens, as taxpayers, may be dramatically affected.

In October 2013, the Wall Street Journal reported that in the period leading up to and immediately following the Detroit Chapter 9 bankruptcy filing, investors had removed \$44 billion from domestic municipal bond funds, the fastest removal rate on record.³² Though Detroit's filing was likely not the only factor driving the municipal bond exodus, the idea that the largest municipal bankruptcy filing in U.S. history was not a contributing factor seems, at best, unrealistic.

While the Detroit bankruptcy's actual contribution to the exodus is difficult to pinpoint, there should be little doubt investors have taken notice.³³ As investor wallets are increasingly impacted, perceptions and awareness are naturally affected, not only on an individual level but perhaps even regionally or nationally.³⁴ For instance, experts have noted, as Detroit's Chapter 9 filing has pushed on, various events during the eligibility stage, such as the treatment of general obligation debt,

³⁰ Orange County, CA was able to extend debt just three years after declaring bankruptcy and received a ratings boost. *See* Watkins, *supra* note 8, at 113-14.

³¹ *See supra* notes 13-14 (documenting the rise in filings).

³² *See* Cherney, *supra* note 23.

³³ Once again, advanced investment and economic analysis would prove useful in this analysis. However, the focus of this piece is on the common sense notion that in the period leading up to and immediately following the largest municipal bankruptcy in history (Detroit, MI), the fact that municipal bond funds experienced the fastest exodus of investment funds ever recorded must have some corollary connection beyond mere coincidence. *See id.*

³⁴ *See* Gene Amromin & Ben Chabot, *Detroit's Bankruptcy: The Uncharted Waters of Chapter 9*, CHI. FED LETTER, Nov. 2013, at 1, available at https://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2013/cflnovember2013_316.pdf.

have had reverberating effects on national municipal bond markets.³⁵

This impact can be highlighted by the fact that investor responses to these events have caused experts to go so far as to urge caution in reacting solely on what has occurred in Detroit.³⁶

Billion dollar municipal bankruptcies create disincentives for future investors that result in increased costs of extending debt.³⁷ Not only does this create a problem with securing cost-effective public funding but likewise, as illustrated above, it impacts individual taxpayers themselves in the form of increased taxes, or in special cases such as municipal utility districts, increased utility bills.³⁸

B. Ashton, Bekins, *Federalism, & the Tenth Amendment*

The Constitution grants the federal government the exclusive power to oversee a system of bankruptcy.³⁹ Chapter 9 of the Bankruptcy Code is the only chapter that deals with municipalities,⁴⁰ organizations that at their very nature are state-

³⁵ See Christine Benz, *Don't Write Off Munis Out of Hand*, MORNINGSTAR (Aug. 22, 2013, 3:00 PM), <http://www.morningstar.com/cover/videocenter.aspx?id=609042> (“Furthermore, mid-June was also when the Detroit emergency manager [Kevyn Orr] presented his debt-restructuring plan, which proposed an unprecedented treatment of general-obligation debt as unsecured. That certainly caused some reverberations in the market from a credit perspective, and so we think . . . [this] certainly contributed to those major outflows in June.”); see also Cherney, *supra* note 23 (Although the main point of the article examines opportunities in these investments, the underlying point is that the opportunities have been created by the mass exodus in municipal bond funds.).

³⁶ See Benz, *supra* note 35 (“Certainly with all the headlines that Detroit is making currently, that understandably spurs some fears about the whole municipal asset class. But I would actually urge investors to caution against treating the entire muni asset class as being monolithic because I think the specific economic, demographic, and financial ailments that have been facing Detroit for decades are not really applicable to the market as a whole.”).

³⁷ See Kordana, *supra* note 21, at 1067 (“Potential purchasers of municipal bonds, in turn, will know that municipalities can act opportunistically in this manner, and they will take this into account in purchasing municipal bonds by demanding high interest rates.”) (citing Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 336-37 (1976)).

³⁸ See *id.* at 1071.

³⁹ U.S. CONST. art. I, § 8, cl. 4.

⁴⁰ 11 U.S.C. § 109 (2012).

based. Because of this interaction between the state and federal government, there is inherent conflict over state sovereignty that has permeated Chapter 9's history since inception.

The original version of Chapter 9—referred to as “Chapter IX”—was constructed in May of 1934 as a reaction to the Great Depression.⁴¹ In the wake of economic collapse, many municipalities around the country were left unable to repay their debts. Chapter IX gave municipalities the power to file for bankruptcy and force certain creditor minorities to participate in debt readjustment agreements.⁴² It did not, however, provide for bankruptcy proceedings.⁴³ In fact, a municipality could only file under Chapter IX *after* reaching a debt readjustment agreement with creditors and only after an absolute majority of the municipality's creditors had approved the plan.⁴⁴ Essentially, Chapter IX operated to push the municipality over the hump after it had worked with its creditors to handle the majority of the situation itself.

Despite Congress' efforts to lawfully navigate the state sovereignty issue, Chapter IX was declared unconstitutional within two years after its adoption, in the case of *Ashton v. Cameron County Water Improvement District*.⁴⁵ Though the Court justified its holding on the Tenth Amendment, its main concerns were based heavily on ensuring the protection of states as sovereigns and on the Code impairing the ability of states to impede contracts under the Contracts Clause.⁴⁶

In response to *Ashton*, Congress enacted a new version of Chapter IX in 1937.⁴⁷ Subsequently, the Supreme Court upheld this version of Chapter IX, which actually involved very little substantive revision, in the 1938 case of *United States v. Bekins*.⁴⁸

⁴¹ See Kimhi, *supra* note 16, at 362-64.

⁴² See *id.* at 364-65.

⁴³ See *id.* at 365.

⁴⁴ See *id.*

⁴⁵ 298 U.S. 513, 532 (1936) (challenging the constitutionality of a Texas water improvement district's bankruptcy filing).

⁴⁶ *Id.* at 531-32.

⁴⁷ See Eric W. Lam, *Municipal Bankruptcy: The Problem with Chapter 9 Eligibility—A Proposal to Amend 11 U.S.C. § 109(c)(2)* (1988), 22 ARIZ. ST. L.J. 625, 628 (1990).

⁴⁸ 304 U.S. 27, 54 (1938) (involving a California irrigation district's bankruptcy filing that was challenged on Fifth and Tenth Amendment constitutional grounds).

In upholding this revision, the *Bekins* majority attempted to avoid what they deemed to be a “legislative no-man’s land.”⁴⁹ In contrast with *Ashton*, the *Bekins* Court reviewed the legislative policy behind the chapter’s original enactment, noted the implications of the Contract Clause on these situations, and recognized that relief for financially distressed municipalities could only come through use of the federal bankruptcy system.⁵⁰ Interestingly, some scholars believe the Court in *Bekins* had simply become more pragmatic than it had been just two years earlier because the revisions to the Code are quite minimal.⁵¹

C. 1970s: Chapter 9 Becomes a True Bankruptcy Chapter

Chapter IX operated quietly until the 1970s when national economic difficulties once again placed emphasis on municipal bankruptcy. In April 1975, New York City experienced a serious financial crisis when it lacked the funds to pay for its debt service or basic operating expenses and the financial markets refused to extend the city any more credit.⁵² Hoping to avoid financial disaster, city officials turned to President Ford and the federal

⁴⁹ *Id.* at 51; see also Lam, *supra* note 47, at 629-30.

⁵⁰ *Bekins*, 305 U.S. at 51-52. “There is no hope for relief through statutes enacted by the States, because the Constitution forbids the passing of State laws impairing the obligations of existing contracts. Therefore, relief must come from Congress, if at all.” *Id.* at 51.

⁵¹ See Lam, *supra* note 47, at 630 n.42. Interestingly, in the early stages of this piece’s research, constitutional law expert Professor Jack Wade Nowlin of the University of Mississippi School of Law posited the idea that the dramatic change in the Court’s sentiment toward the issue may have come on the heels of changes related to the end of the *Lochner* era in 1937. This idea was founded in the fact that in *Ashton*, Justice McReynolds wrote the opinion of the Court while Justices Cardozo, Brandeis, and Stone as well as Chief Justice Hughes dissented, with Justice Cardozo penning the dissent. Yet, some two years later, in an opinion that adopted Justice Cardozo’s *Ashton* dissent’s reasoning almost entirely, Chief Justice Hughes wrote the *Bekins* Court’s opinion while Justice Cardozo took no part in the consideration and decision of the case. Upon further review, this initial suspicion was not confirmed based on further research by the author and Professor Nowlin as it appears Justice Cardozo took no part in the consideration of this case due to his declining health at the time. Justice Cardozo subsequently died in July 1938. However, other scholars have noted similarly that this change in the Court’s sentiment is particularly interesting. KENNETH N. KLEE, A SHORT HISTORY OF MUNICIPAL BANKRUPTCY 5 (2012), available at <https://cumberland.samford.edu/files/Short%20History%20of%20Municipal%20Bankruptcy.pdf>.

⁵² See Kimhi, *supra* note 16, at 366.

government for assistance.⁵³ Rather than provide assistance, President Ford recommended New York use municipal bankruptcy and Chapter IX to solve its problems.⁵⁴

The problem with the President's solution was that Chapter IX did not function like today's bankruptcy proceedings; it could not alleviate New York's problems. Left virtually untouched from the 1930s, Chapter IX could only "facilitate the approval of an already existing debt readjustment agreement."⁵⁵ Since New York failed to have any such agreement in place, this prevented the city from being able to access Chapter IX.⁵⁶ In response, Congress amended Chapter IX in April of 1976 for the purpose of restructuring the chapter so that it could help cities like New York in the future.⁵⁷

The 1976 revisions included some fundamental adjustments to Chapter IX.⁵⁸ First, it improved accessibility by removing the requirement that a municipality present a "debt readjustment agreement approved by an absolute majority of the creditors prior to the filing."⁵⁹ Under the new chapter, all municipalities were allowed to file even if a majority of creditors opposed the filing or a debt readjustment agreement had not been prepared prior to filing.⁶⁰

Second, the bankruptcy procedures themselves were modified, adding many of the features now considered to be powerful debtor benefits:

[T]he amended Chapter IX created an automatic stay to prevent creditors from seizing municipal property; it included a cram down provision that enabled municipalities to force through a debt readjustment agreement despite the objection of the majority of the creditors; it contained provisions that allowed municipalities to receive new financing at the

⁵³ *See id.*

⁵⁴ *See id.*

⁵⁵ *See id.* at 367.

⁵⁶ *See id.*

⁵⁷ *See id.*

⁵⁸ *See id.*

⁵⁹ *See id.*

⁶⁰ *See id.*

expense of their old creditors; it allowed municipalities to reject and assume executory contracts; and more.⁶¹

Another revision to the Chapter dealt with the authorization eligibility provision that would later become modern-day section 109(c)(2).⁶² This section provided: “[a]ny State’s political subdivision . . . which is *generally authorized* to file a petition under this chapter by the legislature . . . is eligible for relief”⁶³ The use of “generally authorized” mirrored the proposed language the Senate had originally considered when it enacted the Code.⁶⁴ As the Senate Report explained, *generally authorized* meant it “require[d] general authorization by the State legislature, or by a governmental officer . . . or governmental organization . . . empowered by State law to authorize [such a] filing.”⁶⁵ The use of “generally authorized” was chosen as the solution to the Senate’s Tenth Amendment concerns that “[a]bsent such a requirement for affirmative action by the state, a serious constitutional question would be raised.”⁶⁶

D. 1994: From “Generally Authorized” to “Specifically Authorized”

The final major Chapter 9 revision prior to the current version of section 109(c)(2) occurred in 1994. As previously mentioned, the law at that time required a municipality to be “generally authorized” by state law or by a “governmental officer or organization empowered by State law.”⁶⁷ Although implementation of the “generally authorized” language was

⁶¹ See *id.* at 368 (footnotes omitted).

⁶² Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315 (codified at 11 U.S.C. §§ 401-418 (Supp. 1976)); see also Lam, *supra* note 47, at 630-31 (at the time, the provision was located in Section 84 of the 1976 Bankruptcy Act).

⁶³ Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315 (codified at 11 U.S.C. §§ 401-418 (Supp. 1976)) (emphasis added); see also Lam, *supra* note 47, at 630-31.

⁶⁴ S. 2266, 95th Cong. § 906 (1978), reprinted in COLLIER ON BANKRUPTCY app. pt. 4(e) (16th ed. 2012); see Lam, *supra* note 47, at 631.

⁶⁵ See Lam, *supra* note 47, at 631 (quoting S. REP. NO. 95-989, at 110 (1978), reprinted in COLLIER ON BANKRUPTCY app. pt. 4(e) (16th ed. 2012)).

⁶⁶ See *id.*

⁶⁷ Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315 (codified at 11 U.S.C. §§ 401-418 (Supp. 1976)); see also Lam, *supra* note 47, at 631-32.

intended to provide clarity and guidance, use of the term actually led to broad interpretations among federal bankruptcy courts.⁶⁸

For instance, in *In re Pleasant View Utility District of Cheatham County*,⁶⁹ the court applied the language broadly, concluding that the municipality's ability to incur debts and to make and enter contracts "indicated sufficient general authorization by the state for a local government unit to file for bankruptcy."⁷⁰ In essence this meant that by existing as a municipality within the state, the entity had satisfied the "generally authorized" language.

In contrast, *In re North and South Shenango Joint Municipal Authority*⁷¹ relied on a similar line of reasoning as the *In re Pleasant View* court yet was subsequently overturned and rejected by the Court of Appeals.⁷² Despite the Court of Appeals' rejection of the *In re Pleasant View* reasoning, bankruptcy courts in other places like Missouri, Mississippi, Colorado, and New Hampshire continued to follow the very broad standard of interpretation.⁷³

The opposite approach to the "generally authorized" language was applied in states such as Connecticut and Pennsylvania.⁷⁴ In *In re Westport Transit District*, for instance, the court found that a transit company was not generally authorized because the power to file under Chapter 9 was "not a power necessarily implied for [the debtor] to discharge its stated powers."⁷⁵

Congress revised the Code in 1994 as a response to the split created by the *generally authorized* language. The new revision required debtors to be *specifically authorized* by state law to participate in Chapter 9 rather than be *generally authorized*. In making this revision, Congress hoped to clarify what the *generally*

⁶⁸ See *infra* notes 69-75.

⁶⁹ 24 B.R. 632 (Bankr. M.D. Tenn. 1982).

⁷⁰ See Christopher Smith, Note, *Provisions for Access to Chapter 9 Bankruptcy: Their Flaws and the Inadequacy of Past Reforms*, 14 BANKR. DEV. J. 497, 506 (1998).

⁷¹ 14 B.R. 414 (Bankr. W.D. Pa. 1981).

⁷² See Smith, *supra* note 70, at 506.

⁷³ See *id.* (citing *In re City of Wellston*, 43 B.R. 348 (Bankr. E.D. Mo. 1984); *In re Greene Cnty. Hosp.*, 59 B.R. 388 (Bankr. S.D. Miss. 1986); *In re Vill. at Castle Rock Metro. Dist. No. 4*, 145 B.R. 76 (Bankr. D. Colo. 1990); *In re Sullivan Cnty. Reg'l Refuse Disposal Dist.*, 165 B.R. 60 (Bankr. D.N.H. 1994)).

⁷⁴ See *id.* at 509.

⁷⁵ *In re Westport Transit Dist.*, 165 B.R. 93, 98 (Bankr. D. Conn. 1994); Smith, *supra* note 70, at 509.

authorized language in the state authorization section 109(c)(2) requirement had failed to provide. Under this revision, municipalities were precluded from filing under Chapter 9 unless the state either passed express authorization legislation or set procedures in place for gaining specific authorization through a designated governmental agency or officer.⁷⁶

Contrary to the intent of the 1994 revision, some scholars argue that the change in language actually accomplished very little and has left the same lingering questions.⁷⁷ However, despite these arguments, there is support for the idea that this language revision has provided clarity as twenty-nine states currently have statutes in place either expressly authorizing or de-authorizing access to Chapter 9.⁷⁸

Regardless of the debate over the exact impact of the 1994 revision, the resultant prominence of express authorization statutes leaves little room for debate as to whether states employing such statutes authorize or de-authorize Chapter 9 access. By making an affirmative statement regarding municipal authorization to Chapter 9, potential municipal debtors, investors, and other interested parties are better able to assess the municipal landscape within those particular states, thereby improving transparency.⁷⁹

II. APPROACHES TO SPECIFIC AUTHORIZATION: A STATE SURVEY

As previously mentioned, the manner in which states treat specific authorization and Chapter 9 access varies greatly. Though a large contingency of states has yet to address Chapter 9 expressly through legislation, a majority of states have chosen to expressly do so.⁸⁰ The following section provides a comprehensive breakdown for how each state has chosen to deal with Chapter 9

⁷⁶ However, some scholars believe the changes have resulted in nothing more than cosmetic differences because the states continue to address Chapter 9 in dramatically diverse fashions. See Smith, *supra* note 70, at 513-14.

⁷⁷ See *id.* at 514.

⁷⁸ See *infra* Part II.

⁷⁹ See *infra* Part II.

⁸⁰ See generally *infra* Part II; Daniel J. Freyberg, Comment, *Municipal Bankruptcy and Express State Authorization to Be a Chapter 9 Debtor: Current State Approaches to Municipal Insolvency—and What Will States Do Now?*, 23 OHIO N.U. L. REV. 1001 (1997).

access and, more specifically, the 109(c)(2) specific authorization eligibility requirement.

State treatment of Chapter 9 authorization by the states can be divided into four distinct classifications: blanket express authorization states, de-authorization or effective de-authorization states, conditional authorization states, and states without controlling Chapter 9 authority. Furthermore, while these four main classifications are relatively straightforward, the conditional authorization classification may be further subdivided into three additional sub-classifications: Political Model states, Administrative Model states, and Hybrid Model states.⁸¹

An illustrative example of both the Administrative and the Hybrid Model has been provided.⁸² A breakdown of all additional Administrative and Hybrid Model states has been provided in the Appendix.⁸³ These breakdowns not only outline the structure of the individual state's authorization system, they also work to highlight that particular model's individual characteristics. A detailed analysis of the states utilizing the Political Model has been provided in the following section; however, due to the concise and simple nature of this model, no additional comprehensive breakdown is necessary.⁸⁴

⁸¹ Though, at times, some of the nuances between dividing sub-classifications blur the lines in a particular state.

⁸² For a breakdown of the illustrative Administrative Model state, New York, see *infra* notes 110-27 and accompanying text. For a similar breakdown of the illustrative Hybrid Model state, Michigan, see *infra* notes 129-69 and accompanying text.

⁸³ See *infra* Appendix A & B.

⁸⁴ See *infra* Part II.C.1 (The Political Model).

A. Blanket Express Authorization States—An Entrance with No Gate

Fourteen states expressly authorize Chapter 9 access for financially distressed municipalities without further restriction.⁸⁵ In most instances, these broad blanket authorization statutes represent a relatively broad approach by enabling any qualifying governmental unit to file under Chapter 9. As the following Texas statute illustrates, these statutes, though broad, are typically relatively straightforward and easy to interpret. The Texas statute reads, “[a] municipality, taxing district, or other political subdivision that is subject to this section may proceed under all federal bankruptcy laws intended to relieve municipal indebtedness.”⁸⁶

⁸⁵ Express authorization states include:

Alabama. ALA. CODE § 11-81-3 (2014).

Arizona. ARIZ. REV. STAT. ANN. § 35-603 (2002).

Arkansas. ARK. CODE ANN. § 14-74-103 (1998).

Colorado. COLO. REV. STAT. § 37-32-102 (2010).

Florida. FLA. STAT. ANN. § 218.01 (West 2000).

Idaho. IDAHO CODE ANN. § 67-3903 (2001).

Kentucky. KY. REV. STAT. ANN. § 66.400 (West 2014). In Kentucky, any taxing agency or municipality may file under Chapter 9. Counties, however, must get approval through a state local debt officer and state local finance officer which will have some oversight controls. Therefore, counties in Kentucky could be considered to be under a Political Model of Conditional Authorization while all other state political subdivisions would be considered to have blanket authorization. *Id.*

Minnesota. MINN. STAT. ANN. § 471.831 (West 1997). Minnesota grants statutory authorization to municipalities for Chapter 9 bankruptcy filings. The state limits its municipal definition to “count[ies], statutory or home rule charter cit[ies], or town[s]; or a housing and redevelopment authority, economic development authority, or rural development financing authority.” *Id.* The state also places a cap on debt that does not allow net debt to exceed 3% of the estimated market value of taxable property within a municipality (15% for school districts). MINN. STAT. ANN. § 475.53 (West 2014).

Missouri. MO. ANN. STAT. § 427.100 (West 2002).

Montana. MONT. CODE ANN. § 7-7-132 (2011).

Nebraska. NEB. REV. STAT. § 13-402 (1997).

Oklahoma. OKLA. STAT. ANN. tit. 62, § 283 (West 2009).

South Carolina. S.C. CODE ANN. § 6-1-10 (1986).

Texas. TEX. LOC. GOV'T CODE ANN. § 140.001 (West 2001).

Washington. WASH. REV. CODE ANN. § 39.64.040 (West 2014).

⁸⁶ TEX. LOC. GOV'T CODE ANN. § 140.001(a) (West 2001).

Though blanket authorization statutes leave no question as to whether the state authorizes access, these statutes do fail to address the macro-level economic concerns mentioned earlier in this piece.⁸⁷ For instance, blanket authorization fails to involve those invested in the municipal process that are vested with the responsibility of properly balancing the macro-level concerns of the municipality's solvency. In effect, by granting blanket authorization, these states have potentially opened themselves up to greater investor concerns. There can be little doubt investors would prefer investment in states placing greater scrutiny on municipalities seeking to avoid paying off liabilities.

B. De-Authorization or Effective De-Authorization States—A Complete Roadblock

In complete contrast to blanket authorization, a small faction of states have either expressly de-authorized access to Chapter 9 or have instituted financial policies which effectively de-authorize Chapter 9 access within the state.⁸⁸ These varied approaches to preventing access have manifested themselves in various forms.

For example, Georgia is the only state with a complete and total bar to Chapter 9 access without limitations.⁸⁹ Put simply, the Georgia statute reads, "No . . . municipality . . . shall be authorized to file a petition for relief from payment of its debts . . . under any federal statute providing for such relief . . ." ⁹⁰ Additionally, the Georgia statute goes even further to preclude governmental actors from being able to authorize access on an individual basis. This part of the statute reads, "No chief

⁸⁷ See *supra* Part I.A.

⁸⁸ Express de-authorization or effective de-authorization states include:

Georgia. GA. CODE ANN. § 36-80-5 (2006).

Iowa. IOWA CODE ANN. § 76.16 (West 2007).

Kansas. KAN. STAT. ANN. §§ 10-1101 to 10-1122 (West 2014). Kansas has the Cash-Basis Law, which provides guidelines for all municipal indebtedness within the state. *Id.* § 10-1112.

Massachusetts. MASS. GEN. LAWS ANN. ch. 44, §§ 2-7 (West 2010). Massachusetts has no statute authorizing access to Chapter 9; however, the state does have a state-based system of controls dealing with municipal finance. *Id.*

Rhode Island. R.I. GEN. LAWS §§ 45-12-22.2, 45-12-32 (2009).

⁸⁹ GA. CODE ANN. § 36-80-5 (2006).

⁹⁰ *Id.* § 36-80-5(a).

executive, mayor, board of commissioners, [etc.] . . . shall be empowered to cause or authorize the filing by or on behalf of any . . . municipality . . . of any petition for relief from payment of its debts.”⁹¹

Similarly, a few other states have instituted policies which make municipal insolvency a practical impossibility. For instance, Iowa has instituted a bar similar to Georgia, yet the state has specifically permitted Chapter 9 access in the event that the municipality is rendered insolvent due to indebtedness that has been involuntarily incurred.⁹² Similarly, Rhode Island has statutorily provided for the state to bail the financially distressed municipality out using state funds once certain requirements have been met but only under very limited circumstances.⁹³

In a completely different manner, Kansas has effectively de-authorized access to Chapter 9 by adopting a Cash-Basis Law which makes it unlawful for a municipality to incur indebtedness exceeding the amount of funds it has in the state treasury with few exceptions.⁹⁴ Similar in effect, yet completely different in application, Massachusetts has instituted a system for municipal debt that effectively de-authorized access to Chapter 9 by placing

⁹¹ *Id.* § 36-80-5(b).

⁹² IOWA CODE ANN. §§ 76.16, 76.16A (West 2007).

⁹³ R.I. GEN. LAWS § 45-12-32 (2009). Despite lacking direct statutory guidance, Rhode Island probably comes closest to being classified as a state that effectively de-authorized Chapter 9 access based on the payment by the state of the municipality’s debt when financially distressed situations arise. Additionally, Rhode Island law also requires the Chief Financial Officer of municipalities to frequently supply various members of the municipality as well as other state officials with fiscal monitoring reports for the purpose of maintaining vigilance in the form of monitoring municipal indebtedness. *Id.* § 45-12-22.2. In the event a municipality (defined as a city, town, school district) is unable to pay its indebtedness, the treasurer or finance director of the troubled debtor is to immediately notify the governing body of the municipality (mayor, city manager, town manager, committee or board, etc.) who must then investigate the delinquency. *Id.* § 45-12-32(a). If the director confirms that the debtor will be unable to make its payment, the director must inform the Director of Revenue with the state who will then investigate the matter independently. *Id.* If it is then found that the debt will be unable to be paid it will then be reported to the general state treasurer and the treasurer will pay the amount of the due or overdue payment out of state funds. *Id.* § 45-12-32(b).

⁹⁴ KAN. STAT. ANN. §§ 10-1101 to 10-1122 (West 2014). The Cash-Basis Law makes it unlawful for a municipality to create indebtedness in excess of the amount of funds said municipality has on hand in the treasury. *Id.* § 10-1112. However, there are some exceptions. For instance, the debt limits may be exceeded when “[p]ayment has been authorized by a vote of the electors of the municipality.” *Id.* § 10-1116(a)(1).

strict limitations on the debt that municipalities are allowed to incur.⁹⁵ Further, rather than authorizing Chapter 9 access, the state has specifically provided for how the state itself will pay what is owed on the debt.⁹⁶

In a manner similar to the blanket authorization states, in each of their individual methods of addressing Chapter 9, these states have taken an affirmative stance on the subject. The merits of these stances are, however, more difficult to critique from an economic standpoint. On one hand, these conservatively structured financial policies work to ensure that municipalities almost never incur such dire financial distress as those that engage in Chapter 9 relief. On the other hand, these policies seem to work against the idea that debt and public investment help promote the economy and enable municipalities within these states to sustain growth that, when utilized in the proper way, serves the best interests of their taxpayers.

C. Conditional Authorization States—An Entrance with Gatekeepers

In contrast to both blanket authorization and de-authorization states, many states have chosen to grant access through some form of conditional authorization based on conditions or requirements at the state level that must be satisfied prior to being granted Chapter 9 access. While all conditional authorization systems utilize prerequisite requirements that must be met, the particular forms of conditional authorization vary greatly among the states. In the practical sense, where the states differ within this classification is based upon where they have chosen to place the ultimate responsibility for granting

⁹⁵ MASS. GEN. LAWS ANN. ch. 44, §§ 2-7 (West 2010). For further elaboration on Massachusetts' system, see Freyberg, *supra* note 80, at 1015. Massachusetts has a state-based system of controls dealing with municipal finance in which it limits the amounts and types of debt entities are permitted to incur and requires two-thirds approval from citizens in order to incur a financial liability. MASS. GEN. LAWS ANN. ch. 44, §§ 2-7 (West 2010). If the municipality cannot pay its debts it must notify the Commissioner of Revenue. *Id.* § 19A. If, upon inspection, the Commissioner confirms the findings that the municipality is unable to pay its debt, the State Treasurer must pay what is owed. *Id.* The money owed by the debtor will then be recovered by moneys otherwise payable to the local municipality. *Id.*

⁹⁶ MASS. GEN. LAWS ANN. ch. 44, § 19A (West 2010).

authorization. Because of this, this classification can be divided into three sub-classifications: the Political Model, the Administrative Model, and the Hybrid Model.

1. The Political Model

Several states have chosen to implement a Political Model of conditional authorization. This model is highlighted by the characteristic that in order to gain access to the federal bankruptcy system—and thus Chapter 9—some statutorily designated actor who is a product of the political system must grant the municipality that access.⁹⁷ Most states utilizing this model of authorization vest these powers in either the Governor, a state financial officer such as the Tax Commissioner, the Legislature, or some combination of those parties.⁹⁸

In Connecticut, for example, municipalities are expressly authorized to access Chapter 9 but they must first gain approval from the Governor and the Governor must then go before the General Assembly to explain the reasons for approval.⁹⁹ Similarly, Louisiana allows access to Chapter 9 but requires financially distressed municipalities to first submit a plan for approval to the State Board Commission and also acquire written approval from the Governor and the Attorney General.¹⁰⁰ Similarly, North Carolina requires approval from the Local Government Commission,¹⁰¹ and Ohio requires approval from the Tax Commissioner.¹⁰²

This particular method of conditional authorization appears to tackle many of the concerns addressed throughout this paper. For instance, by placing the decision-making authority in the hands of duly elected officials like the Governor, the Political Model promotes the democratic principles of transparency and

⁹⁷ Political Model states include:

Connecticut. CONN. GEN. STAT. ANN. § 7-566 (West 2010).

Louisiana. LA. REV. STAT. ANN. § 13:4741 (2008).

North Carolina. N.C. GEN. STAT. § 23-48 (2009).

Ohio. OHIO REV. CODE ANN. § 133.36 (LexisNexis 2007).

⁹⁸ See *supra* note 97.

⁹⁹ CONN. GEN. STAT. ANN. § 7-566 (West 2010).

¹⁰⁰ LA. REV. STAT. ANN. §§ 13:4741, 39:619-39:622 (2008).

¹⁰¹ N.C. GEN. STAT. § 23-48 (2009).

¹⁰² OHIO REV. CODE ANN. § 133.36 (LexisNexis 2007).

accountability that the American governmental system already relies heavily on. Further analysis of the Political Model's advantages and disadvantages is provided herein.¹⁰³

2. The Administrative Model

In contrast to the Political Model, several states have placed authorization power in the hands of experts and have implemented some form of state-based *procedure* to deal with financially distressed municipalities.¹⁰⁴ These states exemplify the Administrative Model.

In practice, the Administrative Model may be applied broadly and can take on many forms which, at times, serve to mimic many of the bankruptcy court system's characteristics. For instance, if one were to imagine the Administrative Model states along a spectrum, on one end of the spectrum would lie Nevada, which has implemented an intricate system for monitoring municipal fiscal emergencies yet conspicuously appears to lack a statute either authorizing or de-authorizing access to Chapter 9.¹⁰⁵ From a practical standpoint Nevada's system is structured so that it could, should the proper parties wish to do so in the future, authorize access on a case-by-case basis or adopt an authorization statute to act as an umbrella of protection above and beyond the current law.

On the other end of the spectrum are states which have an elaborate procedure or system, such as Pennsylvania, but which have built ultimate access to Chapter 9 into their system as a last

¹⁰³ See *infra* Part III.B.1.

¹⁰⁴ Administrative Model states include:

California. CAL. GOV'T CODE § 53760 (West 2014). Commonly referred to as A.B. 506, the statute permits Chapter 9 access but requires either the municipality to participate in a neutral evaluation process or the declaration of a fiscal emergency process prior to gaining access. *Id.*

Nevada. NEV. REV. STAT. ANN. §§ 354.675-354.7235 (LexisNexis 2006 & Supp. 2008).

New Jersey. N.J. STAT. ANN. §§ 52:27-2, 52:27-34 to 52:27-45.11 (West 2001).

New York. N.Y. LOCAL FIN. LAW §§ 85.00-85.80 (McKinney 2011).

Pennsylvania. 53 PA. CONS. STAT. ANN. §§ 11701.102-11701.201, 5571-5572 (West 2014); 74 PA. CONS. STAT. ANN. § 1773 (West 2014).

¹⁰⁵ NEV. REV. STAT. ANN. §§ 354.675-354.7235 (LexisNexis 2006 & Supp. 2008).

resort.¹⁰⁶ Among these, New York's current law exemplifies many of the characteristics unique to an Administrative Model of conditional authorization. A detailed analysis of this system is provided below as an illustration of how an Administrative Model might be structured.¹⁰⁷

Further analysis of the advantages and disadvantages of the Administrative Model are provided herein.¹⁰⁸ Similarly, additional comprehensive breakdowns of each of the states utilizing Administrative Models are provided in the Appendix.¹⁰⁹

New York. New York utilizes an Administrative Model which focuses on determination of whether a "financial emergency" exists.¹¹⁰ New York permits Chapter 9 access though it provides alternate means of attempting to remedy the financial emergency.¹¹¹ Uniquely, the financial emergency laws in the state specifically exclude the city of New York.¹¹²

For all qualifying municipalities, the law requires three triggering events to occur in order for any sort of action or special proceeding to take place.¹¹³ First, a municipality's payment of some debt must be due or overdue.¹¹⁴ Second, thirty days must have passed since a demand for payment was made and served upon the municipality.¹¹⁵ Third, at least thirty days must have lapsed since the demand was made and payment must have either been refused or neglected.¹¹⁶

Despite the three aforementioned requirements, New York also allows a municipality to file a voluntary petition in certain

¹⁰⁶ 53 PA. CONS. STAT. ANN. §§ 11701.102-11701.201, 5571-5572 (West 2014); 74 PA. CONS. STAT. ANN. § 1773 (West 2014).

¹⁰⁷ All other administrative model conditional authorization systems are similarly analyzed in the Appendix.

¹⁰⁸ See *infra* Part III.B.2.

¹⁰⁹ See *infra* Appendix A.

¹¹⁰ N.Y. LOCAL FIN. LAW § 85.00 (McKinney 2011). The statute provides that the statute only applies to municipalities in which the legislature has declared a financial emergency to exist.

¹¹¹ *Id.* § 85.80.

¹¹² *Id.* § 85.00.

¹¹³ *Id.* § 85.10.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.* The statute also specifies what such a demand for payment must include to qualify. *Id.* § 85.20.

situations.¹¹⁷ In those instances, the petition must include a statement that the municipality is unable to pay its debts, the intention of the municipality or its financial control board to file a repayment plan, a list of the debts and obligations of the municipality, and a list of all the creditors affected by the plan.¹¹⁸ Upon such a filing, an automatic stay is instituted against any actions brought by creditors.¹¹⁹

Once such a petition has been filed, a repayment plan must also be filed.¹²⁰ The actual filing of the repayment plan, however, can take place in a couple of ways; the municipality itself may file the plan or, if it refuses to do so, the emergency financial control board may file the plan on behalf of the municipality after forty-five days of noncompliance.¹²¹

Once the repayment plan has been filed, a court will consider the proposed plan in light of four requirements.¹²² The plan must provide for: the eventual satisfaction of all municipal debts and obligations, as quick a payment back to those creditors as is practicable and equitable, the preservation of any applicable priorities of creditors, and approval from the municipality's emergency financial control board.¹²³ If the repayment plan fails to satisfy those requirements, the court must enter an order disapproving of the plan.¹²⁴

The automatic stay may also be lifted in other circumstances. For instance, once instituted, an automatic stay may be lifted upon a creditor's showing that the municipality has "failed to comply with a material provision of the repayment plan; or that,

¹¹⁷ *Id.* § 85.30 (upon voluntary petition by the municipality or "in the event a municipality refuses to file such petition after request by its emergency financial control board").

¹¹⁸ *Id.*

¹¹⁹ *Id.* However, the petition and automatic stay are both subject to challenge by creditors on grounds that the petition is not in good faith. *Id.*

¹²⁰ *Id.* § 85.40.

¹²¹ *Id.* The Act defines the Emergency Financial Control Board of the municipality as "any such board established by state law for the municipality." *Id.* § 85.00.

¹²² *Id.* § 85.40.

¹²³ *Id.*

¹²⁴ *Id.* Once the court enters the order disapproving the plan, the automatic stay will be lifted unless an amended plan is filed within ten days. *Id.*

due to a material change in circumstances, the repayment plan no longer complies with the [aforementioned] requirements.”¹²⁵

As previously mentioned, New York authorizes municipalities or the emergency financial control board of a municipality to file a petition under Chapter 9 in lieu of following the state petition and repayment plan path.¹²⁶ This option has one express limitation; a municipality may not file under Chapter 9 if any local ARRA bonds remain outstanding.¹²⁷

3. The Hybrid Model

The third sub-classification of conditional authorization models currently implement is the Hybrid Model. To illustrate what the Hybrid Model attempts to accomplish, imagine the Political Model representing one end of a spectrum and taking a position that the duly elected officials, as representatives of their constituents, are the best people to decide the fate of a financially distressed municipality. On the other end, imagine that the Administrative Model represents the idea that expertise and process will lead to the optimal solution. By attempting to meld the best of both these worlds together, the Hybrid Model represents the middle of that spectrum, attempting to take the best characteristics of both of the other models.

Currently, only two states explicitly qualify as Hybrid Model states, Michigan and Illinois.¹²⁸ Michigan, provided below as an illustration, uses an intricate structure that continually relies on members of the political process as well as experts in various capacities to attempt to reach the optimal conclusion. With Detroit’s pending Chapter 9 proceedings in mind however, Michigan’s authorization structure is expected to be highly scrutinized in the coming months or years and could dramatically change depending on how that action proceeds.

¹²⁵ *Id.* § 85.50.

¹²⁶ *Id.* § 85.80.

¹²⁷ *Id.* ARRA bonds are bonds purchased by the state of New York Municipal Bond Bank Agency and secured by its pledge of tax revenues. *Id.*

¹²⁸ Hybrid Model states include:

Illinois. 50 ILL. COMP. STAT. ANN. 320/1-14 (West 2014). Illinois refers to its law on the subject as the Local Government Financial Planning and Supervision Act. *Id.*

Michigan. MICH. COMP. LAWS ANN. §§ 141.1541-1575 (West 2014).

Michigan.¹²⁹ Michigan utilizes an Administrative Model involving several stages of review and procedural options. The process begins with a preliminary review performed by the state financial authority to determine whether there is probable financial distress within a local municipality. Such a preliminary review can be triggered by a broad range of events including anything from the governing body of the local municipality requesting a review to a petition submitted by more than five percent of the local government's registered electors.¹³⁰ Under law, local government officials are required to provide full assistance in the review process despite whether they initiated the process.¹³¹

Throughout the review process, the state financial authority is required to provide periodic reports on its findings to the Local Emergency Financial Assistance Loan Board¹³² (Board) and to the public at large.¹³³ Upon completion of the report, the Board makes a final determination as to whether probable financial stress exists.¹³⁴ If probable financial stress is found to exist, the

¹²⁹ As previously mentioned, Michigan's law is currently being considered for repeal in light of the recent Detroit Chapter 9 bankruptcy filing. This analysis is current as of September 2014. Should the law be repealed, the current structure still serves an illustrative purpose regarding how the administrative model may operate in practice.

¹³⁰ MICH. COMP. LAWS ANN. § 141.1544 (West 2014). Events that may trigger a preliminary event include (a) the governing body of the local municipality requests review; (b) a creditor with an unpaid claim that satisfies certain parameters makes a request; (c) a petition is submitted by more than five percent of the registered electors of the local government's jurisdiction; (d) written notification received that the local government has not made its deposit into the local government pension fund; (e) the local government fails to make payments for at least a week beyond scheduled payment dates of wages and salaries or other compensation for employees or retirees; (f) written notification is received of a default on a debt obligation; (g) the state senate or house submits a written request for preliminary review; (h) the local government violates any number of provisions under the statutes guiding state bond laws; and (i)-(s) several other incidents which can trigger preliminary review. *Id.*

¹³¹ *Id.* § 141.1544(2).

¹³² *Id.* For instance, an interim report must be provided within twenty days of commencement of the review and upon completion of the final report, copies of the final report must be provided to the local emergency financial assistance loan board as well as the local government and the local jurisdiction's state senators and representatives. *Id.*

¹³³ *Id.* Michigan requires the state financial authority make a copy of its final report available on the department of treasury's website. *Id.*

¹³⁴ *Id.*

Governor is required to appoint a review team to review the situation further.¹³⁵

Once a review team is appointed it can “[e]xamine the books and records of the local government” and “[u]tilize the services of other state agencies and employees.”¹³⁶ Within sixty days of appointment the review team must submit a written report to various authorities.¹³⁷ As with the state financial authority’s probable financial distress report, a copy of this report must be made available on the state department of the treasury’s website for public viewing.¹³⁸ The written report is required to analyze the financial condition of the entity¹³⁹ and make a determination as to whether a financial emergency exists.¹⁴⁰

Within ten days of the review team’s submission of its final report, the Governor must make the ultimate determination of whether or not a financial emergency exists.¹⁴¹ At that point, if a financial emergency has been declared, the local government has four options: a consent agreement option, an emergency manager option, a neutral evaluation process option, and a Chapter 9 option.¹⁴²

Option #1: Consent Agreement. The consent agreement option attempts to remedy the financial distress by providing for a comprehensive plan to fix the situation without resorting to other exigencies. This option consists of the chief administrative officer

¹³⁵ *Id.* § 141.1544(3). The review team must include the state treasurer, the director of the department of technology, management, and budget, a nominee of the senate majority leader, and a nominee of the speaker of the house of representatives. *Id.* Similarly, if the potentially distressed municipality is a school board, the statute requires the review team to also include the superintendent of schools for the district. *Id.* § 141.1544(4).

¹³⁶ *Id.* § 141.1545(1)(a)-(b).

¹³⁷ *Id.* § 141.1545(3). These authorities include “the chief administrative officer and the governing body of the local government, the speaker of the house of representatives, the senate majority leader, the superintendent of public instruction if the local government is a school district, [as well as] each state senator and state representative who represents that local government.” *Id.*

¹³⁸ *Id.*

¹³⁹ *Id.* § 141.1545(3)(a)-(m). This analysis includes any potential defaults or financial obligations which the municipality may not be able to meet. *Id.*

¹⁴⁰ *Id.* § 141.1545(4)(a)-(b). The statute specifically provides guidance on when a financial emergency should or should not be found. *Id.* § 141.1545(6).

¹⁴¹ *Id.* § 141.1546(1)(a)-(b).

¹⁴² *Id.* § 141.1547(1)(a)-(d).

of the local government negotiating and coming to an agreement with the state treasurer on a plan to remedy the situation.¹⁴³ The agreement must “address the financial emergency within the local government and provide for the financial stability of the local government.”¹⁴⁴ Specifically, the agreement must address what happens upon breach of the agreement, provide for the development of continuing operations, and provide for the development of a recovery plan.¹⁴⁵

Option #2: Emergency Manager. Under the emergency manager option, the Governor appoints an emergency manager to handle the local government’s financial distress.¹⁴⁶ The emergency manager then acts in place of the local government’s governing body in what is, effectively, a receivership.¹⁴⁷ Similar to the consent agreement option, the emergency manager is charged with implementing a plan and taking actions to enable the orderly accomplishment of those plans.¹⁴⁸ Under this option, the emergency manager possesses many powers, including the ability to modify, reject, and terminate contracts as well as review all the financial plans or obligations of the local government.¹⁴⁹ However, some question remains as to the constitutionality of this perceived ability of a receiver to impair contracts.¹⁵⁰

One particularly interesting requirement under this option is that the salaries and benefits of the Chief Administrative Officer and the members of the local governing body must be eliminated.¹⁵¹ Statutorily, Michigan is the only state to provide for such action. Upon elimination of these salaries and benefits, the emergency manager then has the power to temporarily reinstate those wages and benefits “to the extent that the emergency manager finds [this action to be] consistent with the financial and operating plan.”¹⁵² Additionally, the emergency manager can

¹⁴³ *Id.* § 141.1548(1).

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* § 141.1548(1)-(2). The Governor may place the local government into a receivership or neutral evaluation process. *Id.* § 141.1548(1).

¹⁴⁶ *Id.* § 141.1549(1).

¹⁴⁷ *Id.* § 141.1549(2).

¹⁴⁸ *Id.* § 141.1550(1).

¹⁴⁹ *Id.* § 141.1552(1).

¹⁵⁰ U.S. CONST. art. I, § 10, cl. 1.

¹⁵¹ MICH. COMP. LAWS ANN. § 141.1553 (West 2014).

¹⁵² *Id.*

make a determination as to “whether possible criminal conduct contributed to the financial situation resulting in the local government’s receivership status” and may report those findings to the state attorney general or local prosecuting attorney.¹⁵³ Additionally, this also appears to be exclusively provided for by statute in Michigan.

The emergency manager does have some restrictions on her powers. One restriction is that she “shall not sell or transfer a public utility” without approval from a majority of the jurisdiction’s electors.¹⁵⁴ An additional restriction is that “[u]nless the potential sale and value of an asset is included in the emergency manager’s financial and operating plan, the emergency manager shall not sell an asset of the local government valued at more than \$50,000.00 without the state treasurer’s approval.”¹⁵⁵ A third restriction is that the emergency manager is not given “the power to impose taxes, over and above those already authorized by law,” without a majority of qualified electors voting on the issue and approving it.¹⁵⁶

The emergency manager must submit a report, similar to both preliminary reviews, detailing the financial situation of the troubled municipality to various state and local officials as well as the public at large.¹⁵⁷ Michigan law also provides specific requirements for what such a report must entail.¹⁵⁸

If the emergency manager comes to believe there is “no reasonable alternative to rectifying the financial emergency,” then she may recommend to the Governor and State Treasurer that the local government be authorized to proceed under Chapter 9.¹⁵⁹

¹⁵³ *Id.* § 141.1556.

¹⁵⁴ *Id.* § 141.1552(4).

¹⁵⁵ *Id.* § 141.1555.

¹⁵⁶ *Id.* § 141.1568.

¹⁵⁷ *Id.* § 141.1557. These officials include the Governor, the State Treasurer, the Senate Majority Leader, the Speaker of the House of Representatives, each state Senator and House of Representatives member who represents the local government, and the clerk of the local government. *Id.*

¹⁵⁸ *Id.* The report must contain the following: all expenditures with a value of more than \$5,000.00; all contracts awarded or approved with a value of more than \$5,000; all loans approved, sought, or disapproved with a value of more than \$5,000; a description of any new employment positions or vacancies; a copy of the emergency manager’s contract and compensation package; and a copy of the financial and operating plan. *Id.*

¹⁵⁹ *Id.* § 141.1558.

Should that occur, the Governor has the power to institute additional controls or to approve access to Chapter 9.¹⁶⁰

Option #3: Neutral Evaluation Process. The neutral evaluation process option involves “[t]he local government and the interested parties agreeing to . . . , through a mutually agreed-upon process, select a neutral evaluator to oversee the . . . process and facilitate all discussions in an effort to resolve their disputes.”¹⁶¹ This option requires that all interested parties be informed of the decision to engage in the process.¹⁶² If all interested parties are not notified, the State Treasurer may force the local government into a receivership.¹⁶³

Under the neutral evaluation process, the neutral evaluator must satisfy specific qualifications in order to be qualified. These qualifications include a particular number of years of high-level business experience as well as training in municipal finance.¹⁶⁴ Furthermore, “[t]he neutral evaluator shall not impose a settlement on the participants.”¹⁶⁵ Additionally, the neutral evaluator will inform all interested parties about the process and the unique circumstances of the powers held under Chapter 9 compared to other Bankruptcy Code chapters.¹⁶⁶

Option #4: File for Chapter 9 Relief. The last option available to the municipality is to file for bankruptcy under Chapter 9. Electing to pursue this option, however, has two particular requirements. First, it requires written approval from the Governor.¹⁶⁷ Second, it requires a majority vote from the governing body of the local government.¹⁶⁸ Additionally, the Governor has discretion to place additional requirements on the local government that may include, but are not limited to, appointing a person to act on behalf of the local government throughout the Chapter 9 proceeding.¹⁶⁹

¹⁶⁰ *Id.* Should the Governor decide to approve Chapter 9 access she or he must inform the State Treasurer and the emergency manager in writing of the decision. *Id.*

¹⁶¹ *Id.* § 141.1565(3).

¹⁶² *Id.* § 141.1565(1).

¹⁶³ *Id.*

¹⁶⁴ *Id.* § 141.1565(6).

¹⁶⁵ *Id.* § 141.1565(11).

¹⁶⁶ *Id.* § 141.1565(12).

¹⁶⁷ *Id.* § 141.1566(1).

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* § 141.1566(2).

D. States Without Controlling Chapter 9 Authority—An Unknown Path

Finally, though a majority of states have some controlling law regarding Chapter 9, many states have yet to provide guidance on the issue of eligibility or authorization within their state.¹⁷⁰ While these states lack statutory authority, some debate

¹⁷⁰ States that have de-authorized or not provided specific authorization to access Chapter 9 include the following:

Alaska.

Delaware. Though Delaware has no statute addressing Chapter 9, the state's law does limit the amount of debt a city can take on. For instance, cities with a population over 50,000 may not borrow an amount exceeding 16% of the assessed valuation of the taxable real estate within that city. DEL. CODE ANN. tit. 22, § 106 (West 2014).

Hawaii.

Indiana. While Indiana lacks direct Chapter 9 statutory guidance, the state constitution does limit debt levels for political or municipal corporations to two percent of the value of taxable property within the taxable area. IND. CONST. art. 13, § 1; IND. CODE ANN. § 36-1-15-6 (West 1997). This limitation is, however, subject to override by a petition from a majority of the property owners in the area under certain situations where such excess debt is necessary for public protection and defense. IND. CODE ANN. § 36-1-15-7 (West 1997). Because of this distinction, this author is classifying Indiana as lacking specific authorization rather than as a state which has effectively de-authorized Chapter 9 access.

Maine. Maine has no Chapter 9 authorization; however, Title 30-A, Part 2, Subpart 9, Chapter 229 allows for the formation of a Municipal Finance Board that can step in and provide state-based assistance should a municipality require financial assistance or become distressed. ME. REV. STAT. tit. 30-A, §§ 6101-6113 (1990). The issue of specific authorization, however, remains unsettled. Also, municipal debt levels are statutorily limited to, at most, 15% and often less than 10% depending on the type of municipality involved. *Id.* § 5702. Additionally, municipalities in Maine are required to file an annual comprehensive outstanding debt report. *Id.* § 5704.

Maryland. Maryland requires any local governmental subdivision authorized to incur debt to file a detailed annual comprehensive financial condition report with the State Treasurer. MD. CODE ANN., LOCAL GOV'T § 16-103 (West 2013).

Mississippi. Mississippi places a cap on debt wherein total outstanding debt shall not exceed 1% of all taxable property located within the governing authority. MISS. CODE ANN. § 17-21-51(2) (2013). Another Mississippi statute limits bonds to no more than 15% of the total taxable value of property located within the governing authority. *Id.* § 21-33-303. Additionally, Mississippi municipalities are required to submit a budget report each fiscal year. *Id.* § 21-35-5. This statute also provides guidance for municipal budgets. *Id.* Of great import is that the "total expenditures authorized to be made . . . shall not exceed the aggregate cash balance . . . plus the amount of estimated

revenues to accrue to such fund . . . and the amount which may be raised for such fund by a lawful tax levy during the current fiscal year.” *Id.* § 21-35-15. In this way, Mississippi shows traces of the Cash Basis Law that Kansas utilizes to de-authorize access. *See supra* note 94 and accompanying text.

New Hampshire. Prior to the 1994 Amendments, bankruptcy case law in New Hampshire held that the power to “sue and be sued” allowed municipalities to be “generally authorized” in the state to file under Chapter 9. *In re Sullivan Cnty. Reg'l Refuse Disposal Dist.*, 165 B.R. 60 (Bankr. D.N.H. 1994). However, the Municipal Finance Act sets the debt limit for counties at no more than two percent of the total assessed value of the area and for municipalities at no more than three percent of the assessed property values. N.H. REV. STAT. ANN. § 33:4-a (2014). Debt for sewer systems and treatment works are not included in the net debt assessments or caps. *Id.* § 33:5. New Hampshire also allows emergency borrowing in extreme circumstances upon approval from the Commissioner of the Revenue Administration, the Governor, and the council. *Id.* § 33:6.

New Mexico. New Mexico law places extensive power within the administrative and political authorities to oversee municipal fiscal matters. The state places much of the financial control and oversight power of state finances with the State Board of Finance and the Department of Finance under Chapter 6, Article 1. N.M. STAT. ANN. §§ 6-1-1 to 6-1-13 (West 1989). On a more local level, pursuant to Article 6, New Mexico places control in the Local Government Division of the Department of Finance to effectively oversee and examine any financial matters of local public bodies. *Id.* §§ 6-6-2 to 6-6-19.

North Dakota.

Oregon. Irrigation or drainage districts may, upon default in payment of principal or interest on warrant or bonded indebtedness, file for bankruptcy. OR. REV. STAT. ANN. § 548.705 (West 2011). Oregon law also specifically excludes public employee pensions from bankruptcy proceedings. *Id.* § 238.445.

South Dakota. South Dakota law states that city retirement and pensions may not be subject to any “process of law whatsoever.” S.D. CODIFIED LAWS § 9-16-47 (2014).

Tennessee. Prior to the 1994 Amendments and now codified in TENN. CODE ANN. § 7-82-306 (West 2011), Tennessee case law held that a utility district was qualified to file Chapter 9 bankruptcy stemming from its power to sue and be sued, make and enter contracts, and incur debts. *In re Pleasant View Util. Dist. of Cheatham Cnty.*, 24 B.R. 632 (Bankr. M.D. Tenn. 1982).

Utah. The Utah Constitution limits city, town, school district, and other municipal corporations debt to four percent of the value of taxable property within that area. UTAH CONST. art. 14, § 4.

Vermont. Vermont law specifically states that municipal employees’ retirements are to be exempt from any system of bankruptcy. VT. STAT. ANN. tit. 24, § 5066 (2007).

Virginia. Virginia law requires the treasurer or chief financial officer of each municipality to file an annual statement of revenues and expenditures with the Auditor of Public Accounts. VA. CODE ANN. § 15.2-2510 (2008).

Additionally, Virginia law limits bonds or other interest bearing indebtedness at ten percent of total assessed valuation of real estate. *Id.* § 15.2-2634. Virginia also provides that upon an affidavit being filed with the Governor alleging default by a municipality on any of its indebtedness, the Governor must immediately make a summary investigation into the matter. *Id.* § 15.2-2659. If the default is confirmed, the Governor must immediately order the Comptroller to withhold all further payment to the locality “appropriated and payable” by the state to the locality “until the default is cured” and, additionally, shall route funds withheld by the Comptroller to those parties toward whom the debtor has defaulted. *Id.* Additionally, the Governor is required to publish notification of this default in a daily newspaper in the capital city of Richmond. *Id.*

West Virginia. West Virginia law specifically provides that the pensions of municipal police officers and firefighters are not subject to bankruptcy. W. VA. CODE § 8-22A-25 (2009). West Virginia also requires each municipal corporation to file a financial statement annually detailing the financial state of the municipality with the state Tax Commissioner. *Id.* § 8-13-23. Additionally, West Virginia enacted the Municipal Financial Stabilization Fund Act in recognition of the importance of maintaining municipal fiscal health. *Id.* §§ 8-37-1 to 8-37-4. This Act enables the municipality to create a stabilization overflow fund to cover general fund shortages or for any other areas in the municipality needing financial assistance. *Id.* § 8-37-4. West Virginia also limits indebtedness to 2.5% of the total valuation of taxable property within the district (with some exceptions). *Id.* § 13-1-3. An exception to that limit is school boards, which are limited to a five percent cap of total valuation. *Id.* § 13-1-34. Additionally, the state has vested the responsibility of oversight of all issuers of general obligation bonds with the Municipal Bond Commission. *Id.* § 13-3-6. The Municipal Bond Commission acts as the fiscal agent for all bond issuers. *Id.* The Commission is required to prepare a complete and full report of its operations and investments each year and submit it to the Governor, the President of the Senate, the Speaker of the House, and the Legislative Auditor. *Id.* § 13-3-15.

Wisconsin. Wisconsin law requires all counties and towns to publish an annual report detailing all revenues and expenditures. WIS. STAT. ANN. §§ 59.65, 60.41 (West 2000). Even broader, Wisconsin requires that each municipality (except counties with populations over 500,000 and first-class cities) publish and hold public hearings regarding the annual budget each year. *Id.* § 65.90. The state limits the aggregate amount of indebtedness a municipality may take on at five percent of the value of taxable property located in the municipality. *Id.* § 67.03(1). The state requires all public utilities to file an annual balance sheet with the Public Service Commission. *Id.* § 196.07.

Wyoming. Wyoming law places debt limits at four percent of the total valuation of taxable property for all cities and towns. WYO. STAT. ANN. § 15-7-109 (2011). Further, for public improvement indebtedness, the state does not allow creation of debt in excess of the taxes for the current year. *Id.*

remains regarding whether the *specifically authorized* eligibility requirement in 109(2)(c) definitively requires a guiding statute or whether a case-by-case approach is actually what was intended.¹⁷¹

The likely reasoning behind why some states choose not to address the Chapter 9 access issue specifically no doubt varies greatly from state to state. In certain instances, states may simply wish to address the issue on an individual legislative basis, opting to read the “specifically authorized” language as an opportunity to decide on an individualized basis and adjust accordingly. Another reason, not completely out of the realm of possibility, is the idea that growth and the ability of a municipality to survive on debt are simply less critical concepts that have yet to rise as issues in certain states. States like Alaska and Hawaii would likely fall into this category because of their strong tax bases.

While the reasoning may vary, the fact remains that a lack of statutory guidance on the issue is, in and of itself, just as much a stance on Chapter 9 access as anything. Similar to those states that have granted blanket authorization, these states are actively promoting uncertainty in their municipal investments. While this may not concern states such as Alaska and Hawaii, other states where growth is a concern should certainly take particular note of this issue and what role their lack of guidance plays.

III. THE CASE FOR SPECIFIC STATUTORY AUTHORIZATION OF CHAPTER 9 ACCESS WITH A STATE-BASED CONDITIONAL AUTHORIZATION MODEL SERVING AS GATEKEEPER

When municipalities become insolvent, many parties are affected; not only do creditors absorb the hit, but the municipality, its investors, and its residents are affected as well. As these bankruptcies occur more frequently and involve greater amounts of outstanding debt, the economic impact felt beyond the individual municipalities will likely increase as well. As such, investors may become more cautious toward municipal debt, or worse, may become considerably less willing to invest in municipalities.

¹⁷¹ For further analysis on the debate over the meaning of the “*specifically authorized*” language, see Nicholas B. Malito, *Municipal Bankruptcy: An Overview of Chapter 9 and a Critique of the “Specifically Authorized” and “Insolvent” Eligibility Requirements of 11 U.S.C.A. § 109(c)*, 17 NORTON J. BANKR. L. & PRAC. 517 (2008).

While consideration of the broader economic effects is important, it is also important that municipalities have a means of finding relief in situations of dire financial distress. Without Chapter 9, municipalities would have no other means of proceeding through a process of bankruptcy.¹⁷² This means that many of the “advantages” granted to municipalities in Chapter 9 would otherwise be unavailable.¹⁷³ Congress recognized this need in the 1937 re-enactment of what was essentially the original Chapter 9.¹⁷⁴

The individual states bear the responsibility of balancing these conflicting concerns. States must attempt to find the optimal balance between the economic effect of municipal bankruptcy and the needs of insolvent municipalities to seek relief in disastrous situations. This responsibility on the states stems from the fact that bankruptcy courts are not tasked with making their decision based on the broader economic landscape.¹⁷⁵ Rather, bankruptcy courts are charged with reaching a solution for the individual insolvent municipality and ensuring continued provision of basic services.¹⁷⁶

As a solution to balancing these countervailing concerns, this Comment proposes states adopt a two-pronged approach.¹⁷⁷ First, each state should expressly authorize access through a statute that affirmatively provides for the state’s Chapter 9 treatment in situations where necessary. Second, each state should implement a conditional authorization system based on the Political Model that is structured specifically to ensure that the proper balance is found between the broad macro-level economic concerns and the needs of the insolvent municipality. As some states have done, by adopting this approach, states would provide guidance and assistance in an effort to avoid an eventual Chapter 9 filing and ensure that the system is used only as a last resort.

Additionally, this section will compare and contrast the advantages and disadvantages of the three conditional

¹⁷² See 11 U.S.C. § 109 (2012) (describing who may be a debtor for each individual Chapter of the Bankruptcy Code).

¹⁷³ See Watkins, *supra* note 8.

¹⁷⁴ See *supra* note 41 and accompanying text.

¹⁷⁵ See *infra* Part I.B.

¹⁷⁶ See *infra* Part I.B.

¹⁷⁷ See *infra* Parts III.A-B.

authorization sub-classifications—the Political Model, the Administrative Model, and the Hybrid Model. Furthermore, the section will highlight why the Political Model strikes the optimal balance states should be attempting to achieve, why the Administrative Model serves as a viable alternative for those states which value expertise and procedure over transparency and accountability, and why the Hybrid Model, though it attempts to accomplish a noble goal, fails to reach this balance though it combines the characteristics of each.

A. The Case for Express Chapter 9 Authorization as a Last Resort

Though states lacking guidance on the issue do not necessarily bar access to the bankruptcy system,¹⁷⁸ failing to do so statutorily leads to uncertainty for interested parties. The United States Constitution explicitly provides that “Congress shall have Power To . . . establish . . . uniform Laws on the subject of Bankruptcies.”¹⁷⁹ In keeping with that, the Bankruptcy Code places substantial hurdles on municipalities hoping to be deemed eligible within Chapter 9.¹⁸⁰ The scope of the “*specific authorization*” requirement is only one of those hurdles.¹⁸¹

Though these eligibility hurdles can prove quite substantial and often difficult to overcome, debtors who become eligible enjoy several advantages that would otherwise be unavailable to them.¹⁸² For instance, only federal law can override contrary state law¹⁸³ or overcome the impairment by states of the obligation of contracts under the Contracts Clause.¹⁸⁴ In addition, other advantages include, but are not limited to, an automatic stay that immediately halts creditor actions against the debtor

¹⁷⁸ 11 U.S.C. § 109(c)(2) (2012).

¹⁷⁹ U.S. CONST. art. I, § 8, cl. 4; see also Jonathan J. Spitz, Comment, *Federalism, States, and the Power to Regulate Municipal Bankruptcies: Who May Be a Debtor Under Section 109(c)?*, 9 BANKR. DEV. J. 621, 621 (1993).

¹⁸⁰ See *supra* note 9 and accompanying text.

¹⁸¹ See *supra* note 9 and accompanying text.

¹⁸² See *supra* note 8 and accompanying text.

¹⁸³ U.S. CONST. art. I, § 8, cl. 4 (uniform laws on bankruptcies); U.S. CONST. art. VI, cl. 2 (Supremacy Clause); see also Henry C. Kevane, *Chapter 9 Municipal Bankruptcy: The New “New Thing”?* Part I, BUS. L. TODAY, May 2011, at 1.

¹⁸⁴ U.S. CONST. art. I, § 10, cl. 1 (Contracts Clause).

municipality, restricted powers for bankruptcy judges to wield against debtor municipalities, and the ability to force dissenting creditors to comply with a debt readjustment plan through an advantage aptly named the “cram down” provision.¹⁸⁵

By effect, this desperate power structure leads to a system that, once initiated, operates as an uncharacteristically anti-creditor system.¹⁸⁶ While these benefits are important—and possibly even necessary—for troubled municipalities to rectify their distress, the incredible power this structure provides to debtors highlights how important the gatekeeper role becomes for states when serving to control Chapter 9 access. That is why the system should only be used as a last resort.

Despite its desperate power structure, Congress recognized that Chapter 9 served an essential purpose.¹⁸⁷ Recognizing the structural limitations placed on it by the constitutional protection of state sovereignty, as well as the knowledge that only the federal government could provide for a system of bankruptcy, Congress designed Chapter 9 to function as a last resort with states serving the gatekeeper role.¹⁸⁸ In fact, Chapter 9 was “designed to permit, if not encourage, active state involvement in the post-bankruptcy affairs of the municipality.”¹⁸⁹ By acknowledging the state’s necessary role in gatekeeping, Congress was able to structure Chapter 9 so that it could serve its purpose, which is to ensure the continued provision of the municipality’s basic services rather than to reach an adequate solution for creditors.¹⁹⁰

Because of Congress’ careful structuring and the intended gatekeeping role for states, the federal bankruptcy system, with all its advantages for debtors, maintains the ability to provide clarity and structure to a process that has dramatic economic implications.¹⁹¹ As such, the system also has the ability to allow the states, while acting as sovereigns, to control the parties it

¹⁸⁵ See *supra* note 8 and accompanying text.

¹⁸⁶ This is true when compared to the other chapters of the Bankruptcy Code, especially Chapters 7, 11, and 13.

¹⁸⁷ See *infra* Parts I.C-D.

¹⁸⁸ See *infra* Parts I.C-D.

¹⁸⁹ See Kevane, *supra* note 183, at 2.

¹⁹⁰ See Kimhi, *supra* note 16, at 356.

¹⁹¹ See Malito, *supra* note 171, at 524-29 (Part III.B).

wishes in order to allow access to such a powerful system.¹⁹² This system, through an established and dedicated federal court system that is specifically designed to handle financial distress, provides recourse and process for troubled municipalities.

Resistance to Chapter 9 appears to stem largely from fear of political consequences associated with a municipal bankruptcy filing.¹⁹³ Though these concerns are understandable, states should acknowledge that the benefits provided by Chapter 9—when used properly and only as a last resort—outweigh the negative potential consequences of disallowing it.

Though section 109(c)(2) provides that specific authorization may also be granted “by a governmental officer or organization empowered by State law,” the resultant language in the 1994 revisions left questions regarding Congress’s intent in relation to states authorizing Chapter 9 access.¹⁹⁴ Admittedly, though this language does not absolutely require statutory guidance, a lack of such from the state legislative body unnecessarily maintains a level of uncertainty within the state.

In support of this idea, several states have opted for simple and concise blanket authorization statutes.¹⁹⁵ To add credit to the idea that some affirmative stance is necessary, other states have opted for de-authorization.¹⁹⁶ However, blanket authorization—as well as de-authorization—is insufficient because it fails to fully account for the economic effects a municipal bankruptcy can have, to consider the necessary role states must serve as gatekeepers, and acknowledge the necessary role Chapter 9 serves.¹⁹⁷ Additionally, and in the alternative, de-authorization is further ineffective because it exposes troubled municipalities to inefficient and costly alternatives like individual state court actions from creditors and an ever-increasing snowball of debt that would otherwise be stopped under Chapter 9’s automatic stay.

For those states lacking express legislation, authorizing Chapter 9 access statutorily would provide several benefits. First,

¹⁹² See generally *id.*

¹⁹³ See *supra* notes 10-12 and accompanying text.

¹⁹⁴ 11 U.S.C. § 109(c)(2) (2012).

¹⁹⁵ See *supra* notes 85-86 for a survey of Express Authorization states.

¹⁹⁶ See *supra* notes 88-96 for a survey of De-Authorization or Effective De-Authorization states.

¹⁹⁷ See *supra* Part I.A.

an express statute provides guidance for municipal decision makers as they attempt to find the optimal solution. By taking an affirmative stance toward mitigating the insecurity accompanying a lack of statutory guidance, states allow decision makers at the municipal level to operate with knowledge of the financial framework in which they will be operating and consider responsibly all the options provided to them. Further, for these decision makers, express authorization, in any form, enables the municipality to rely on an existing set of rules and procedures regarding the process of federal bankruptcy relief and what stands at the proverbial end of the line.

Though the benefit of this knowledge and guidance for municipal decision makers is important, the benefit is not limited to those parties. Current and potential creditors, such as investors or parties contracting with the municipality, are also given the benefit of working within a transparent financial system. As with the municipal decision makers, this transparency enables investors to make better-formed decisions and, ultimately, promote a more efficient marketplace to operate within.

B. Why States Should Implement a Conditional Authorization Model

Continued municipal reliance on debt ensures that more municipalities will inevitably face financial distress. As such, more municipalities will require debt readjustment assistance in some form. This idea can be concerning to those with conservative financial views. However, this risk is acknowledged by the efficient market hypothesis, which states that financial markets are financially efficient; thus, the risk of default is already reflected in the market price of the debt offered.¹⁹⁸ Chapter 9 of the Code is the federal government's attempt to provide a remedy in those situations where financially distressed municipalities reach dire financial circumstances and require debt readjustment.

Constitutional protections of state sovereignty prevent Chapter 9 from fully protecting all interested parties, including

¹⁹⁸ See *Efficient Market Hypothesis*, MORNINGSTAR INVESTING GLOSSARY, http://www.morningstar.com/InvGlossary/efficient_market_hypothesis_definition_what_is.aspx (last visited Mar. 27, 2015).

taking into account the economic impact municipal bankruptcies may have.¹⁹⁹ In fact, Chapter 9 is structured so that the individual states serve as gatekeepers specifically because they are best suited to balance the need for financial assistance with proper consideration of the economic impact such a filing may produce.²⁰⁰

Currently, state approaches to handling access to Chapter 9 vary greatly. Blanket authorization statutes offer complete and unencumbered access to Chapter 9²⁰¹ while the four states which completely bar access to Chapter 9 through either a blanket de-authorization statute or policies that effectively de-authorize access make it a virtual impossibility.²⁰²

In the middle of the spectrum between blanket authorization and blanket de-authorization, a state-based, preemptory, conditional authorization system offers the optimal solution. Currently, eleven states use some form of this type of system where financially distressed municipalities go through a particular process or must be granted authorization from a particular state political actor prior to being granted Chapter 9 access.²⁰³ These conditional authorization systems, in whichever form they take, create a buffer between the municipality with its vested interests and the pro-debtor Chapter 9 system.

The following section will provide a breakdown of three conditional authorization model sub-classifications—the Political Model, the Administrative Model, and the Hybrid Model—using the analogy of judicial selection as a lens to compare and contrast each and explain why the Political Model comes closest to maintaining the integrity of the democratic system.²⁰⁴ Much of this section relies on the previous information provided in the

¹⁹⁹ See *supra* Part I.B for a discussion of the history of Chapter 9 and the federalism conflict. See also *supra* Part III.A for an argument for express authorization as a last resort choice.

²⁰⁰ See *supra* Part I.B; see also *supra* Part III.A.

²⁰¹ See *supra* Part II.A for a survey of states who have given blanket authorization to file Chapter 9. See also *supra* Part III.A.

²⁰² See *supra* notes 88-96 for a survey of De-Authorization or Effective De-Authorization states.

²⁰³ See *supra* notes 97-169 for a survey of Conditional Authorization states employing Political, Administrative, and Hybrid Models.

²⁰⁴ See *supra* Part III.B for an argument for employing a Conditional Authorization model.

state breakdown section, and the analysis of each model is cumulative in nature.²⁰⁵

1. Maximizing Accountability & Democracy Through the Political Model

The Political Model offers an efficient and cost-effective method of authorization that emphasizes political accountability and promotes transparency, public discussion, and democracy. This type of system places ultimate control over whether a debtor municipality may file for Chapter 9 relief with someone in the state political process—such as the Governor, the Legislature, or some other designated party. Under this model, political actors who are somewhat insulated from the immediate financial emergency—unlike a city council, mayor, or school board—yet who, at least theoretically, maintain a vested interest in reaching the optimal solution are vested with the ultimate responsibility of authorizing access.²⁰⁶ This method is currently being used in several states, including Connecticut, Louisiana, North Carolina, and Ohio.²⁰⁷

This model can be further understood by considering the analogy of judicial selection. Operating very similarly to the Election Method for judicial selection, the Political Model promotes democracy through transparency and political accountability. By requiring permission from a designated party, the Political Model eliminates any ambiguity surrounding political accountability.²⁰⁸ Ensuring that broader economic concerns are adequately considered, the Political Model provides a clear and designated medium for voters, constituents, and other interested parties to voice concerns and have an opportunity to be heard.²⁰⁹ Effectively, this model garners the full attention of the designee

²⁰⁵ See *supra* Part II for a discussion and survey of states' approaches to specific authorization.

²⁰⁶ Cf. Kimhi, *supra* note 16. There is some debate regarding whether politicians would truly see the benefits of this.

²⁰⁷ See *supra* notes 97-103 and accompanying text.

²⁰⁸ See Frederick Tung, *After Orange County: Reforming California Municipal Bankruptcy Law*, 53 HASTINGS L.J. 885, 918 (2002).

²⁰⁹ See *id.*

because, as political figures, these parties are subject to public approval via election.²¹⁰

Another feature of the Political Model is the ability of creditors, or those directly affected by Chapter 9 filings, to also be heard and to engage in the democratic process. An argument can certainly be made that while debtor municipalities need recourse via Chapter 9, creditors are substantially underrepresented in the process.²¹¹ The Political Model enables a virtual leveling of the playing field in that regard. The very nature of the Political Model, and the abilities of creditors to contact designated parties and be heard, provides a free market element to a process that, once eligibility has been declared, runs the risk of becoming decidedly pro-debtor.²¹² This opportunity allows creditors to engage in the democratic process on the front end and at the state level rather than being forced to battle on eligibility grounds once the process is already initiated in federal bankruptcy court.²¹³

As previously mentioned, the Political Model utilizes members of the state political process.²¹⁴ By their very nature as state representatives, these parties are naturally more concerned with macro-level economic issues involving the state because they are vested in the ultimate outcome.²¹⁵ Federal bankruptcy courts, on the other hand, are federal entities that are removed from the situation. Bankruptcy courts are not tasked with consideration of the broader economic concerns of the state or surrounding area and, though some may argue otherwise, they are not charged with ensuring Chapter 9 is used only when necessary.²¹⁶ While this insulation from the state economic environment is critical for the bankruptcy system to operate equitably, the state actors vested with authorization powers under the Political Model also serve a critical role—balancing the competing concerns a potential Chapter 9 bankruptcy filing presents.

²¹⁰ *See id.*

²¹¹ *See generally* Malito, *supra* note 171 (specifically the introduction and conclusion as well as the general analysis of the piece that focuses on Chapter 9's disproportionate power when compared to other Chapters).

²¹² *Id.*

²¹³ *Id.*

²¹⁴ *See supra* notes 208-13 and accompanying text.

²¹⁵ *See supra* notes 208-13 and accompanying text.

²¹⁶ *See generally* Kimhi, *supra* note 16.

The Political Model offers economic advantages as well. By being a cost-effective and efficient option for addressing Chapter 9 specific authorization, the Political Model avoids the potentially lengthy and politically insulated procedure that the Administrative Model promotes. Cost and efficiency are important because Chapter 9 proceedings alone are already expensive and time consuming.²¹⁷ Added costs for a financially distressed municipality only further impacts the municipality by taking away from the bottom line and utilizing state resources that would otherwise be available for use.²¹⁸

For instance, when Westfall, Pennsylvania engaged in Chapter 9 proceedings, it had only a single creditor and involved no further appeals yet the town accumulated accountant and attorney fees of over \$600,000.²¹⁹ By requiring a simple and concise authorization process, such as requiring approval from the Governor and then requiring the Governor to seek approval from the Legislature such as Connecticut has chosen to do, states can attempt to “cut the red tape” and reach an ultimate authorization decision more efficiently.

Further, efficiency is also important because creditor demands continue to accumulate until a Chapter 9 petition is filed and the automatic stay is instituted even though municipalities may become more severely insolvent.²²⁰ Because the Political Model requires less in the form of proverbial “hoops to jump through” than the Administrative Model,²²¹ the Political Model has the unique ability to reach an ultimate decision more quickly and efficiently.

Another advantage of the Political Model is flexibility. Should the authorized state political actor wish to require more information from the debtor municipality, require the municipality to engage in further preventative actions, or wish to consult with an expert on the subject prior to granting

²¹⁷ See Lauren M. Wolfe, Comment, *The Next Financial Hurricane? Rethinking Municipal Bankruptcy in Louisiana*, 72 LA. L. REV. 555, 569 (2012).

²¹⁸ *Id.* (\$600,000 in attorney fees and accountant fees in a situation with only one creditor and a small town.).

²¹⁹ *See id.*

²²⁰ 11 U.S.C. § 362 (2012).

²²¹ See *supra* notes 104-27 and accompanying text for a discussion of the Administrative Model of Conditional Authorization.

authorization, that political actor may do so under this model. In contrast to the Administrative Model or the Hybrid Model, the Political Model allows for the individual circumstance and a centralized investigative party to dictate the necessary action.

While the Political Model offers several advantages, it is not without criticisms. To parallel the judicial selection debate, as Judge Posner said when comparing elected judges to appointed judges, those who are “elected . . . [must] be more sensitive to public opinion than a judge whose tenure does not depend on the whim of the electorate.”²²² This statement applies equally to conditional authorization and is particularly poignant with regard to the Political Model. While political involvement has its benefits, it is also still susceptible to the pitfalls of politics.²²³

For instance, scholars have questioned whether requiring the approval of politically motivated individuals—people unavoidably susceptible to the fear of committing “political suicide”—may make Chapter 9 a virtual impossibility.²²⁴ Further, given the idea that political involvement means inherent periodic campaigns and elections, delay is possible, in some instances, by politicians attempting to either make it through the next election or kick the issue down the road to the next incoming political actor should an election be lost.²²⁵

Another criticism of the Political Model is that it opens the door to corruption.²²⁶ As with the democratic process as a whole, democracy is a double-edged sword. Though the members of the political process have a vested interest in protecting local economic interests, those same parties are also exposed to creditor lobbying, bribery, and overall corruption.²²⁷

Perhaps no Chapter 9 example is more illustrative of how political corruption can stain a municipality’s financial health than Jefferson County, Alabama, which emerged from bankruptcy

²²² See Richard A. Posner, *Judicial Behavior and Performance: An Economic Approach*, 32 FLA. ST. U. L. REV. 1259, 1266 (2005).

²²³ See *id.*

²²⁴ See Wolfe, *supra* note 217, at 575; see also Kimhi, *supra* note 16, at 391.

²²⁵ See *supra* note 224.

²²⁶ See Kimhi, *supra* note 16, at 378; see also Watkins, *supra* note 8, at 103.

²²⁷ See *supra* note 226.

in December 2013.²²⁸ There, corrupt politicians and businesspersons were able to, over a lengthy period of years, amass an incredible \$5.4 billion in outstanding debt in a county that produced only \$190 million in revenues per year.²²⁹ Subsequently, many of those officials eventually faced federal criminal charges and prison time.²³⁰ While those remedies certainly seek to disincentivize future politicians from engaging in such corrupt behavior, Jefferson County nonetheless is still saddled with the dire financial circumstances and subsequent Chapter 9 proceedings that those corrupt individual's decisions created.²³¹

In situations like Jefferson County the concern is obvious; however, the Political Model also raises concerns regarding powerful creditors using substantial political clout and leverage to game the system and prevent legitimate Chapter 9 municipalities from otherwise gaining access. As one scholar noted, “[b]y leaving the decision to approve a bankruptcy filing in the hands of a powerful group of politicians, politics, rather than prudent policy, is likely to be the primary influence.”²³²

While this concern with the Political Model is certainly reasonable and deserves important consideration, it is equally important to recognize that all models of state authorization are exposed to this same pitfall.²³³ Despite the individual factual circumstances, the situations always have similarities. Creditors, such as those invested in Detroit's pensions or Jefferson County's sewer system, may have hundreds of millions or even billions of dollars at stake when it comes to authorization of a municipality to enter Chapter 9.²³⁴ The notion that those parties will wish to pursue their own interests is simply a by-product of the democratic system.

²²⁸ Barnett Wright, *It's Over. Jefferson County Today Emerges from Bankruptcy Following Sale of New Sewer Warrants*, AL.COM (Dec. 3, 2013, 10:52 AM), http://blog.al.com/spotnews/2013/12/its_over_jefferson_county_emer.html.

²²⁹ See Michael D. Floyd, *A Brief History of the Jefferson County, Alabama Sewer Financing Crisis*, 40 CUMB. L. REV. 691, 701-02, 707, 711 (2010).

²³⁰ *Id.* at 701.

²³¹ *Id.* at 701-02.

²³² Wolfe, *supra* note 217, at 575.

²³³ *Id.* at 576.

²³⁴ See *supra* notes 1-6, 229-30 and accompanying text.

Perhaps these concerns are best addressed by considering the foundation of the democratic system. Despite the concerns, the Political Model places authorization power in the hands of those who have been democratically elected. As such, those duly elected officials ought, presumptively, to bear that same responsibility because they are already vested by the people with the power to make decisions for the betterment of those they represent. In this way, Chapter 9 authorization would take on a life much like passing enabling legislation or deciding important issues like income tax rates, which is already decided in this manner. Additionally, should elected parties fail their constituencies, the democratic process enables those parties to be replaced in the next election. In these ways the Political Model is the most in line with the American form of government because of the level to which it promotes democracy through transparency and accountability.

2. Promoting Expertise & Procedure Through the Administrative Model

While the Political Model is a viable alternative, it is not the only model states have chosen to enact. Rather than focusing on democratic principles, the Administrative Model's focus is on ensuring that well-qualified people are placed in the decision-making roles and full consideration is given to the financially distressed situation through a well-defined procedure.²³⁵ Several states, such as New York and Pennsylvania, use systems such as this.²³⁶

In practice, Administrative Models vary greatly between the states. For instance, while New York provides a relatively straightforward procedure which relies on experts to help the municipality through the process, Nevada relies on a procedure that enlists the expertise of the Department of Taxation and the Nevada Tax Commission.²³⁷ Though there is this variance, promotion of the idea that the best solution is achieved through the provision of options, the use of bureaucracy and procedure,

²³⁵ See *supra* Part II.C.2 for a discussion of states with the Administrative Model.

²³⁶ See *supra* Part II.C.2 for an analysis of New York's Administrative Model. See also *infra* Appendix A for analysis of Pennsylvania's Administrative Model.

²³⁷ See *supra* Part II.C.2.

and the enlistment and reliance on expert advice is the common thread.

The Administrative Model can be attractive for several reasons. First, many Administrative Models are formed with recognition of the need for adaptability and address this need by providing various enumerated options. While the Political Model enlists a governmental actor to make these decisions unilaterally if they wish, Administrative Models require compliance with a well-defined procedure. For instance, Nevada accomplishes this by providing various methods of declaring a financial emergency—such as through Department of Taxation inquiry, municipal request, or Department of Taxation takeover.²³⁸ In each of these options, the Nevada Tax Commission, made up of non-political figures, effectively assumes the role of fact-finder and provides technical and financial expertise in attempting to determine the financial severity involved in the situation and considering all available options.²³⁹

Another reason the Administrative Model may prove to be an attractive option is the degree to which the procedure is well-defined. While Political Model statutes are often concise and simple, leaving room for some degree of uncertainty with regard to the actual duty imposed, Administrative Models are statutorily much more descriptive and well-defined.²⁴⁰ While critics may assert the idea that this creates more “red tape,” and thus sacrifices time and resources, Administrative Model proponents would argue that this form of authorization provides greater clarity and certainty.

While it is certainly true that the more labor and resources a system requires the more it costs the state, the Administrative Model places greater value on finding the optimal solution rather than finding the quickest solution. By placing the responsibility of authorization with a designated expert—a Commission, Department, or Agency—charged specifically with this task, the

²³⁸ NEV. REV. STAT. ANN. §§ 354.675-354.7235 (LexisNexis 2008).

²³⁹ *Id.*

²⁴⁰ Compare CONN. GEN. STAT. ANN. § 7-566 (West 2010) (Connecticut, with its express authorization statute consisting of one broad statement), with 53 PA. CONS. STAT. ANN. §§ 11701.102-11701.201, 5571-5572 (West 2014), and 74 PA. CONS. STAT. ANN. § 1773 (West 2014) (Pennsylvania).

Administrative Model gives credit to the idea that such important and technical decisions should be left, or at least in part decided, by people with expertise in the field. Expertise and a non-political nature lends itself to an independence that the Political Model cannot claim.

To rely again on the parallel created between this issue and the debate over judicial selection, this idea concerns a sentiment possibly best expressed by Judge Posner. Judge Posner alluded to the fact that elected judges are simply less independent than appointed judges, meaning they are less able to think for themselves and are, forcibly, much more concerned with the overall well-being of their constituents.²⁴¹ In much the same way, the Political Model is less independent than the Administrative Model because when it places responsibility in the hands of someone exposed to the political system, they surrender some of that ability to be independent.²⁴²

As mentioned previously, an Administrative Model can take on many forms. One characteristic that appears to be unique to Administrative Model states is the utilization of some sort of early warning system or pre-financial emergency procedure. For instance, North Carolina's process requires municipalities to periodically self-report on their fiscal health to a special state agency that deals exclusively with local government finances.²⁴³ These early warning systems are valuable because they provide a pre-Chapter 9 alternative that attempts to help rehabilitate the distressed municipality early on, potentially preventing the financial distress from reaching full-on crisis levels altogether.²⁴⁴ Ideally, the utilization of such a pre-warning system could significantly decrease the likelihood of a municipality's financial situation from deteriorating to the point where Chapter 9 is inevitable.

²⁴¹ See Posner, *supra* note 222, at 1266-68.

²⁴² *Id.* (discussion of the judicial selection debate, particularly with concern to what happens when responsibility is placed in the hands of political, administrative, or bureaucratic figures).

²⁴³ Kimhi, *supra* note 16, at 393 (discussing North Carolina's Local Government Commission (LGC)).

²⁴⁴ See *id.* at 394.

3. The Best of Both Worlds—Or the Worst? The Hybrid Model

While both the Political and Administrative Models offer advantages that states may find attractive for various reasons, Illinois has chosen an approach that seems to promote the idea that the optimal system is achieved by combining the features of each of those two systems. Though this piece has drawn theoretical lines between systems classified as being either political or administrative in nature, this Hybrid Model system blurs the lines between those two classifications. Though this method promotes the idea that taking the optimal characteristics from two competing theories will produce the best solution, questions arise because this hybrid approach also brings with it the downsides of each of the two conventional models.

While this Hybrid Model is much less easy to define than its more conventional brethren, a few similar features commonly appear. For instance, this model appears to focus on promoting the accountability that is so characteristic of the Political Model and combines that with the reliance on expertise, structure, and procedure that the Administrative Model represents.²⁴⁵

For example, functionally Illinois relies on a political actor—the Governor—to determine whether a financial emergency exists.²⁴⁶ To do this, the Governor is provided with explicit details as to how to proceed and is also given a timeline for these proceedings to take place.²⁴⁷ In this manner, traces of the Administrative Model are seen because the Governor is charged with deciding whether or not to form a Financial Planning and Supervision Committee, made up of various experts and political members, to review the situation and whether to bring in additional independent experts.²⁴⁸ In addition to this, the committee is given oversight powers and the ability to recommend that the municipality file a petition under Chapter 9.²⁴⁹

²⁴⁵ See *supra* Section II.C.1 for a discussion on the Political Model states and Section II.C.2 for a discussion on the Administrative Model states.

²⁴⁶ See *infra* Appendix B (Additional Hybrid Model State: Illinois); see also *infra* note 324 and accompanying text.

²⁴⁷ See *infra* Appendix B (Additional Hybrid Model State: Illinois).

²⁴⁸ See *infra* Appendix B (Additional Hybrid Model State: Illinois); see also *infra* notes 326-30 and accompanying text.

²⁴⁹ See *infra* Appendix B (Additional Hybrid Model State: Illinois); see also *infra* notes 338-39 and accompanying text.

Though this type of system appears to offer advantages, concerns do arise. For instance, while a Political Model is statutorily simple and concise, promoting efficiency and transparency that lends itself to political accountability, this hybrid authorization model leaves considerably more room for political maneuvering. Within this hybrid system, no one political actor or designated party holds the ultimate decision-making responsibility; therefore, no single political actor must force herself to answer to the constituency.

Additionally, this hybrid authorization model appears to promote bureaucratic principles by enabling a committee to oversee the process. Though this principle appears to work well in the Administrative Model, where experts are placed in critical fact-finding roles, here the eleven-member committee of people from vastly different perspectives and self-interests is expected to operate consistently with the best interests of the municipality in mind.²⁵⁰

Furthermore, the committee is vested with the power to bring in additional experts to handle various aspects of the process, further reducing the efficiency and clarity of the system.²⁵¹ Though some degree of expertise could certainly lend itself to promoting the search for an optimal solution, one must wonder to what degree additional levels of oversight begin to simply overcomplicate an already complex situation. Furthermore, the Governor's level of involvement and responsibility remain a mystery as questions regarding these issues also go unresolved.

Though one could effectively argue the merits of expertise against those of promoting democratic principles, without locating additional hybrid models to review, in practice, one must hesitate to see any real benefit. One thing, however, is certain. State authorization for municipal bankruptcy is an important and critical decision. Interested parties on both sides of the equation deserve a system that operates to promote, above all, finding an optimal solution, without muddying the waters. A Hybrid Model is much less defined than either of the two other models. Because it appears to be employed in only two states, there remains an

²⁵⁰ See *infra* Appendix B (Additional Hybrid Model State: Illinois).

²⁵¹ See *infra* Appendix B (Additional Hybrid Model State: Illinois).

overarching concern that this model actually combines the worst characteristics of the Administrative and Political Models, and thus is not an optimal solution.

CONCLUSION

Chapter 9's purpose is to ensure municipal survival and the continued ability to provide basic municipal services. Because bankruptcy courts are neither charged with, nor empowered with, the task of evaluating the macro-level economic concerns of municipal bankruptcy, that responsibility falls to the states. Despite this, the ability to access the municipal bankruptcy system under Chapter 9 serves a necessary role when utilized as a last resort.

Because today's Code requires a municipality to be "specifically authorized" by the state to file for Chapter 9 relief, municipalities are unable to access the system without some form of affirmative action by the state. Without a proper state-based authorization system, the increased use of Chapter 9—a disproportionately pro-debtor system—could have a detrimental impact on municipal economics extending beyond the individual financially distressed municipality.

Currently, many states have chosen to handle Chapter 9 access in three distinct ways—through blanket authorization, blanket de-authorization or effective de-authorization, and conditional authorization.²⁵² For those states utilizing conditional authorization as a means of keeping the gate, three sub-classifications have arisen—the Political, the Administrative, or the Hybrid model. While the majority of states have affirmatively addressed Chapter 9 access in some form, a substantial number of states have yet to take such action.

This Comment has urged those states having yet to do so to statutorily authorize Chapter 9 access as well as implement a Political Model of conditional authorization to satisfy the 109(c)(2) eligibility requirement. The Political Model of authorization promotes the democratic principles of transparency and

²⁵² See *supra* Part II.A for a discussion of Blanket Express Authorization states, Part II.B for a discussion of De-Authorization or Effective De-Authorization states, and Part II.C for a discussion of Conditional Authorization states.

accountability while valuing efficiency and timeliness in an effort to reach the optimal solution. Though the Administrative Model offers a viable and reasonable alternative because of the value it places on expertise and procedure, the Hybrid Model appears to become less of what it was intended—a model that combines the other two model's best features—and more of an amalgam of the less desirable characteristics of each.

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APPENDIX A

Additional Administrative Model States

California. Commonly referred to as A.B. 506, California has implemented perhaps the simplest form of an administrative model for authorization. A.B. 506 grants Chapter 9 access but requires financially distressed municipalities to engage in either of two provided options prior to filing.²⁵³ Under this system, troubled municipalities may file after engaging in either a “neutral evaluation process” or the declaration of a fiscal emergency.²⁵⁴

A.B. 506 was California’s response to the recognition that municipal bankruptcy can have broad “fiscal consequences” outside of the individual municipality and out to the state as a whole.²⁵⁵ Additionally, the legislature hoped that by passing A.B. 506, it could reserve Chapter 9 exclusively as a last resort.²⁵⁶

The neutral evaluation option allows both the troubled municipality and its creditors to engage in a neutral evaluation to attempt to resolve the dispute.²⁵⁷ The statute specifically provides guidance on how the neutral evaluator should be selected, the

²⁵³ CAL. GOV’T CODE § 53760 (West 2014).

²⁵⁴ *Id.*

²⁵⁵ Assemb. Bill 506, 2011-2012 Assemb., Reg. Sess. § 1(a) (Cal. 2011) (“Filing for Chapter 9 can reduce service levels to the taxpayers and residents of a municipality. In some circumstances, it can have major short- and long-term fiscal consequences for the municipality, the surrounding municipalities, and the state. Filing for bankruptcy protection under Chapter 9 should be considered a last resort, to be instituted only after other reasonable efforts have been made to avoid a bankruptcy filing or otherwise appropriately plan for it. It is in the interest of the state, local governments, and the public that local governmental entities have sufficiently sound financial capacity to provide required services to the public and meet their contractual and other obligations during any restructuring or financial reorganization process. Furthermore, it is in the best interest of the public, the state, and local governmental entities that employees, trade creditors, bondholders, and other interestholders be included in an appropriate restructuring process and have an adequate understanding of the financial capacity of local governmental entities and their obligations, as a clear understanding of both is necessary for any restructuring or reorganization process.”).

²⁵⁶ *Id.* The legislature cited the broad economic effects and specifically addressed issues like pensions and public funding of future indebtedness. *Id.*

²⁵⁷ CAL. GOV’T CODE § 53760.3 (West 2014). For a detailed analysis of the Neutral Evaluation Process, see generally Karol K. Denniston, *Neutral Evaluation in Chapter 9 Bankruptcies: Mitigating Municipal Distress*, 32 CAL. BANKR. J. 261 (2012).

qualifications said evaluator should possess, and how the evaluator should operate within the proceedings.²⁵⁸

The other option available to troubled municipalities is the declaration of a fiscal emergency. Should a municipality elect to pursue this path, doing so requires elector approval from a majority vote of the local governing body at a public hearing and proper notice given to the constituency.²⁵⁹

Nevada. Nevada uses an administrative model that places much of the control over the process with the Nevada Tax Commission and the Department of Taxation.²⁶⁰ Nevada's system involves these two governmental bodies determining whether a severe financial emergency exists in the troubled municipality through an exhaustive fact-finding process. Under this law, there are two methods by which a severe financial emergency can be declared, via Department of Taxation inquiry and via municipal request.²⁶¹

Method #1: Financial Emergency via Department of Taxation Inquiry. If a municipality determines it is in need of financial assistance, it may request an appearance before the Nevada Tax Commission to seek assistance from the Department of Taxation.²⁶² If the Tax Commission determines that assistance is needed, it may then order the Department of Taxation to provide technical assistance to the municipality as it "deems necessary and appropriate."²⁶³

During the time which assistance is provided, the Department of Taxation is charged with several specific duties. Among those duties is the determination of whether any of the enumerated conditions Nevada provides exists within the particular municipality.²⁶⁴ These conditions are statutorily provided and include, but are not limited to, events such as consistently failing to file required financial reports to the local government or issuing checks it is unable to cover through its

²⁵⁸ CAL. GOV'T CODE § 53760.3 (West 2014).

²⁵⁹ *Id.* § 53760.5.

²⁶⁰ NEV. REV. STAT. ANN. §§ 354.675-354.7235 (LexisNexis 2008).

²⁶¹ *Id.* §§ 354.675, 354.686.

²⁶² *Id.* § 354.675(1).

²⁶³ *Id.* § 354.675(3)-(4).

²⁶⁴ *Id.* § 354.685(1).

deposits.²⁶⁵ If any one of the enumerated conditions is found, the Department must notify the local government, request the information needed to determine the extent of the condition, and “[r]equire the local government to formulate a plan of corrective action to mitigate the possible financial emergency.”²⁶⁶

Within forty-five days of notification that a potential financial emergency exists, the local government must provide a corrective action plan.²⁶⁷ From there, the Committee on Local Government Finance will review the plan and provide recommendations to the local government as well as the Department of Taxation for how to remedy the situation.²⁶⁸ If the Department of Taxation determines that a severe financial emergency exists, it must then report that information to the Nevada Tax Commission.²⁶⁹ Upon such reporting, the Nevada Tax Commission must then hold a hearing to determine if, in fact, a severe financial emergency exists.²⁷⁰ If a severe financial emergency is determined to exist, the Department of Taxation is required to “take over the management of the local government as soon as practicable.”²⁷¹

Method #2: Financial Emergency via Municipal Request. In addition to a Department of Taxation inquiry, a local government may also request declaration of a severe financial emergency if a majority of its members vote and approve a plan to request the Nevada Tax Commission “order that the Department [of Taxation] . . . take over the management of the local government.”²⁷² If such a request is made, the Nevada Tax Commission is required to “order the Department [of Taxation] to take over the management of the local government.”²⁷³

Under either method, once the Department of Taxation assumes control of the management of the local government it is required to implement new policies and financial plans and

²⁶⁵ *Id.* § 354.685(1)(a)-(aa).

²⁶⁶ *Id.* § 354.685(2)(a)-(c).

²⁶⁷ *Id.* § 354.685(3).

²⁶⁸ *Id.* § 354.685(4)(a)-(b).

²⁶⁹ *Id.* § 354.685(7).

²⁷⁰ *Id.*

²⁷¹ *Id.*

²⁷² *Id.* § 354.686(1).

²⁷³ *Id.* § 354.686(2).

appoint a financial manager and any other necessary persons needed to remedy the emergency.²⁷⁴ Should “the Department take[] over the management of a local government because . . . [of] litigation,” a stay is put in place—similar to the one placed under Chapter 9 proceedings²⁷⁵—until that particular creditor “meet[s] with the Department to formulate a program for the liquidation of the debt owed.”²⁷⁶

Should such circumstances arise, additional requirements are placed on the Executive Director of the Department of Taxation. She must determine the total amount of expenditures necessary to continue to perform the basic functions of government, determine the amount of revenue expected to be received and available to the

²⁷⁴ *Id.* § 354.695(1)(a)-(n). With the approval of the Committee on Local Government Finance, the Department shall

(a) Establish and implement a management policy and a financing plan for the local government; (b) Provide for the appointment of a financial manager for the local government who is qualified to manage the fiscal affairs of the local government; (c) Provide for the appointment of any other persons necessary to enable the local government to provide the basic services for which it was created in the most economical and efficient manner possible; (d) Establish an accounting system and separate accounts in a bank or credit union, if necessary, to receive and expend all money and assets of the local government; (e) Impose such hiring restrictions as deemed necessary after considering the recommendations of the financial manager; (f) Negotiate and approve all contracts entered into by or on behalf of the local government before execution and enter into such contracts on behalf of the local government as the department deems necessary; (g) Negotiate and approve all collective bargaining contracts to be entered into by the local government, except issues submitted to a factfinder whose findings and recommendations are final and binding pursuant to the provisions of the Local Government Employee-Management Relations Act; (h) Approve all expenditures of money from any fund or account and all transfers of money from one fund to another; (i) Employ such technicians as are necessary for the improvement of the financial condition of the local government; (j) Meet with creditors of the local government and formulate a debt liquidation program; (k) If the Department has taken over the management of a local government because the local government is involved in litigation or threatened litigation, carry out the duties set forth in NRS 354.701, if the provisions of that section are applicable; (l) Approve the issuance of bonds or other forms of indebtedness by the local government; (m) Discharge any of the outstanding debts and obligations of the local government; and (n) Take any other actions necessary to ensure that the local government provides the basic services for which it was created in the most economical and efficient manner possible.

²⁷⁵ Similar to the automatic stay provided by Chapter 9.

²⁷⁶ *Id.* § 354.701.

local government, and consider any alternative revenue sources available.²⁷⁷

If the Executive Director determines that there are not enough funds to pay the “required debt service and operating expenses,” she can provide the Committee on Local Government Finance with that conclusion.²⁷⁸ The Committee will then decide whether more funds are needed and “prepare a recommendation [for] the Nevada Tax Commission as to which . . . additional taxes or charges should be imposed by the local government.”²⁷⁹ These decisions must then be provided in the form of a public hearing held within the jurisdiction in question.²⁸⁰ The statute also provides for a Severe Financial Emergency Fund created in the State Treasury to operate “as a revolving fund” to be administered by the Executive Director of the Department of Taxation when necessary.²⁸¹

Unlike most other states with an elaborate state-based system, Nevada does not appear to authorize access to Chapter 9. Instead, the statute provides a procedure for the dissolution or disincorporation of the local government unit should the situation fail to be rectified within three years.²⁸² In such a scenario the Executive Director must determine the amount of tax that must be levied, and “[t]he manner in which . . . services provided by the local government must be limited to ensure a balanced budget” from that point forward.²⁸³

The Committee will then review the Executive Director’s findings to make a recommendation to the Tax Commission.²⁸⁴ At that point, the Tax Commission must hold a public hearing where the Executive Director will provide all relevant recommendations

²⁷⁷ *Id.* § 354.705(1)(a)-(c).

²⁷⁸ *Id.* § 354.705(2).

²⁷⁹ *Id.* Additional taxes may include an additional property tax, additional tax on lodging, additional services charges, and additional sales taxes. *Id.* § 354.705(2)(a)-(d).

²⁸⁰ *Id.* § 354.705(3).

²⁸¹ *Id.* § 354.721(1). The fund’s purpose is to provide a means of loaning local governments the funds needed to pay operating expenses in situations where the Department has taken over management of the municipality, where a resolution has been adopted to use the money for operating expenses only, and where the municipality agrees to repay the entire amount of the loan. *Id.* § 354.721(2)-(3).

²⁸² *Id.* § 354.723(1).

²⁸³ *Id.*

²⁸⁴ *Id.* § 354.723(2).

to the local government's governing body.²⁸⁵ If after a public hearing the Tax Commission finds that the Committee and Executive Director were correct, "a question must be submitted to the electors of the local government . . . [to] ask[] whether the local government should be disincorporated or dissolved."²⁸⁶

Should electors wish to avoid disincorporation or dissolution, the statute provides parameters for the maximum taxation that can be levied²⁸⁷ as well as a procedure to follow under those circumstances.²⁸⁸ On the other hand, should electors approve dissolution, the Department of Taxation management of the local government unit "ceases at the time of the disincorporation or dissolution."²⁸⁹

New Jersey. New Jersey utilizes an Administrative Model approach that vests much of its responsibility in the purview of the Municipal Finance Commission (Commission) and the Superior Court.²⁹⁰ In comparison to other states utilizing the Administrative Model, New Jersey's statutory guidance is relatively less clear as to what is exactly required to take place. The statute does, however, provide guidance for how long, and under what circumstances, the Commission will take over financial operations for the municipality and will attempt to seek a solution.²⁹¹

Additionally, the Commission is given broad power to oversee the municipality's fiscal affairs when it becomes troubled. These powers include issuing subpoenas to compel witnesses to appear before it,²⁹² "carry[ing] out directions not complied with by [the] municipality,"²⁹³ and appointing an auditor to oversee the financial emergency.²⁹⁴

²⁸⁵ *Id.* § 354.723(3).

²⁸⁶ *Id.* § 354.723(4).

²⁸⁷ *Id.* § 354.723(4)(a)-(c).

²⁸⁸ *Id.* § 354.723(5)(a)-(c).

²⁸⁹ *Id.* § 354.7235.

²⁹⁰ N.J. STAT. ANN. §§ 52:27-2, 52:27-34 to 52:27-45.11 (West 2010).

²⁹¹ *Id.* § 52:27-4. For instance, once the Commission has taken control, it shall remain in control until all indebtedness that has fallen due or will fall due within a year has been paid, funded, or refunded. *Id.*; see also *id.* § 52:27-5.

²⁹² *Id.* § 52:27-12.

²⁹³ *Id.* § 52:27-13.

²⁹⁴ *Id.* § 52:27-13.1.

In the event that a municipal financial emergency occurs, New Jersey has granted the Superior Court with jurisdiction to oversee the attempted rectification of the situation.²⁹⁵ The Superior Court is given the power to enter judgments and, ultimately, to authorize and approve municipal debt readjustment plans that will become binding on all creditors.²⁹⁶

New Jersey does expressly authorize access to Chapter 9.²⁹⁷ In order for a municipality to file for Chapter 9 relief, the state requires a two-thirds approval vote from the governing body's electors as well as approval from the Commission.²⁹⁸

Pennsylvania. Pennsylvania has an Administrative Model which vests most of its authority in the Department of Community Affairs of the Commonwealth (DCAC) under the Municipalities Financial Recovery Act (Act) and with the State Department of Internal Affairs (SDIA). Pennsylvania implemented the Act specifically to protect the “integrity of municipalities,” and to address the adverse impact municipal insolvency can have on an individual municipality as well as the state as a whole.²⁹⁹

The Act places much of the responsibility of determining financial distress and monitoring municipal financial affairs with the DCAC.³⁰⁰ Under the Act, the DCAC has many responsibilities

²⁹⁵ *Id.* § 52:27-34.

²⁹⁶ *Id.* § 52:27-36 (pending the approval of creditors making up eighty-five percent of the total indebtedness).

²⁹⁷ *Id.* §§ 52:27-40, 52:27-41.

²⁹⁸ *Id.*

²⁹⁹ 53 PA. CONS. STAT. ANN. § 11701.102 (West 2014) (finding failed municipalities “affect adversely the health, safety and welfare not only of the citizens of the municipality but also of other citizens in this Commonwealth”). Pennsylvania defines a municipality as “[e]very county, city, borough, incorporated town, township and home rule municipality.” *Id.* § 11701.103.

³⁰⁰ *Id.* § 11701.202. But, compare the fact that the Act also vests the powers to request a determination of municipal financial distress in several parties. *Id.* §§ 11701.202(1)-(10) (vesting the electors, some creditors, and the DCAC among others all with some power to begin the process). The following parties can request a determination: “[t]he governing body of the municipality upon passing a resolution by a majority vote of the governing body after a special public meeting duly advertised . . . by law”; “[a] creditor with a matured claim to whom the municipality owes \$10,000 or more, if the creditor agrees in writing to suspend pending actions . . . for a period of nine months or until the municipality adopts a plan”; “[t]en percent of the number of electors of the municipality that voted at the last municipal election, by petition to the [DCAC] alleging the municipality is fiscally distressed”; “[t]en percent or more of the beneficiaries of a pension fund . . . petition[ing]” the DCAC after the municipality fails

including “compil[ing] financial data,”³⁰¹ “assess[ing that] data,”³⁰² “notify[ing] agencies of [its] determination,”³⁰³ “act[ing] as [an] analyzer of municipal reports,”³⁰⁴ “furnish[ing] program data to municipalit[ies],”³⁰⁵ “develop[ing an] early warning system,”³⁰⁶

to submit its “minimum obligation” as required by the Municipal Pension Plan Funding Standard and Recovery Act; “[t]en percent of the employees of the municipality who have not been paid for over 30 days . . . signing collectively the petition to the [DCAC]”; “[t]rustees or paying agents of a municipal bond indenture”; “[t]he elected auditors, appointed independent auditors or elected controllers of a municipality if they have reason to believe a municipality is in a state of financial distress” meeting the criteria set out in section 201; “[a] trustee or actuary of a municipal pension fund, if the municipality has not made a timely deposit of its minimum obligation payment as required by . . . the Municipal Pension Plan Funding Standard and Recovery Act”; and “[t]he chief executive officer of any city.” *Id.*

³⁰¹ *Id.* § 11701.121(a) (requires maintaining “information and data on the fiscal status of municipalities to determine” whether they meet the criteria for declaring municipal financial distress and compiling that information through a yearly “Survey of Financial Condition” sent to each municipality seeking all information that helps determine whether the criteria of municipal financial distress has been met).

³⁰² *Id.* § 11701.121(b) (requiring application of the criteria set out in § 11701.201 to the data received through the survey as well as conducting further investigation, if need be). Also, this provision provides the Department can provide “appropriate recommendations” should the municipality need assistance in “correct[ing] minor fiscal problems.”

³⁰³ *Id.* § 11701.121(c). The statute requires the Department to “immediately notify the heads of all Commonwealth agencies” should a determination be made of municipal financial distress. Additionally, once the DCAC Secretary makes a determination that a municipality is financially distressed and the various state agencies have been notified, each state agency is required to assess any matters it may have concerning the troubled municipality and report back to the DCAC. *Id.* § 11701.122.

³⁰⁴ *Id.* § 11701.121(d) (requiring the Department act as the named “analyzer for relevant reports, data and information” related to the Commonwealth and to “determine which [of those] reports, data and information relate to the fiscal condition of” the municipality in question).

³⁰⁵ *Id.* § 11701.121(e) (requiring furnishing the distressed municipality in question with the information from “each Commonwealth agency . . . for possible inclusion . . . into the [new] plan”).

³⁰⁶ *Id.* § 11701.121(f). The statute requires the Department to develop an early warning system that utilizes the “necessary fiscal and socioeconomic variables to identify municipal financial emergencies” before crisis levels are reached. Also, it requires testing the reliability of this early warning system.

“distribut[ing] grants and loans,”³⁰⁷ and “promulgat[ing] rules and regulations.”³⁰⁸

The Act also provides several other tools that are at the DCAC’s disposal. For example, the Act requires all municipalities to complete a financial conditions survey for the DCAC each year.³⁰⁹ Also, the Act allows the municipality to request a tax increase above the maximum rates allowed by law.³¹⁰

Regarding the actual determination of municipal financial distress, the Act provides a series of criteria for the DCAC to assess in determining whether municipal financial distress exists.³¹¹ According to the Act, should any one of these criteria be met and if “the department assesses . . . that it is a valid indication of municipal financial distress,” the DCAC is to exercise its powers.³¹²

When it comes to actually filing under Chapter 9 of the Bankruptcy Code, Pennsylvania does not allow such a filing without prior approval from the State Department of Internal

³⁰⁷ *Id.* § 11701.121(g) (requiring the Department to “distribute grants and loans to financially distressed municipalities in accordance” with the Act).

³⁰⁸ *Id.* § 11701.121(h) (requiring the Department to declare the “rules and regulations necessary to implement the provisions” of the Act).

³⁰⁹ *Id.* § 11701.123(a).

³¹⁰ *Id.* §§ 11701.123(c)(1)-(3), 11701.141 (to be granted by the Court of Common Pleas of each county).

³¹¹ *Id.* § 11701.201.

³¹² *Id.* § 11701.201(1)-(11). The criteria are: “[t]he municipality has maintained a deficit over a three-year period”; “[t]he municipality’s expenditures . . . exceeded revenues for a period of three years or more”; “[t]he municipality has defaulted in payment of principal or interest on any . . . bonds or notes or in payment of rentals due”; “[t]he municipality has missed a payroll for 30 days”; “[t]he municipality has failed to make required payments to judgment creditors for 30 days [after] the date . . . of the judgment”; “[t]he municipality . . . has failed to forward taxes withheld on the income of employees or has failed to transfer . . . employee contributions [to] Social Security [for a 30 day period]”; “[t]he municipality has accumulated and . . . operated for each of two successive years [at] a deficit equal to 5% or more of its revenues”; “[t]he municipality has failed to make the budgeted payment . . . as required by . . . the Municipal Pension Plan Funding Standard and Recovery Act”; “[a] municipality has [attempted] to negotiate resolution or adjustment of a claim in excess of 30% against a fund or budget and has failed to reach an agreement with creditors”; “[a] municipality has filed a municipal debt readjustment plan pursuant to Chapter 9 of the Bankruptcy Code”; and “[t]he municipality has experienced a decrease in a quantified level of municipal service from the preceding fiscal year which has resulted from the municipality reaching its legal limit in levying real estate taxes for general purposes.” *Id.*

Affairs (SDIA).³¹³ The reasoning behind this is that the SDIA has the power to approve any debt readjustment plan.³¹⁴ Regarding such, the SDIA has a duty to “make a careful and thorough investigation of the financial condition” of the municipality.³¹⁵

The SDIA’s investigation must include: an analysis of the municipality’s assets and liabilities and its “sinking fund,” management of the municipality’s affairs to ensure that they are being done in a “careful, prudent, and economic manner,” determining whether the attempted filing under Chapter 9 is an attempt to evade payment of contractual obligations, and determining whether, if approved, “the plan of readjustment . . . [would] be helpful to the financial condition of the [municipality], and is feasible, and . . . fair and equitable to all creditors.”³¹⁶

The statute also provides for any agency or agencies of the state government who are creditors of the municipality, as well as any other creditors of the municipality, to have the opportunity to be heard and to have the ability to examine the findings made by the SDIA.³¹⁷ Additionally, the SDIA has the ability to require particular modifications be made to the “proposed plan[] for readjusting the debts” as it sees fit.³¹⁸

Pennsylvania also has a specific statute regarding public transportation bonds that explicitly states that no metropolitan transportation authority may file under Chapter 9 so long as there are any remaining outstanding bonds.³¹⁹

³¹³ *Id.* § 5571.

³¹⁴ *Id.*

³¹⁵ *Id.* § 5572.

³¹⁶ *Id.*

³¹⁷ *Id.*

³¹⁸ *Id.*

³¹⁹ 74 PA. CONS. STAT. ANN. § 1773 (West 2014).

APPENDIX B

Additional Hybrid Model State: Illinois

Illinois. Illinois applies a hybrid model where the state has created certain hurdles the municipality must go through prior to seeking Chapter 9 relief.³²⁰ Where the hybrid model characteristics come into play are that those hurdles predominately involve members of the political process, such as the Governor.³²¹ Under this system a financially distressed municipality can petition the Governor, with the approval of two-thirds of the governing body of the municipality, to request establishment of a Financial Planning and Supervision Committee.³²² At that point, the Governor has sixty days to determine whether a fiscal emergency exists and to decide whether to establish the requested commission.³²³

The Illinois model provides some avenues for creditor protection as well. For instance, during the sixty day period when the Governor must determine whether a fiscal emergency exists, the Governor is required to provide “reasonable notice and opportunity for a hearing to all creditors of the petitioning unit of local government” who will be subject to the automatic stay that would come into play once a fiscal emergency is declared.³²⁴ Additionally, to further ensure creditors’ interests are considered equitably, the Governor’s decision to declare a fiscal emergency, as well as all other determinative decisions, is subject to judicial review.³²⁵

Should the Governor elect to establish a Financial Planning and Supervision Commission, the commission must consist of eleven members.³²⁶ The statute expressly provides who eight of the members must be, including:

³²⁰ Illinois refers to its law on the subject as the Local Government Financial Planning and Supervision Act. 50 ILL. COMP. STAT. ANN. 320/1-14 (West 2005).

³²¹ *Id.* § 320/4(a).

³²² *Id.*

³²³ *Id.* § 320/5(b)(1)-(2).

³²⁴ *Id.* § 320/5(b)(2).

³²⁵ *Id.*; 735 ILL. COMP. STAT. ANN. 5/3-101 (West 2003).

³²⁶ 50 ILL. COMP. STAT. ANN. 320/5(b)(3) (West 2014).

the Governor, the state Comptroller, the Director of Revenue, the Director of the Governor's Office of Management and Budget, the State Treasurer, the Executive Director of the Illinois Finance Authority, the Director of the Department of Commerce and Economic Opportunity and the presiding officer of the governing body of the unit of local government, or their respective designees.³²⁷

The other three members of the Commission are nominated by a process where the governing officer of the local government unit nominates five candidates for three positions on the commission.³²⁸ The chairman of the commission has the power to approve those five candidates or, if she is not satisfied that there are three qualified candidates amongst the five nominees, she may request more nominations from the governing officer of the local government.³²⁹ The statute provides that the appointees should satisfy two requirements: (1) she should have "knowledge and experience in financial matters, financial management, or business organization or operations, including experience in the private sector in management of business or financial enterprise, or in management consulting, public accounting, or other professional activity"; and (2) she should not have held any publicly-elected office at any time within the past two years.³³⁰

Once a commission is formed, it may appoint a financial advisor to assist in the process.³³¹ An automatic stay goes into place once the Governor makes the determination that a fiscal emergency is present.³³² Also, within 120 days of the Commission's first meeting, the local governing body must submit a detailed financial plan to the financial advisor and the Commission for how it will rectify the situation—including "[e]liminat[ing] all fiscal emergency conditions" and essentially restoring the local governmental unit to solvency.³³³ The Commission will then either approve or disapprove of the local

³²⁷ *Id.* § 320/5(b)(3)(A).

³²⁸ *Id.* § 320/5(b)(3)(B).

³²⁹ *Id.*

³³⁰ *Id.* § 320/5(b)(3)(B)(i)-(ii).

³³¹ *Id.* § 320/6(c).

³³² *Id.* § 320/7(a).

³³³ *Id.* § 320/8.

government's plan.³³⁴ Prior to approving or disapproving such a plan, the Commission must "give reasonable notice and opportunity for a hearing to all creditors of the unit of local government."³³⁵ The plan must be approved if it "is bona fide and can reasonably be expected to be implemented," if it "is a good faith plan reasonably anticipated to alleviate the fiscal emergency," and if "the plan is in the best interest of the . . . local government and its creditors."³³⁶

Once established, the Commission and the subsequently appointed financial advisor have several enumerated powers, including the power to review financial decisions such as budgets and tax levy ordinances or resolutions and the power to order the local government to negotiate with creditors.³³⁷ Additionally, the Commission is vested with the power to make revisions to the plan or to require the local government to substantiate any part of the plan that needs further clarification as well as recommend that the local government file a petition under Chapter 9 of the Bankruptcy Code.³³⁸ In addition, the governing body of the local government and all of its employees are expressly directed to assist the Commission in all of its duties.³³⁹

³³⁴ *Id.* § 320/8(b).

³³⁵ *Id.* § 320/8(c).

³³⁶ *Id.*

³³⁷ *Id.* § 320/9(a)(1)-(9). Additional powers include: the power to inspect and secure any internal documents of the local government or its employees; the power to consult with the local government's creditors; the power to assist in structuring the terms of debt obligations; the power "[t]o make and enter into . . . contracts . . . necessary or incidental to the performance of its duties" on behalf of the local government; and the power to consult with the local government officials to make recommendations for cost reductions or revenue increases to assist with the process. *Id.*

³³⁸ *Id.* § 320/9(b)(1)-(4).

³³⁹ *Id.* § 320/9(c).

