GATEKEEPERS GONE WRONG: REFORMING THE CHAPTER 9 ELIGIBILITY RULES

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ABSTRACT

In order to gain access to chapter 9 bankruptcy, municipalities must demonstrate that they meet several eligibility requirements. These requirements were put in place to prevent municipalities from making rash decisions about filing for bankruptcy. Too often, however, these requirements impede municipalities from attaining desperately needed relief. This Article demonstrates that as currently utilized, the chapter 9 eligibility rules overemphasize deterrence and are not rationally connected to the reasons the chapter 9 bankruptcy system was developed. This Article therefore posits that the chapter 9 eligibility requirements should be relaxed.

To support this claim, the Article conducts a detailed analysis of the history and theory of chapter 9 to determine the primary reasons for the eligibility rules and the core functions of a municipal bankruptcy solution. It then demonstrates how many of the concerns driving the eligibility rules' existence are addressed in other chapter 9 mechanisms and proposes sweeping revisions to the eligibility rules to facilitate appropriate access to chapter 9. Specifically, municipalities in fiscal distress should be able to access bankruptcy when they demonstrate a need for the primary types of assistance that bankruptcy can best provide: nonconsensual debt adjustment, elimination of the holdout creditor problem, and breathing space. Through its analysis, this Article brings needed attention to the broader questions of who should have access to bankruptcy and when that access should be granted.

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INTRODUCTION

In December 2013, U.S. Bankruptcy Judge Steven Rhodes issued his decision that Detroit was eligible for bankruptcy under chapter 9 of the Bankruptcy Code.[1] Judge Rhodes's ruling was significant for many reasons, not least because it allowed the largest municipal bankruptcy case in U.S. history to move forward. But Judge Rhodes also made a key observation when he issued his ruling: Detroit had waited too long to file for bankruptcy, filing long after it was in the city's best fiscal interest to do so.[2] As a consequence, Detroit residents and officials were suffering unnecessarily when they could have sought—and been granted—federal relief much earlier.

Another city that Judge Rhodes could have had in mind when he made this observation was Atlantic City, New Jersey, which is facing some truly desperate times. The city's $262 million budget has a $100 million deficit.[3] It owes about $400 million to its bondholders and casinos and has no concrete plan for making those payments.[4] Although New Jersey recently provided Atlantic City with a rescue loan package, city officials had already begun delaying paychecks to workers to save up money to make debt payments, and the state's repayment terms are particularly harsh.[5] For the past ten years, Atlantic City has struggled with a rapidly shrinking property tax base, the closure of one third of its casinos, a sharp decline in gambling revenue, and fierce competition from new casinos in neighboring states.[6] Some city officials suggested that the city ought to file for bankruptcy;[7] yet, the years of decline Atlantic City has faced may mean that bankruptcy is no longer a viable option. Specifically, Atlantic City's shrinking revenues and casino closures indicate that the city may not have adequate resources to

1. *In re* City of Detroit, 504 B.R. 97 (Bankr. E.D. Mich. 2013).

2. Chad Halcom, *Judge Rhodes: Detroit Bankruptcy, Filed in Good Faith, Will Continue*, CRAIN'S DETROIT BUS. (Dec. 4, 2013, 3:17 PM), http://www.crainsdetroit.com/article/20131203/NEWS/131209960/judge-rhodes-detroit-bankruptcy-filed-in-good-faith-will-continue (noting that Judge Rhodes stated "that debtors in bankruptcy court often wait longer to file than is in their own fiscal interests" and "Detroit is no exception.").

3. Salvador Rizzo, *Even with Cash from the State, Bankruptcy is Still a Threat to Atlantic City*, NORTHJERSEY.COM (June 5, 2016, 4:52 PM), http://www.northjersey.com/news/even-with-cash-from-the-state-bankruptcy-is-still-a-threat-to-atlantic-city-1.1610728.

4. *Id.*

5. *Id.*; *see also* Frank Shafroth, *The Challenges of Intergovernmental Relations in Insolvency*, GMU MUNICIPAL SUSTAINABILITY PROJECT (Aug. 4, 2016), https://fiscalbankruptcy.wordpress.com/2016/08/04/the-challenges-of-intergovernmental-relations-in-insolvency/ (describing the loan agreement between Atlantic City and New Jersey as "one-sided" with a "scorched earth nature").

6. Rizzo, *supra* note 3.

7. *Id.*

fund a bankruptcy and plan of adjustment. Atlantic City now finds itself between a rock and a hard place: unable to liquidate as a business could, but beyond the point where federal bankruptcy would be sensible, it has become dependent on reluctantly-given state aid and continues to struggle.

The stories of Detroit and Atlantic City illustrate how difficult it can be to figure out when or whether[8] to file for municipal bankruptcy. Indeed, these cities are just two of many municipalities that cannot easily determine whether a federal bankruptcy solution makes economic and political sense.[9] As David Skeel and Clayton Gillette have observed, politics and concerns about stigma play a role in determining whether a municipality will file for bankruptcy or not.[10] But on the legal front, a municipality's entry into the federal bankruptcy system is further complicated by chapter 9's eligibility requirements, which incorporate a dizzying array of hurdles a municipality must clear before obtaining federal relief. The expense, time, and legal effort necessary for an eligibility determination may ultimately discourage cities from taking advantage of the bankruptcy process. This Article argues that the chapter 9 eligibility rules unnecessarily impede access to municipal bankruptcy, a process that already has sufficient safeguards against opportunistic or careless filings. The front-end gatekeeping provided by the eligibility requirements is also aberrational within the bankruptcy system: no other type of debtor is subjected to such a rigorous, litigious screening process[11] before bankruptcy relief is granted.[12]

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8. As will be discussed below, the question of *when* to file for bankruptcy is often inextricably linked to the question of *whether* a municipality should file. Nevertheless, this Article articulates two distinct problems: (1) how timing affects a municipality's ability to seek maximum relief; and (2) how the eligibility rules fail to filter would-be debtors in a way that recognizes those debtors that would receive optimal relief in bankruptcy.

9. Other municipalities include, for example, Chicago and North Las Vegas. *See, e.g.*, Ted Dabrowski, *Chicago Slides Toward Bankruptcy*, HUFFINGTON POST: THE BLOG (May 15, 2015, 4:12 PM) http://www.huffingtonpost.com/ted-dabrowski/chicago-slides-toward-ban_b_7287366.html; James Nash, *North Las Vegas Risks Insolvency Like Detroit, Fitch Says*, BLOOMBERG BUS. (May 5, 2014, 7:34 PM), http://www.bloomberg.com/news/articles/2014-05-06/north-las-vegas-risks-insolvency-like-detroit-fitch-says.

10. Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Role in Municipal Bankruptcy*, 125 YALE L.J. 1150, 1183 ("The stigma of a bankruptcy filing also has a chilling effect, especially for large and complex municipalities.").

11. The means test is another screening process used to determine debtor eligibility for chapter 7 bankruptcy. Although cumbersome and expensive, recent research concludes that it is not that difficult to pass. In addition, U.S. Trustee motions to dismiss or convert chapter 7 cases for debtors who do not pass the means test have fallen by more than half since 2010. Ed Flynn, *Inside the Black Box: The Means Test at 10*, 35-APR Am. Bankr. Inst. J. 46 (2016).

12. For example, to commence a chapter 11 case an entity generally needs only to file a petition and accompanying schedules with the bankruptcy court. *See* ADMIN. OFFICE OF U.S. COURTS, *Chapter 11 – Bankruptcy Basics*, http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (noting that upon filing a petition for chapter 11 relief, the entity in

Although municipal bankruptcy is rare, municipal distress is not.[13] As increasing numbers of cities and towns face fiscal distress, many will consider chapter 9 as an option for resolving their problems.[14] It is therefore crucial to determine with precision what cities stand to gain from a municipal bankruptcy filing. This Article will illustrate that the current eligibility rules stand in the way of this determination and discourage municipalities from seeking relief until long after a municipality has begun to experience severe distress. By the time a municipality files for chapter 9, therefore, it may not be in the best position to take full advantage of all that bankruptcy has to offer.[15]

Although the chapter 9 bankruptcies filed over the past few years have renewed scholarly interest in municipal bankruptcy,[16] the academic literature to date has only briefly and sporadically touched on chapter 9 eligibility.[17] A holistic reform of the eligibility requirements is needed

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question automatically becomes a "debtor in possession" that can reorganize in bankruptcy).

13. *See generally* Wolf Richter, *Fed's Dudley Warns About Wave of Municipal Bankruptcies*, WOLF STREET (Apr. 14, 2015), http://wolfstreet.com/2015/04/14/feds-dudley-warns-on-municipal-bonds-bankruptcies-defaults/ (describing "emerging fiscal stresses" in the municipal sector and noting that bond ratings do not necessarily reflect the widespread problems municipalities are facing).

14. *See, e.g.*, Sean Whaley, *NLV Mayor Backs Bankruptcy Power for Cities, Counties*, L.V. REV. J. (Apr. 4, 2015, 7:55 AM), http://www.reviewjournal.com/news/nevada-legislature/nlv-mayor-backs-bankruptcy-power-cities-counties (describing a bill pending in the Nevada legislature to allow the state's cities and counties to file for chapter 9).

15. For example, filing for bankruptcy may facilitate a municipality's ability to impose a tax increase on otherwise unconsenting parties. *In re* City of Stockton, 493 B.R. 772, 790 (Bankr. E.D. Cal. 2013) ("Putting the fiscal house in order so that voters might be willing to entertain tax increases is the whole point of chapter 9.").

16. For example, several scholars have considered reforms for the chapter 9 confirmation requirements. *See infra* Part III.A.2. Attention to confirmation, however, is only half of the solution, as municipalities need access to bankruptcy before they can even begin to consider the confirmation requirements.

17. *See* Christopher Smith, Comment, *Provisions for Access to Chapter 9 Bankruptcy: Their Flaws and the Inadequacy of Past Reforms*, 14 BANKR. DEV. J. 497 (1998) (suggesting that Congress clarify the requirements for state authorization and refine the definition of "municipality"); 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) (arguing that states should enact statutes regarding the resolution of municipal fiscal distress); 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) (arguing that the state authorization requirement should revert back to general authorization and that the insolvency requirement be amended to allow municipalities to file once they reach the "zone of insolvency"); 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 (1990) (proposing an amendment to the state authorization requirement); Frederick Tung, *After Orange County: Reforming California Municipal Bankruptcy Law*, 53 HASTINGS L.J. 885 (2002) (focusing on California's authorization provision); M. Heith Frost, *States as Chapter 9 Bankruptcy Gatekeepers: Federalism, Specific Authorization, and Protection of Municipal Economic Health*, 84 Miss. L.J. 817 (2015) (arguing that states should implement a combination of express and conditional authorization for chapter 9);

because a municipality will not be able to reap the benefits of chapter 9 without first being deemed eligible for relief. As this Article will illustrate, the eligibility requirements are largely unnecessary, as chapter 9 has so many negative consequences and built-in costs that only cities in desperate financial shape will use it. Furthermore, the standards for confirming a plan of adjustment in chapter 9 provide substantial safeguards that are often replicated by the eligibility rules, forcing municipalities that engage in the chapter 9 process to fight duplicative battles at the eligibility and confirmation stages and further increasing the costs of an already expensive process.

Critics argue that, since chapter 9 is not used very often compared to the other bankruptcy chapters, it is not very useful.[18] Yet, this Article will show that chapter 9 is not being used because it is so difficult to access in its current formulation. Changing the eligibility rules may help a municipality prevent a truly dire situation, transforming chapter 9 from a last resort into a valuable tool in a municipality's arsenal. By focusing on increasing chapter 9's utility, this Article's proposals also provide guidance to courts and legislatures considering the question of which municipalities should have access to chapter 9 bankruptcy tools.

This Article thus makes two distinct contributions to the existing literature. First, the Article ties bankruptcy theory together with municipal finance research that pinpoints common sources of municipal fiscal distress in order to identify when and why a municipality might choose to file for chapter 9. Second, the Article proposes a set of revisions to the eligibility rules designed to facilitate, rather than impede, access to chapter 9. In doing so, this Article demonstrates the shortcomings of the eligibility rules as currently constituted.

Importantly, this Article focuses only on general-purpose municipalities: cities, towns, and counties. Special-purpose entities, which may also be

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Michael J. Deitch, Note, *Time for an Update: A New Framework for Evaluating Chapter 9 Bankruptcies*, 83 FORDHAM L. REV. 2705 (2015) (proposing a multipart test for analyzing whether a municipality meets the statutory conditions required for chapter 9); Tom D. Hoffmann, Comment, *Municipal Bankruptcy Authorization Under Chapter 9: A Call for Uniformity Among States*, 34 ST. LOUIS U. PUB. L. REV. 215 (2014) (arguing that all states should uniformly authorize unfettered access to chapter 9 bankruptcy for their municipalities in order to promote uniformity and predictability).

18. *See, e.g.*, Katherine Newby Kishfy, Comment, *Preserving Local Autonomy in the Face of Municipal Financial Crisis: Reconciling Rhode Island's Response to the Central Falls Financial Crisis with the State's Home Rule Tradition*, 16 ROGER WILLIAMS U. L. REV. 348, 358 (2011) ("Overall . . . Chapter 9 bankruptcy provides an incomplete solution to the problem of municipal insolvency."); Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351 (2010); Richard C. Schragger, *Democracy and Debt*, 121 YALE L.J. 860, 864 (2012) ("[T]he solution to state and local fiscal crises is largely a matter of politics . . . .").

eligible to file for chapter 9 bankruptcy, face eligibility hurdles as well, but these hurdles are of a different nature. Although many of the proposed changes to the eligibility rules may be applied to special-purpose entities, these entities merit their own consideration and, possibly, their own entry rules.[19]

This Article proceeds in five parts. Part I serves as the foundation for the rest of the Article, introducing the literature on municipal fiscal distress and pinpointing common triggers. Part II connects this foundation with bankruptcy history and theory to determine why a federal bankruptcy solution exists for municipalities. Part III explains how the current eligibility rules discourage many municipalities from seeking federal relief. Part IV then proposes specific reforms for the chapter 9 eligibility process. Using the groundwork laid in the previous parts, Part IV suggests sweeping changes to the eligibility rules to facilitate access to chapter 9. Part IV also addresses concerns regarding the proposed changes, emphasizing that significant safeguards remain to prevent opportunistic or bad faith filings. Part V briefly concludes by emphasizing how these changes will enable distressed municipalities to take full advantage of the federal bankruptcy toolkit and by raising a connection to the broader issue of access to bankruptcy.

I. CAUSES OF MUNICIPAL DISTRESS

Although the causes of municipal distress have been extensively studied, it remains difficult to determine when a municipality's entry into bankruptcy would make sense. This Part begins to fill this gap by using the existing literature to identify and categorize sources of distress. A better understanding of the underlying sources of municipal distress drives the creation of the rules, discussed in Part IV, that determine when a municipality should be eligible for bankruptcy.

Definitively ascertaining the sources of municipal fiscal distress is not an easy task, as distress varies depending on factors such as the type of municipal entity, the nature and variety of the municipality's creditors, and the overall state of the economy.[20] Variation in municipalities across the country necessarily means that some creditors may be more lenient than others, or some municipalities may have more access to debt financing than

19. *See* Laura Napoli Coordes, *Restructuring Municipal Bankruptcy*, 2016 UTAH L. REV. 307, 348–49 (advocating for separate rules and procedures for special-purpose entities in chapter 9).

20. *See generally* Samir D. Parikh, *A New Fulcrum Point for City Survival*, 57 WM. & MARY L. REV. 221, 230 – 37 (2015).

others. Nevertheless, common themes exist and can provide valuable insight into some of the main causes of fiscal crises.[21]

A. Overview: Cyclical v. Structural Distress

There are arguably many ways to categorize the types of distress municipalities face; however, a prominent distinction is that between distress that is cyclical, or rises and falls over time, and distress that is structural in nature, resulting from long-term deficit imbalances.[22] These two types of distress frequently form the basis for categorizing more specific situations.

Because cyclical distress fluctuates naturally as part of the business cycle, a focus on the category of structural imbalance is particularly valuable, both because it is easier to control the causes of structural distress than it is to exert control over the overall boom-and-bust nature of the national economy and because structural imbalances can make it more difficult to resolve cyclical problems.[23] A municipality's fiscal structure, economic and demographic trends within the municipality, and the decisions of the municipality's political leaders all contribute to structural imbalance.[24] For example, during good times, a municipality's governing body might decide to permanently reduce tax rates but keep expenditures constant.[25] When the economy weakens over time, this structural imbalance is exposed and may cause the municipality more difficulty than if the governing body had decided to hold tax rates constant. Thus, cyclical and structural distress are related: cyclical fluctuations complicate problems with structural imbalances, and vice versa.

The cyclical-structural lens thus helps demonstrate that although distress can be caused by factors outside of a municipality's control,[26] municipalities may nevertheless be able to prevent or minimize the effects of such cyclical

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21. *See, e.g.*, Jessica L. Sandham, *NEA: Fiscal Troubles Ahead for Many States*, EDUCATION WEEK (Nov. 25, 1998), http://www.edweek.org/ew/articles/1998/11/25/13nc.h18.html (discussing a report from the National Education Association describing fiscal troubles in several states).

22. MATTHEW MURRAY ET AL., BROOKINGS MOUNTAIN W. & MORRISON INST. FOR PUB. POLICY, STRUCTURALLY UNBALANCED: CYCLICAL AND STRUCTURAL DEFICITS IN CALIFORNIA AND THE INTERMOUNTAIN WEST 7 (2011). http://www.brookings.edu/~/media/research/files/papers/ 2011/1/05-state-budgets/0105_state_budgets.pdf.

23. *Id.* at 4.

24. *Id.* at 3.

25. *Id.* at 8 (describing California, which, through Proposition 13, has amended its constitution to limit local property tax revenue growth). Political structures may also influence this decision, as it is often much easier to lower taxes (rather than raise them) in many states.

26. *See generally* Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633 (2008).

crises when they arise by controlling sources of structural imbalance. With this overview in mind, the next subsections will examine prevailing theories of the causes of structural distress.

B. Management Problems: Source or Scapegoat?

Scholars often point to political leadership or "management" problems as a source of structural imbalance. These problems typically take two forms: those related to the structure of the municipality's government, and those related to the decisions emanating from that government.

Management-related problems can include high turnover in city government, diverging interests between municipal officials and their constituents, and a fragmented decision-making structure.[27] These problems are related: for example, municipal officials whose terms are about to expire may take a very different view of the long-term costs and benefits of current expenditures than city residents.[28] These officials may show a tendency to "kick the can down the road," leaving it up to incoming officials to ensure adequate funding for these expenditures. For their part, city residents may feel very differently about whether and how to fund a particular project, as they will be more likely than an outgoing official to bear the costs (or reap the benefits) of present expenditures.

Fragmented decision-making structures can heighten the tendency to make rash decisions about expenditures. Clayton Gillette explains fragmented decision-making as a budgetary system where "there are multiple points of access and review before a decision is finalized."[29] As a result, "those who seek government funds may find success through a variety of avenues, and none of the gatekeepers on those avenues has reason to be concerned about the budget as a whole."[30] Decision-makers may therefore commit to making expenditures without considering the effects of their decisions on other municipal agencies.[31]

The consequences of overly optimistic decision-making have become

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27. *See* Clayton P. Gillette, *Can Municipal Political Structure Improve Fiscal Performance?*, 33 REV. BANKING & FIN. L. 571, 572 (2014). Fiscal mismanagement and the influence of special interests can also create management problems. *See, e.g.*, Caitlin McGlade, *Glendale Audit Fallout: 4 Officials on Leave*, ARIZ. REPUBLIC (Aug. 26, 2013, 10:29 AM), http://archive.azcentral.com/community/glendale/articles/20130824audit-fallout-officials-leave-prog.html (describing an illegal effort in Glendale, Arizona to hide fiscal activities from the city council and suspiciously high salaries paid to city administrators).

28. Gillette, *supra* note 27, at 572.

29. *Id.* at 576.

30. *Id.*

31. *Id.*

strikingly clear in recent years. As a recent example of how decisions made in better times can hurt a municipality later, consider San Bernardino, California, which long ago decided to link its public-safety personnel's compensation to that of workers in similarly-sized communities.[32] Over time, these communities have flourished while San Bernardino has struggled. Yet, public safety workers in San Bernardino are still paid the same as workers in these wealthier communities, and San Bernardino, which is now in bankruptcy, has been largely unsuccessful in making up the difference.[33] Detroit is a further example of a city faced with the consequences of overly optimistic thinking: a boom town in the early part of the 20th century, Detroit saw its population shrink in later years as the automotive industry, which the city relied on for jobs, closed factories and relocated them to other cities.[34]

Problems with employee compensation, pensions, and other postemployment benefits could also make up their own category. Since the turn of the century, cities have experienced rapid increases in the costs of promised employee benefits, which, along with salaries and health benefits, typically make up the largest portion of city budgets and debts.[35] In addition to San Bernardino, many cities and towns, including Prichard, Alabama; Central Falls, Rhode Island; and Vallejo, California have struggled to pay these benefits in and outside of bankruptcy.[36]

Given constraints on city decision-making, some scholars suggest categorizing municipal distress according to what local management can and cannot control. For example, Omer Kimhi has divided fiscal distress sources into two categories: socioeconomic processes outside of the city and local management problems.[37] In the first category, Kimhi includes factors such as the national business cycle, suburbanization, and state and federal

32. *See* Frank Shafroth, *Puerto Rico & Greece: A Disparity*, GMU MUN. SUSTAINABILITY PROJECT (July 6, 2015), https://fiscalbankruptcy.wordpress.com/2015/07/06/puerto-rico-greece-a-disparity/; *see also* STEPHEN D. EIDE, MANHATTAN INST., DEFEATING FISCAL DISTRESS: A STATE RESPONSIBILITY 4 (2013), http://www.manhattan-institute.org/pdf/cr_78.pdf (referring to "gross mismanagement by Detroit officials").

33. One could argue that San Bernardino could overcome this problem by reducing employees. Yet, the city needs to retain a minimum number of employees to provide basic city services, something it cannot do if it is to retain their compensation levels.

34. Micki Maynard, *How Detroit Went from Boom Town to Bust*, JALOPNIK (Mar. 23, 2011, 4:00 PM), http://jalopnik.com/5784999/how-detroit-went-from-boom-town-to-bust.

35. *See* Eide, *supra* note 32, at 2.

36. Cate Long, *The Real History of Public Pensions in Bankruptcy*, REUTERS (Aug. 8, 2013), http://blogs.reuters.com/muniland/2013/08/08/the-real-history-of-public-pensions-in-bankruptcy/.

37. Omer Kimhi, *A Tale of Four Cities—Models of State Intervention in Distressed Localities Fiscal Affairs*, 80 U. CIN. L. REV. 881, 905–06 (2012).

policies that affect municipalities.[38] In the second category, he lists factors like city size and procedural fragmentation.[39] Like cyclical and structural sources, these categories easily intersect: to take a few examples, suburbanization has a direct impact on city size, and changes in state and federal policy can directly affect the way a municipality makes decisions, as when a state puts a municipality under a state oversight board.

C. Individual Poverty: Cause or Consequence?

There is no doubt that problems with a city's management and problems with its residents can be linked. But some scholars have argued that management problems are too often used as a "scapegoat" for insolvency that is actually caused by more "systemic challenges," such as poverty and population loss.[40] Although it is difficult to disentangle the numerous factors at play in municipal financial failure, individual poverty almost certainly plays a role.

Michelle Anderson has observed that most struggling cities, such as Prichard, Alabama and Central Falls, Rhode Island, have high amounts of individual poverty.[41] This poverty can subject the municipality to a downward spiral: residents who can no longer afford to own homes create housing vacancies, which in turn drag down land markets; this drag decreases property tax revenues, which are chiefly used to maintain public safety and enrich the lives of the municipality's residents.[42] Therefore, Anderson points out, as city residents become poorer, the city itself can move deeper into insolvency.[43] When a city takes the probable next step of selling assets to raise revenue, it roots itself even further into insolvency, as those assets are no longer available to the municipality for long-term revenue generation.[44]

As a way to break this cycle, one might suggest that the municipality raise taxes rather than sell assets or cut services. But raising taxes may not be feasible—even in cities where residents and officials are amenable to a tax increase, approval for an increase may need to be sought at the state

38. *Id.* at 906.
39. *Id.*
40. Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118, 1216 (2014) ("[M]ismanagement can be a scapegoat explanation for insolvency that distracts from other systemic challenges.").
41. *Id.* at 1136 (describing the median poverty rate for twenty-eight struggling cities as more than double the national poverty rate).
42. *Id.* at 1138–39.
43. *Id.* at 1139.
44. *Id.* at 1167–68.

level, where a new layer of officials must be convinced of the efficacy and urgency of the increase.[45] Furthermore, tax increases, or the threat of them, can scare away mobile sources of capital, including employers.[46] Thus, it is often extremely difficult for municipalities to increase the revenue available to meet their expenditures without suffering collateral damage.[47] The difficulties associated with even the threat of a tax increase suggest that cities may prefer to reduce debt burdens before they are forced to raise taxes and potentially trigger a cycle of departures.

In short, the economic status of a municipality's population can directly affect the fiscal health of the municipality itself. Because municipalities typically rely on property tax revenue to meet expenditures, municipal fiscal distress is "directly related to the loss of household wealth and income caused by sharp declines in home values, increased foreclosures, and widespread job loss," all of which are exacerbated during cyclical downturns.[48]

D. Federal and State Effects

Just as the fiscal health of a city's residents may impact the municipality's fiscal strength, so too does the health of the municipality's state create effects that resonate at the municipal level. If a state government is facing its own fiscal pressures, some of this pressure will likely be passed down to the state's municipalities in the form of declining state aid, which in turn can force a city to reduce its own public services.[49] State pressures, in turn, can be exacerbated by changes at the federal level.

Some examples of federal and state effects include changes in federal

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45. *See* Karol K. Denniston, *Neutral Evaluation in Chapter 9 Bankruptcies: Mitigating Municipal Distress*, 32 CAL. BANKR. J. 261, 263 (2012) ("Raising taxes is difficult, and in many instances impossible [for municipalities]…."); *see also* Frank Shafroth, *Human & Fiscal Disruption in Municipal Bankruptcy*, GMU MUN. SUSTAINABILITY PROJECT (Dec. 16, 2015), https://fiscalbankruptcy.wordpress.com/2015/12/22/human-fiscal-disruption-in-municipal-bankruptcy/ (describing how Jefferson County, Alabama, tried to raise taxes prior to filing for bankruptcy but failed when a court struck down the tax because state legislators had failed to advertise it properly).

46. *See, e.g.*, Frank Shafroth, *Human & Fiscal Disruption & Mayhem and the Importance of Municipal Bankruptcy*, GMU MUN. SUSTAINABILITY PROJECT (Dec. 10, 2015), https://fiscalbankruptcy.wordpress.com/2015/12/10/human-fiscal-disruption-mayhem-and-the-importance-of-municipal-bankruptcy/ (noting that both Detroit and Puerto Rico have experienced an exodus of families that can afford to leave in conjunction with the cities' fiscal crises).

47. Denniston, *supra* note 45, at 263 (noting that "few cities have significant assets that can be easily sold").

48. John C. Philo, *Local Government Fiscal Emergencies and the Disenfranchisement of Victims of the Global Recession*, 13 J. L. SOC'Y 71, 72 (2011).

49. *Id.* at 78.

and state mandates, revenue cuts, and state limitations on tax levies.[50] Gerald Frug and David Barron have described how state law impacts almost every aspect of municipal budgets.[51] State law typically dictates the essential services municipalities must provide to residents, thereby directly shaping city expenditures.[52] At the same time, states can also restrict how local revenues are generated by, for example, limiting or prohibiting city income taxes.[53] Thus, cities often find themselves at the mercy of the state when it comes to how much revenue they can generate and how much freedom they have to direct expenditures towards various projects.[54] Because of state controls over city services and revenue sources, cities facing declining revenues often only have one avenue through which they can make cuts: shrinking the workforce.[55]

Special legislation at the state level can further constrain a city. For example, states often prohibit cities from spending money for specific purposes, require cities to pay for state-level services, and mandate city funding of state-created governmental authorities.[56] Some cities, like New York City, are under strict state fiscal oversight.[57] In short, city governments do not operate in a vacuum. Instead, they are subject to controls and restrictions from the federal and state governments.[58] Thus, when distress occurs at the federal and state level, it will have an undeniable impact on the municipal level as well.[59]

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50. *See generally* Christopher J. Tyson, *Municipal Identity as Property*, 118 PENN ST. L. REV. 647 (2014) (discussing the connection between city and state boundary law).

51. FRUG & BARRON, *supra* note 45, at 75–98.

52. *Id.* at 92 ("[T]he degree of city flexibility is a product of state statutes and court decisions.").

53. *See id.* at 85–86.

54. *See id.* at 77–78 (noting that the city of Boston is a particularly salient example of this situation).

55. *Id.* at 92–93 (noting that Seattle spends about 80% of its budget on core services, including utilities, and that Denver and Chicago spend between 70–80% of their general fund revenues on personnel costs).

56. *See id.* at 95–98.

57. *Id.* at 93–94 (noting that New York City is under the oversight of the state-created Municipal Assistance Corporation).

58. *See* Frank Shafroth, *"Our City Would Become Unlivable,"* GMU MUNICIPAL SUSTAINABILITY PROJECT (Sept. 24, 2015), https://fiscalbankruptcy.wordpress.com/2015/09/24/our-city-would-become-unlivable/ ("Many of Chicago's fiscal problems are embedded in state law.").

59. *See* Tyson, *supra* note 50 at 695 (discussing Michigan's municipal incorporation and annexation policies and how they have contributed to Detroit's fiscal distress); *see also* Sheila A. Martin & Carolyn N. Long, *Horizontal Intergovernmental Relations in the Portland Metropolitan Region*, 50 WILLAMETTE L. REV. 589, 608 (2014) (noting that "federal money to state and local governments is declining").

E. Failed Projects or Events

Structural distress can also occur from a one-time misfortune rather than a struggle that develops over the long term.[60] These events may be anticipated by officials, although the extent of their impact may be unpredictable. For example, a city may invest in the construction of a stadium on municipal property, with the hope that the stadium will attract residents and visitors to the municipality and generate revenue. If the stadium fails to generate the revenue anticipated, it may cause problems if the municipality has made expenditures that are dependent on revenue flow from the stadium.[61]

A vivid example of a bankruptcy due to failed projections is that of Orange County, California. Orange County filed for bankruptcy after heavy borrowing and risky investments in its investment pool turned sour.[62] The Orange County fund had counted on interest rates staying low or declining, and when rates began to rise, the county found itself in distress.[63]

Alternatively, relatively unexpected one-time events, as when an individual or company successfully brings suit against the city for a tort or contract problem, may also contribute to municipal distress.[64] Recently, Hillview, Kentucky filed for bankruptcy after failing to settle a claim for $11.4 million that stemmed from a breach of contract case.[65] The money owed to the judgment creditor added interest at a rate of 12% annually and was not covered by the city's insurance.[66] Similarly, the town of Mammoth Lakes, California filed for bankruptcy after being saddled with a judgment for $43 million related to a development lawsuit.[67] Mammoth Lakes was

60. Deitch, *supra* note 17, at 2717–18.

61. *See, e.g.*, Rebekah L. Sanders, *Foreclosures Expected to Put Glendale Westgate City Center on New Track*, ARIZ. REPUBLIC (Oct. 26, 2011, 9:02 AM) http://archive.azcentral.com/news/articles/2011/10/26/20111026glendale-westgate-foreclosures-new-track.html (describing a failing project in Glendale, Arizona and noting that the project is "vital to Glendale's financial future").

62. Floyd Norris, *Orange County's Bankruptcy: The Overview; Orange County Crisis Jolts Bond Market*, N.Y. TIMES (Dec. 8, 1994), http://www.nytimes.com/1994/12/08/business/orange-county-s-bankruptcy-the-overview-orange-county-crisis-jolts-bond-market.html.

63. *Id.*

64. *Id.* (noting the threat of lawsuits over risky investments made by Orange County's investment fund); *see also* Michael Galen, Note, *Chapter 9 Bankruptcy in California: The Efficacy of Mandating Alternative Dispute Resolution in Municipal Bankruptcy Filings*, 15 CARDOZO J. CONFLICT RESOL. 547, 559 (2014) (describing the Mammoth Lakes bankruptcy, where the town owed over $42 million to a single creditor).

65. Marcus Green, *City of Hillview in Bullitt County Files for Bankruptcy Protection*, WDRB.COM (Aug. 21, 2015, 9:15 AM), http://www.wdrb.com/story/29845100/city-of-hillview-in-bullitt-county-files-for-bankruptcy-protection.

66. *Id.*

67. Laura Mahoney, *Judge Dismisses Town of Mammoth Lakes Bankruptcy Case Following*

able to settle its lawsuit after filing for bankruptcy and so dismissed its bankruptcy case.[68]

Cataloguing the myriad causes of municipal fiscal distress makes it possible to see that neither bankruptcy nor any other mechanism, standing alone, will resolve all of these diverse causes.[69] Rather, bankruptcy is one of a number of ways to resolve specific types of distress. The next Part will explore the specific role chapter 9 bankruptcy is designed to play in alleviating particular sources of municipal distress.

II. BANKRUPTCY SOLUTIONS

This Part analyzes bankruptcy history and theory to determine the core functions of a federal bankruptcy solution to some of the problems identified in Part I. It discusses the main role chapter 9 has come to serve and distinguishes that role from alternatives, such as state action.

Determining the goals of municipal bankruptcy is a difficult task, complicated by the fact that municipal distress looks very different than that facing an individual or corporation. Nevertheless, a review of the history and literature surrounding chapter 9 reveals several core functions.

A. Bankruptcy Purposes and History

The current iteration of municipal bankruptcy laws has been shaped by years of history. Congress enacted the predecessor to modern-day chapter 9 in response to the Great Depression, when thousands of municipalities defaulted on their obligations.[70] The provisions were meant to be temporary and to serve as an emergency source of federal relief for municipalities facing writs of mandamus from bondholders.[71] Nevertheless, Congress continued to extend the operative date of the provisions and eventually, they became a permanent part of what is now the Bankruptcy Code.

Settlement, BNA BANKR. L. REP., Nov. 29, 2012, 24 BKY 1546.

68. *Id.*

69. *See generally* Francisco Vazquez, *Examining Chapter 9 Municipal Bankruptcy Cases*, *in* CHAPTER 9 BANKRUPTCY STRATEGIES: LEADING LAWYERS ON NAVIGATING THE CHAPTER 9 FILING PROCESS, COUNSELING MUNICIPALITIES, AND ANALYZING RECENT TRENDS AND CASES 173 (Aspatore 2011), 2011 WL 5053640.

70. *See* ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, CITY FINANCIAL EMERGENCIES: THE INTERGOVERNMENTAL DIMENSION 10 tbl. 2-1 (1973) (noting that from 1930–1939, government units defaulted approximately 4700 times).

71. *See* Act of May 24, 1934, Pub. L. No. 73-251, 48 Stat. 798, 798 ("There is hereby found, determined, and declared to exist a national emergency caused by increasing financial difficulties of many local governmental units, which renders imperative the further exercise of the bankruptcy powers of the Congress of the United States.").

In 1936, the Supreme Court held that the first iteration of the municipal bankruptcy legislation was unconstitutional because it infringed on the states' sovereign powers.[72] In response, Congress enacted new legislation that explicitly required no federal interference with municipalities' fiscal or political affairs, no involuntary bankruptcy proceedings, and no state impairment of contractual obligations.[73] The Supreme Court upheld the new legislation in 1938, noting the distinct roles it had delineated for the federal and state governments and observing that the new legislation had been carefully drawn not to impinge on state sovereignty.[74]

Early cases on these bankruptcy laws thus make clear that the role of the bankruptcy court was intended to be limited. The court's singular function was to approve or disapprove a proposed plan of reorganization of a municipality's debt.[75] The court had no ability to direct the flow of a municipality's money and no jurisdiction to set or settle boundary disputes.[76] Thus, as Clayton Gillette and David Skeel observe, chapter 9 essentially served one function: "preventing holdout[] [creditors] from scuttling a restructuring that most creditors had approved."[77]

This core function can be broken down further into two component parts. The first is *nonconsensual* debt adjustment: bankruptcy allows municipalities to rewrite their debt agreements, even if parties disagree with the changes.[78] To achieve this result, bankruptcy enables the municipality to prevent holdout creditors from blocking a restructuring by providing tools to overcome the resistance of a minority of creditors.[79] The second

72. Ashton v. Cameron Cty. Water Improvement Dist. No. One, 298 U.S. 513, *reh'g denied*, 299 U.S. 619 (1936).

73. Act of Aug. 16, 1937, Pub. L. No. 75-302, 50 Stat. 654.

74. United States v. Bekins, 304 U.S. 27, *reh'g denied*, 304 U.S. 589 (1938).

75. *See* Leco Props. Inc. v. R.E. Crummer & Co., 128 F.2d 110, 113 (5th Cir. 1942).

76. Green v. City of Stuart, 135 F.2d 33, 35 (5th Cir. 1943).

77. Gillette & Skeel, *supra* note 10, at 1171; *see also* Melissa B. Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, 33 YALE J. ON REG. 55, 64 (2016) ("[B]ankruptcy's role is to impair claims over the objection of holdout creditors.").

78. *See, e.g.*, Anderson, *supra* note 40, at 1154 (contrasting with state law programs); David N. Crapo, *New Jersey Municipalities, Chapter 9, and Creditors' Rights*, BUS. ADVISOR (Apr. 22, 2015), at 2, http://www.gibbonslaw.com/Resources/Listing.aspx (search in search bar for "New Jersey Municipalities") (noting that the "traditional goal in municipal bankruptcies" was restructuring bond debt, but the new goal is reducing "both bond and retiree-related debt"); Malito, *supra* note 17 ("[M]unicipalities with…problems rooted in labor spending and health-benefit obligations may also seek refuge in Chapter 9 in order to restructure these agreements."); Ashton v. Cameron Cty. Water Improvement Dist. No. One, 298 U.S. 513, 530, *reh'g denied*, 299 U.S. 619 (1936) ("The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned—to change, modify, or impair the obligation of their contracts.").

79. Eide, *supra* note 32, at 5; *see also* Judith Greenstone Miller, *Amendment to Provide Good Faith Filing Requirement for Chapter 11 Debtors*, 102 COM. L.J. 181, 181 (1997) (noting that bankruptcy is meant to be a collective proceeding); Juliet M. Moringiello, *Goals and Governance in Municipal*

component relates to breathing space: chapter 9 temporarily protects a municipal debtor from creditor collection actions, thereby enabling that debtor to establish a repayment plan.[80] Indeed, the imposition of the automatic stay in bankruptcy is a powerful tool for holding pushy creditors at bay: once a bankruptcy case is filed and the automatic stay is in place, creditors can no longer enforce their prepetition claims against the debtor, nor demand any payments for those claims. The imposition of the automatic stay gives the municipality the breathing space it needs to design and submit a plan of adjustment for its debts,[81] and the municipality's exclusive right to submit such a plan while in bankruptcy further protects it from creditor interference.

These functions are not unique to chapter 9; they are also frequently cited as justifications for the bankruptcy system in general. For example, contract impairment, including the impairment of pension obligations, is one of the main functions of federal bankruptcy law,[82] because although a state remains in control of its municipality, it may not bind non-consenting creditors to a debt adjustment procedure if that procedure would violate the Contracts Clause of the Constitution.[83]

Bankruptcy, 71 WASH & LEE L. REV. 403, 447 (2014) ("Congress had a modest goal, that of solving the holdout problem, in passing the [chapter 9] legislation."); Andrew B. Dawson, *Pensioners, Bondholders, and Unfair Discrimination in Municipal Bankruptcy*, 17 U. PA. J. BUS. L. 1, 20 (2014) ("Chapter IX was originally devised for the narrow purpose of giving municipalities a tool to solve the dissenting creditor holdout problem."); *Ashton*, 298 U.S. at 541 (Cardozo, J., dissenting) ("Experience makes it certain that generally there will be at least a small minority of creditors who will resist a composition, however fair and reasonable, if the law does not subject them to a pressure to obey the general will. This is the impasse from which the [bankruptcy] statute gives relief.").

80. *See* Deitch, *supra* note 17, at 2724; Malito, *supra* note 17 (noting that this "breathing spell" is intended to allow the municipality to continue to provide public services to residents); *see also* Frank Shafroth, *Juggling Creditors, Public Safety, & Democracy in the Midst of Municipal Bankruptcy*, GMU MUN. SUSTAINABILITY PROJECT (Dec. 24, 2015), https://fiscalbankruptcy.wordpress.com/2015/12/24/juggling-creditors-public-safety-democracy-in-the-midst-of-municipal-bankruptcy/ (questioning whether legislation proposed to temporarily halt litigation over Puerto Rico's debt is constitutional in the absence of bankruptcy access).

81. Frank Shafroth, *How Does One Define "Essential Public Services" for a Municipality in Distress*, GMU MUN. SUSTAINABILITY PROJECT (July 31, 2015), https://fiscalbankruptcy.wordpress.com/2015/07/31/how-does-one-define-essential-public-services-for-a-municipality-in-distress/ ("Perhaps the single most critical value of municipal bankruptcy is the immediate protection of a city or county's ability to ensure the provision of essential public services while its [sic] sorts out its debts under the ever watchful scrutiny of a federal bankruptcy judge . . . .").

82. J. Robert Stoll et al., *Detroit Eligible to File Chapter 9 Bankruptcy*, MAYER BROWN LEGAL UPDATE (Dec. 13, 2013), https://www.mayerbrown.com/Detroit-Eligible-to-File-Chapter-9-Bankruptcy-Winter-2014/ (follow "Get the full report" link) (noting that Judge Rhodes' opinion in the Detroit bankruptcy singled out contract impairment as "one of the primary purposes" for bankruptcy proceedings).

83. 6 Collier on Bankruptcy ¶ 903.03[2]; Vazquez, *supra* note 69, at *3; 11 U.S.C. § 903(1) (2012). Recently, the Supreme Court reinforced the conclusion that states cannot devise their own debt composition solutions for municipalities in Puerto Rico v. Franklin Cal. Tax Free Tr., 136 S. Ct. 1938,

Notably, however, these purposes are limited, suggesting that chapter 9 by itself was not intended to function as a source of holistic relief to municipalities struggling under all of the various forms of distress described in Part I.[84] For example, bankruptcy by itself will not be able to alter the vast majority of state and federal structures described in Part I.D that influence municipal revenues and expenditures. If changes to federal and state law are necessary for a municipality's rehabilitation, some other mechanism will be needed to implement those changes. This is not to say that chapter 9 cannot assist with accomplishing other goals;[85] however, a municipality's need for assistance with the main functions outlined above should be the focal point when considering a municipality's eligibility for bankruptcy.

Although chapter 9 is limited in scope, it is equally critical to recognize the importance of the role of the bankruptcy judge. As will be discussed in more detail below, the judge helps to ensure that chapter 9's mechanisms are being utilized properly, particularly at the confirmation stage, where the judge is asked to confirm, or approve, the municipality's plan for adjustment of its debts.

Chapter 9's history also reveals the impetus behind the eligibility requirements. Congress implemented strict eligibility rules for chapter 9 primarily to ensure that municipalities turned to federal bankruptcy only as a last resort.[86] Subsequent court decisions have reinforced this point: for example, in *In re Sullivan County Regional Refuse Disposal District*,[87] the New Hampshire bankruptcy court held that the filing of a chapter 9 petition was not in good faith because the decision to file was not "a final alternative chosen *as a last resort*," but rather was made before the municipality had exhausted its state and local alternatives.[88] The *Sullivan* decision illustrates

1942 (2016).

84. *See generally* Moringiello, *supra* note 79 (suggesting that chapter 9 was designed for cooperation between the states and the federal government). Watkins also argues that chapter 9 can effectuate critical structural and political reforms; however, these reforms can arguably be implemented at the state level and are therefore not unique to municipal bankruptcy. *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, 91 (2012–13).

85. For example, the debt discharge a municipality receives in chapter 9 can allow the municipality access to resources it could not obtain outside of bankruptcy. Gillette & Skeel, *supra* note 10, at 1210.

86. or a description of the current eligibility requirements, *see* Part III.A.1, *infra*; *see also* Vazquez, *supra* note 69, at *7; Lam, *supra* note 17, at 630–35; Patrick Collins, Note, *HMO Eligibility for Bankruptcy: The Case for Federal Definitions of 109(B)(2) Entities*, 2 AM. BANKR. INST. L. REV. 425, 428 (1994) ("Congress could not have intended, by enacting section 109(b)(2), to cede to the states the authority to determine which persons shall be allowed access to the federal bankruptcy courts.").

87. 165 B.R. 60 (Bankr. D.N.H. 1994).

88. *Id.* at 82 (emphasis added).

that the driving force behind the eligibility requirements is the notion that bankruptcy relief is a tool of last resort.

B. Distinct Roles for State and Federal Law

The background on chapter 9's history and purposes helps determine the question of what roles federal and state laws should play in resolving a municipality's financial distress. As the judge who oversaw Detroit's bankruptcy recently confirmed, chapter 9 exists so that states (and their municipalities) can use the federal courts to solve problems that they cannot themselves resolve.[89] Specifically, chapter 9 strikes a careful balance: the requirement from the Constitution and Congress that bankruptcy law and the nonconsensual impairment of contracts must come at the federal level is reconciled in chapter 9 with the Tenth Amendment mandate that local government access to federal bankruptcy relief be determined by the states.[90] This balance is struck through the chapter 9 eligibility requirements, and particularly through the requirement that states must authorize their municipalities to file for bankruptcy.[91]

What follows from this balance is the idea that distinct spheres of state and federal power exist, upon which federal and state law, respectively, should not encroach.[92] Proposals to modify chapter 9 are therefore carefully

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89. Steven W. Rhodes, Keynote Address at the American Bankruptcy Institute 33rd Annual Spring Meeting (Apr. 18, 2015), http://cle.abi.org/product/keynote-luncheon-conversation-hon-steven-w-rhodes.

90. *See* Smith *supra* note 17, at 499–500 (1998); Ashton v. Cameron Cty. Water Improvement Dist. No. One, 298 U.S. 513, 531, *reh'g denied*, 299 U.S. 619 (1936) ("The Constitution was careful to provide that 'No State shall . . . pass any Law impairing the Obligation of Contracts.'"). In *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 504, 516 (1942), the Supreme Court upheld a state law permitting the adjustment of municipal debt if the city and 85% of its creditors agreed. Congress subsequently overruled this decision via statute and expressly prohibited state municipal bankruptcy laws adjusting creditors' debts without their consent. H.R. REP. NO. 79-2246, at 4 (1946); *see also* Franklin Cal. Tax-Free Tr. v. Puerto Rico, 805 F.3d 322, 334–35 (1st Cir. 2015) (discussing the congressional response to *Faitoute*); *In re* City of Detroit, 504 B.R. 97, 143–144 (Bankr. E.D. Mich. 2013) (describing how courts, except in *Faitoute*, have consistently interpreted the Contracts Clause to prohibit the states from enacting legislation providing for municipal bankruptcies and how *Faitoute*'s precedential value is limited after courts have consistently distinguished *Faitoute* on its facts); Puerto Rico v. Franklin Cal. Tax-Free Tr., 136 S.Ct. 1938, 1945 (2016) (recognizing that Congress sought "to override *Faitoute*" with § 903 of the Bankruptcy Code).

91. *See* Daniel G. Egan, *City of Harrisburg Chapter 9 Bankruptcy Dismissed*, DLA PIPER RESTRUCTURING E-NEWSL. – GLOBAL INSIGHT (Mar. 1, 2012), https://www.dlapiper.com/en/us/insights/publications/2012/03/city-of-harrisburg-chapter-9-bankruptcy-dismissed/ (discussing the constitutional considerations behind the state authorization requirement in the context of Harrisburg's bankruptcy dismissal).

92. *See* Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and "Dual Sovereignty" Doesn't*, 96 MICH. L. REV. 813, 900 (1998) (noting that when Congress forbade state and local governments from enacting their own bankruptcy codes, it

scrutinized to ensure that this balance is maintained.[93] Although policymakers are often wary of federal assistance that infringes upon state functions, it is equally important to recognize that the state, in turn, ought not prohibit its municipalities from accessing the forms of relief that Congress has determined only federal law can provide.[94]

Thus, although only states may exercise plenary authority over their municipalities, only the federal government can create bankruptcy law.[95] It follows that struggling municipalities should have the option of receiving assistance from the federal courts when a bankruptcy solution is needed.[96] Despite the states' significant authority over their municipalities, they should be discouraged from preventing the federal government from providing relief when municipalities face financial crises that require core bankruptcy solutions: nonconsensual contract adjustment, breathing space, and elimination of a holdout creditor problem.[97] This is particularly true because states, despite their extensive power over municipalities, may simply not be in the best position to provide relief to these entities, due to politics, concerns over stigma, or state-level financial difficulties.[98]

Chapter 9 is designed to be deferential to state law interests, while encouraging federal involvement when needed to adjust the relationship between an insolvent municipal debtor and its creditors.[99] Importantly,

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did so "because state and local institutions should not meddle in what ought to be exclusively national concerns").

93. *See* Freyberg, *supra* note 17, at 1001.

94. Although both state and federal relief may arguably be possible, Congress sought a uniform, federal process for bankruptcy relief. H.R. REP. NO. 79-2246, at 4 (1946). Some scholars have questioned whether Congress's designation of chapter 9 as the sole mechanism for reorganization is compatible with the Tenth Amendment. *See, e.g.*, Stephen J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 AM. BANKR. L.J. 553, 571 (2014). Yet, the Supreme Court has not overruled Congress on this issue, and recent decisions from other courts have held that states cannot perform certain debt adjustment functions, such as cutting pensions and other benefits. *See, e.g.*, Tim Jones & Elizabeth Campbell, *Emanuel Said to Plan Property-Tax Boost for Chicago Pensions*, BLOOMBERG BUS. (Sept. 3, 2015), http://www.bloomberg.com/news/articles/2015-09-03/emanuel-said-to-plan-property-tax-increase-for-chicago-pensions (describing Illinois Supreme Court ruling that threw out Chicago's pension overhaul on the grounds that the benefit cuts the city sought were illegal).

95. Malito, *supra* note 17 ("The federal government is the sole entity that can create a uniform system of bankruptcy laws, but only the states can exert plenary authority over their subdivisions.").

96. *Id.*

97. *See* Adam Feibelman, *Involuntary Bankruptcy for American States*, 7 DUKE J. CONST. L. & PUB. POL'Y 81, 83 (2012) (noting that the federal government is also "protecting fundamental national economic and financial interests" when subnational entities encounter financial crises).

98. *See generally* Coordes, *supra* note 19, at 353–55 (describing the drawbacks of state intervention programs); *see also infra* Part III.C & Part III.D (discussing politics in the City of Harrisburg, Pennsylvania's case and the rhetoric that may discourage state officials from providing optimal relief).

99. Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063, 1066 (2002) (describing how the Code simultaneously "embraces" federalism yet relies on state law).

chapter 9 leaves ample room for a significant state role in resolving municipal fiscal distress; however, in order for chapter 9 to function effectively, states must be aware of the limitations, however minimal, of their role.

1. State Roles

The state's function in addressing municipal distress can take many forms. Perhaps the strongest form is a state bailout, where the state provides direct financial assistance to the city or town.[100] The state may also appoint an emergency manager; in some cases, this manager is even empowered to assume all of the power and authority of local elected officials.[101] These two forms of relief can thus be quite extreme; a more measured, and often more popular form of state relief, is the creation of state oversight boards. These boards do not replace elected officials, but they may still exercise significant authority over the financial affairs of a city or town.[102]

Scholars often advocate state boards as a promising source of aid for a struggling municipality, as boards can perform many valuable functions, including gathering information, obtaining money for the city, and even approving a consensual financial rehabilitation plan.[103] State boards may also exert pressure on local officials who are hesitant to implement measures like a tax increase, even going so far as to sanction cities that fail to follow their recommendations.[104] State boards are also considered valuable because they can centralize fragmented decision-making processes, a key cause of municipal distress.[105] Given these advantages, scholars have argued for an increased state role in resolving municipal fiscal distress rather than a role for federal bankruptcy.[106] These scholars point out that the state, by virtue of its control over the municipality, is often in a good position to ascertain and address the underlying causes of municipal distress.[107]

There is no doubt that the state is an important player in the battle against municipal distress, but states themselves struggle with their own fiscal

100. Anderson, *supra* note 40, at 1215 (noting that the argument for state bailouts on pension liabilities is stronger in cities that have lost population to their metropolitan areas or to the rest of the state).

101. Philo, *supra* note 48, at 87 (citing Michigan as an example).

102. *See* Kimhi, *supra* note 37, at 901–05.

103. *Id.* at 888–891.

104. *Id.* at 902–04 (citing Philadelphia/PICA as an example).

105. *Id.* at 910. See *supra* Part I.B, for more on these processes.

106. Eide, *supra* note 32, at 8–9.

107. Kimhi, *supra* note 32, at 885, 906.

issues, and, as discussed in Part I.D, these struggles reverberate on the local level, exacerbating rather than minimizing municipal distress.[108] Thus, chapter 9 may be valuable when both a municipality and its state are in crisis: a municipality that gains fiscal strength as a result of chapter 9 is likely to be able to withstand reduced aid from a struggling state.[109]

There are also drawbacks to state boards. To be effective, state boards need investments of time, money, and resources, and states that lack one or more of these requirements may find that the boards they have set up cannot provide effective relief. Not all states have boards or debt adjustment programs in place for their municipalities, and some states may be so concerned with their own fiscal health that they will not be able to assist their struggling cities and towns. State officials can also clash with local officials, which in turn can hurt city finances and create more management problems.[110] Thus, although state relief clearly can play a valuable role in alleviating municipal distress, there is a role for the federal government to play when problems arise that the state cannot resolve or when the state itself is not in a position to provide effective relief. Unfortunately, as discussed further below, states too often view federal municipal bankruptcy as a threat to be feared and avoided, rather than a tool that should be utilized under specific circumstances.

2. The Benefits of Federal Relief

Municipalities should turn to bankruptcy law when they need targeted relief that chapter 9 is designed to provide: breathing space, and the need to overcome a holdout creditor or otherwise modify agreements on a non-consensual basis.[111] The ability to impair pensions has recently become an important issue in the municipal distress context, as many cities and towns are struggling with underfunded pension obligations, as described in Part I.B. Although some municipalities, such as those in Illinois, have tried to use state law to modify executory obligations, their efforts have been unsuccessful.[112] Bankruptcy may be a good option for these municipalities,

108. For example, the city of Chicago's distress affects the State of Illinois, and vice versa.

109. *See* Murray, *supra* note 22 at 10 (noting that struggling states often reduce aid to local governments).

110. *See* Dorothy A. Brown, *Fiscal Distress and Politics: The Bankruptcy Filing of Bridgeport as a Case Study in Reclaiming Local Sovereignty*, 11 BANKR. DEV. J. 625, 634–35 (1995) (describing one such clash in the context of Bridgeport mayors and the Bridgeport Financial Review Board). Brown also describes how state officials can be motivated by their own political interests and not the best interests of the city's citizens. *Id.* at 642–43.

111. For a fuller discussion of this concept, *see* Coordes, *supra* note 19, at 308, 311, 350.

112. *See* Meaghan Kilroy, *Illinois Pension Reform Law Unconstitutional, State Supreme Court*

particularly in the face of creditors who resist any attempt to reduce their claims.

When a city's problems are rooted in modifiable obligations, whether labor spending, bond payments, or benefit responsibilities, these cities may be prime candidates for chapter 9's nonconsensual debt adjustment tools.[113] The benefit of having an experienced bankruptcy judge to oversee the debt adjustment process and ensure that it is orderly, legally sound, and fair, should also not be overlooked.[114] The municipal bankruptcy process can thus be a viable solution for resolving problems with modifiable obligations, whose positive effects may extend beyond saving the municipality itself.[115]

This is not to say that every municipality facing unsustainable debt or labor obligations should always file for bankruptcy. Rather, when a municipality is facing these problems, officials should *consider* filing for bankruptcy by asking whether the municipality needs the distinct forms of relief bankruptcy can provide, or whether its problems can be better resolved through state mechanisms. If it is determined that a municipality does need bankruptcy relief, the state and federal governments should not create further impediments for the municipality to access this relief.

C. Other Considerations for Chapter 9 Relief

At this point, a few other observations concerning chapter 9's role in resolving municipal distress should be made. The first is that a key advantage of filing for chapter 9 lies in *preventing* the cycle of mobile capital flight described in Part I. Recall that when a municipality raises taxes or decreases the services it provides, it risks driving out employers and consumers and reducing its tax base. This in turn makes further tax increases

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Rules, PENSIONS & INVESTMENTS (May 8, 2015 12:01 PM), http://www.pionline.com/article/20150508/ONLINE/150509891/illinois-pension-reform-law-unconstitutional-state-supreme-court-rules.

113. *See* Malito, *supra* note 17 (describing the city of Vallejo, California's problems).

114. *See* Frank Shafroth, *Municipal Bankruptcy is Large, Complicated, & Seemingly Unending*, GMU MUN. SUSTAINABILITY PROJECT (Sept. 10, 2015), https://fiscalbankruptcy.wordpress.com/2015/09/10/municipal-bankruptcy-is-large-complicated-seemingly-unending/ (describing Puerto Rico's proposed out-of-court restructuring plan and the complications it faces because it is unable to use the bankruptcy process).

115. *See, e.g.*, Frank Shafroth, *Steep Roads to Municipal Solvency*, GMU MUN. SUSTAINABILITY PROJECT (Sept. 17, 2015), https://fiscalbankruptcy.wordpress.com/2015/09/17/steep-roads-to-municipal-solvency/ (noting that Wayne County's consent agreement fails to address problems with the county's underfunded pension system); Desmond Lachman, *Puerto Rico Needs a Bankruptcy Framework*, AEIDEAS (Sept. 17, 2015, 11:44 AM), https://www.aei.org/publication/puerto-rico-needs-a-bankruptcy-framework/ (contrasting an "orderly bankruptcy procedure" with a "disorderly asset grab").

more onerous on those who remain. Although chapter 9 can be used to help prevent these causes of financial distress by allowing a municipality to avoid tax increases or service decreases, the eligibility rules, discussed more fully below, currently impede its ability to do so. Chapter 9 is frequently decried as an ineffective mechanism for eliminating the causes of fiscal distress; however, if used in conjunction with state measures, it can help municipalities modify unsustainable obligations *before* they become unwieldy, leaving a place for state and local government to design further measures for addressing distress or avoiding it in the future.[116]

Relatedly, the question of *whether* a municipality should file for bankruptcy relief is inextricably linked to the question of *when* a municipality should file. Timing matters in resolving municipal fiscal distress.[117] The literature indicates that municipal and even state officials may delay bankruptcy relief or avoid it entirely.[118] As discussed further in Part III, the current eligibility rules do nothing to address this delay, as they fail to help a bankruptcy judge distinguish municipalities that have bankruptcy-specific problems from those that do not.[119] Instead, the eligibility rules, and the litigation that frequently results from them, further discourage officials from utilizing the bankruptcy process.

This discouragement is problematic because waiting too long to file for bankruptcy relief when relief is needed can worsen a municipality's situation.[120] Trying to simply cope with fiscal distress without proactively

116. JAMES E. SPIOTTO, CHAPMAN & CUTLER LLP, PRIMER ON MUNICIPAL DEBT ADJUSTMENT 6 (2012) ("The limited but vital role of the bankruptcy court is to supervise the effective and appropriate adjustment of municipal debt. . . . Historically, Chapter IX and its successor Chapter 9 were intended to facilitate rather than mandate voluntary municipal debt adjustment and not municipal debt elimination.").

117. *Cf.* Michelle M. Harner & Jamie Marincic Griffin, *Facilitating Successful Failures*, 66 FLA. L. REV. 205, 208-10 (2014) (discussing the importance of timing in the chapter 11 context); *see also* Laura Litvan, *Puerto Rico Debt Measure Pressed by Democrats, Citing Zika Virus*, BNA BANKR. L. REP., May 4, 2015, 28 BKY 557 ("The cost of delay [of bankruptcy relief] is you get to the point where there's nothing to restructure." (quoting Jacob J. Lew, Treasury Secretary).

118. See Feibelman, *supra* note 97, at 82 (noting that sovereign governments predictably delay or avoid seeking debt relief when they suffer financial distress); *see also* Leon R. Barson & Francis J. Lawall, *Chapter 9 Bankruptcy: Restructuring Municipalities in Financial Distress*, *in* CHAPTER 9 BANKRUPTCY STRATEGIES: LEADING LAWYERS ON NAVIGATING THE CHAPTER 9 FILING PROCESS, COUNSELING MUNICIPALITIES, AND ANALYZING RECENT TRENDS AND CASES 7 (Aspatore 2011), 2011 WL 5053630, at *8 ("It appears that almost every state has taken steps to try to avoid the filing of a Chapter 9 within its borders.").

119. *See* Anderson, *supra* note 40, at 1155 (noting that, although it would make sense if the choice among bankruptcy, state programs, and judicial receiverships depended on the nature of the city's fiscal distress, "states rarely offer more than one of the three systems to manage insolvency" due to politics, history, and ideology).

120. *Id.* at 1158 (noting that officials who resort to a "hasty sale" of assets as a way of delaying bankruptcy may get fire sale prices, and cutting services only delays opportunities for more robust

addressing the causes can exacerbate a collective action problem: as Michelle Anderson points out, when each creditor individually pursues its interest in full repayment, creditors as a group force inefficient liquidation of municipal assets as well as spending cuts that diminish the municipality's ability to pay other creditors.[121] As a result, creditors as a whole are worse off.[122] The potential for a collective action problem demonstrates that bankruptcy should not be the "last resort" that it is so commonly described to be.[123] Rather than being allowed to persist, when collective action problems develop, they should be halted by the federal bankruptcy mechanism, which enables a municipality to create a plan to maximize the share allocated to each creditor and to implement that plan over the objections of a holdout creditor.

Given the difficulties that arise with delaying bankruptcy, a change in the way municipal bankruptcy is viewed is necessary. Instead of being seen as a comprehensive distress solution, bankruptcy should instead be viewed as a mechanism that can provide effective solutions to a set of specific, identifiable problems. Viewed in this light, bankruptcy is not a catch-all solution, nor an admission of failure. Instead, it is a mobilization of specific federal tools, to be used in conjunction with state programs and other forms of assistance, to resolve municipal distress and allow cities to reinvest in basic public services.[124] The law cannot change the rhetoric surrounding municipal bankruptcy, but it can provide better incentives to file for bankruptcy and thereby demonstrate when bankruptcy will be an effective solution. Over time, changes in the law may in turn effect changes in the way bankruptcy is viewed and discussed.

Identifying the points at which bankruptcy is better suited than state relief for a municipality helps drive the creation of chapter 9 rules and procedures that are conducive to facilitating successful relief. Despite state

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recovery).

121. *Id.* at 1190; *see also* Kasia Klimasinska, *Puerto Rico Debt Crisis Eludes U.S. Fix, Top Republican Says*, BNA BANKR. L. REP., Oct. 1, 2015, 27 BKY 1312 (describing how bankruptcy access for Puerto Rico "could avoid a protracted legal fight by allowing the government to restructure some debt in court, rather than through individual negotiations").

122. Anderson, *supra* note 40, at 1190.

123. *See* Frank Shafroth, *Avoiding Municipal Insolvency, Except as a Last Resort*, GMU MUN. SUSTAINABILITY PROJECT (Oct. 20, 2015), https://fiscalbankruptcy.wordpress.com/2015/10/20/avoiding-municipal-insolvency-except-as-a-last-resort/ ("I don't use the bankruptcy word except as a very, very last resort . . . that solution could be much more expensive." (quoting Michigan Governor Rick Snyder)).

124. To some extent, bankruptcy is already being utilized in this manner. For example, the Grand Bargain in Detroit was a coalition of state, local, and federal actors working together to save the city. *See also* Moringiello, *supra* note 79 (stressing the complementary nature of chapter 9 and state governance).

programs' significant and varied attributes, bankruptcy has a clear and valuable role to play in resolving municipal fiscal distress, a role that must be reflected in the chapter 9 eligibility rules.

III. LESSONS FROM ELIGIBILITY STRUGGLES

To demonstrate the need for the changes advocated in Part IV, this Part begins by describing how the current municipal bankruptcy eligibility rules provide unnecessary roadblocks, discouraging municipalities from seeking bankruptcy relief when that relief is arguably needed.

In addition to laying out the rules governing chapter 9 eligibility and plan confirmation, this Part examines recent decisions from several chapter 9 filings. It illustrates that other chapter 9 safeguards provide the bankruptcy judge with many ways to prevent opportunistic bankruptcy plans and filings. Furthermore, many issues that arise at the eligibility stage are re-hashed during the confirmation stage. The confirmation decisions, in particular, illustrate how adept bankruptcy courts have become at carefully considering the efficacy and fairness of municipal plans of adjustment, as well as the interests of all stakeholders involved in a chapter 9 bankruptcy.[125]

A. Rules and Examples

1. Eligibility and Confirmation Rules

If a municipality wants to file for bankruptcy, it must comply with the eligibility rules, which are found in § 109(c) of the Bankruptcy Code. Upon filing for bankruptcy, a chapter 9 debtor must show that it satisfies all of these requirements by a preponderance of the evidence.[126] The eligibility rules may therefore be thought of as the "gatekeepers" for a municipality's entry into bankruptcy.

There are five primary eligibility requirements: (1) the entity must be a municipality as defined in the Bankruptcy Code (the "municipality

125. Gillette & Skeel, *supra* note 10, at 1152 ("These episodes have revealed that bankruptcy courts can balance the interests of the various stakeholders—creditors, pensioners, the state, and residents—involved when municipalities face fiscal distress.").

126. Allan H. Ickowitz & Robert S. McWorter, *Understanding the Unique Challenges of Chapter 9 Cases*, *in* REPRESENTING CREDITORS IN CHAPTER 9 MUNICIPAL BANKRUPTCY: LEADING LAWYERS ON NAVIGATING THE CHAPTER 9 FILING PROCESS, COUNSELING MUNICIPALITIES, AND ANALYZING RECENT TRENDS AND CASES 87 (Aspatore 2014), 2014 WL 4785318, at *8 ("The Chapter 9 debtor has the burden of proof to show, by a preponderance of evidence, that it satisfies the eligibility requirements.").

requirement"); (2) the entity must be specifically authorized to be a debtor under state law, meaning state law must exist or be sought specifically granting the municipality, either by type or by name, the ability to file (the "authorization requirement"); (3 the entity must be insolvent, meaning it either is not paying its debts as they become due or is unable to pay its debts as they become due[127] (the "insolvency requirement"); (4) the entity must desire to effect a plan of adjustment (the "plan requirement"); and (5) the entity must (a) obtain the agreement of creditors holding at least a majority in amount of the claims of each class that will be impaired under its plan; (b) negotiate in good faith with creditors; (c) demonstrate that it is unable to negotiate with creditors due to impracticality; or (d) reasonably believe that a creditor may try to be the recipient of a transfer that would otherwise be avoidable as a preference (the "creditor negotiation requirement").[128] In addition to these five requirements, § 921(c) of the Bankruptcy Code allows a court to dismiss a chapter 9 petition if the debtor did not file the petition in good faith or meet other Code requirements (the "good faith requirement").[129]

After a municipal debtor has been deemed eligible for relief, it must submit a plan of debt adjustment to the bankruptcy court for confirmation, or approval. The confirmation standards are contained in § 943 of the Bankruptcy Code.[130] These standards incorporate many of the standards for confirming a plan in chapter 11 bankruptcy,[131] and the municipality is often required to produce substantial evidence in support of the confirmability of its plan.[132] Briefly, a plan must be proposed in good faith. If the plan seeks to impair creditors, or pay them less than what they are otherwise owed, at least one impaired class of creditors must accept the plan. If the judge is tasked with "cramming down," or approving the plan over the objection of a class of creditors, the judge must find that the plan does not discriminate unfairly and that it is fair and equitable. The plan must also generally conform to bankruptcy priority provisions, and the debtor must not be prohibited by law from taking any action necessary to carry out the plan.

127. 11 U.S.C. § 101(32)(C) (2012).
128. *See* 11 U.S.C. § 109(c) (2012).
129. *See id.* § 921(c).
130. 11 U.S.C. § 943 (2012).
131. Specifically, § 943(b)(1) indicates that a plan must comply with bankruptcy provisions made applicable by § 901. 11 U.S.C. § 943(b)(1) (2012). Section 901(a) provides that many of the chapter 11 plan confirmation requirements apply in chapter 9. 11 U.S.C. § 901(a) (2012). This includes, for example, the good faith requirement of § 1129(a)(3). *Id.*
132. Jacoby, *supra* note 77, at 62 ("The plan confirmation requirements are multi-faceted, and notoriously controversial as applied to a municipality.").

The judge must also find that the plan is in the best interests of creditors and is feasible.[133]

The eligibility and plan confirmation requirements are compatible with each other in many ways. As the following subsections will show, many issues requiring similar considerations arise at both the eligibility and confirmation stages.

2. Eligibility and Confirmation Decisions

Recent chapter 9 cases illustrate both the care judges take in determining whether a municipality's plan of adjustment is confirmable and the way in which creditors use hearings on eligibility to raise issues that are ultimately determined at the confirmation stage.

The plan confirmation decision in Detroit's bankruptcy demonstrates both the high bar municipalities face when trying to confirm a plan of adjustment and the rigorous approval process that the plan must undergo. The judge took over 100 pages to make detailed findings as to whether Detroit's plan was in the best interest of creditors, feasible, proposed in good faith, and whether it discriminated unfairly in favor of pension creditors.[134] The judge appointed an expert specifically to investigate and testify to the plan's feasibility,[135] and numerous other consultants advised the judge and the city on plan confirmation.[136] As part of the plan confirmation proceedings, the judge also held a hearing specifically for individual objectors, even inviting some individuals to present evidence.[137] The judge's substantial involvement and investment in plan confirmation demonstrates that the hurdles to Detroit confirming a plan of adjustment were quite high.

Nevertheless, the judge's detailed opinion merely reiterated many of the same conclusions that he had drawn at the eligibility stage of the proceedings. In the Detroit bankruptcy, the court considered 110 objections

133. 11 U.S.C. § 943(b)(7); Gillette & Skeel, *supra* note 10, at 1160 ("[A] municipality that desires to exit Chapter 9 must submit to the court a plan that is 'feasible,' which courts increasingly have interpreted to mean that 'the debtor can accomplish what the plan proposes and provide governmental services.'").

134. *In re* City of Detroit, 524 B.R. 147 ((Bankr. E.D. Mich. 2014).

135. Gillette & Skeel, *supra* note 10, at 1197 ("The bankruptcy judge appointed an independent expert to assess the feasibility of Detroit's restructuring proposal.").

136. Jacoby, *supra* note 77 at 96.

137. Lisa Lambert, *Detroit Trial Ends, Judge to Rule Nov. 7 on Bankruptcy Plan*, REUTERS (Oct. 27, 2014, 7:39 PM), http://www.reuters.com/article/2014/10/27/us-usa-detroit-bankruptcy-idUSKBN0IG22Q20141027.

to eligibility alone,[138] many of which required substantial discovery, which further delayed the court's decision.[139] In the confirmation decision, the bankruptcy judge observed that both before and after the eligibility decision, "nearly every creditor group filed litigation against the City seeking the full protection of its claims."[140] The judge also referenced his eligibility decision several times, citing back to it as addressing issues related to the fair and equitable confirmation requirement,[141] the requirement that no law prohibits the debtor from carrying out its plan,[142] the city's good faith,[143] and the unfair discrimination confirmation standard.[144]

An expert involved in Jefferson County, Alabama's chapter 9 proceedings directly acknowledged that creditors use eligibility hearings as a way to conduct extensive discovery, deplete the debtor's resources, and force it to capitulate to creditor demands.[145] Thus, creditors can use eligibility hearings to drive up costs while raising issues that are ultimately better addressed during confirmation hearings. In Jefferson County's case, the judge confirmed the county's plan after 14 hours of courtroom arguments and made a specific finding that the plan was affordable for the county.[146]

The deliberations in Detroit and Jefferson County demonstrate that judges make careful, considered decisions with respect to plan confirmation. In addition, many of the issues that can be raised at the eligibility stage may be decided again at the confirmation stage. For example, the issue of good faith arises at both the eligibility stage and the plan confirmation stage. Similarly, issues relating to state authorization can arise at both stages: at the eligibility stage, the debtor must show that the state has authorized it to file, and at the confirmation stage, the debtor must

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138. LAN W. KORNBERG ET AL., PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP, BANKRUPTCY COURT HOLDS THAT DETROIT IS ELIGIBLE TO FILE FOR CHAPTER 9 PROTECTION (2013), http://www.paulweiss.com/media/2215871/11dec13memo.pdf.

139. Melissa B. Jacoby, *The Detroit Bankruptcy, Pre-Eligibility*, 41 FORDHAM URB. L.J. 849, 858 (2014) (noting that the "greater volume of discovery . . . produced a series of disagreements requiring court intervention" in the Detroit bankruptcy).

140. *In re* City of Detroit, 524 B.R. 147, 160 (Bankr. E.D. Mich. 2014).

141. *Id.* at 180–81.

142. *Id.* at 211.

143. *Id.* at 247 ("This is the second time during this chapter 9 case that the Court has been called upon to examine the City's good faith.").

144. *Id.* at 256–57.

145. Barnett Wright, *A Year in Bankruptcy: A Jefferson County Story*, AL.COM, (Nov. 9, 2012, 1:30 PM), http://blog.al.com/spotnews/2012/11/a_year_in_bankruptcy_a_jeffers.html.

146. Katy Stech, *Judge Approves Jefferson County, Ala., Bankruptcy-Restructuring Plan*, WALL ST. J. (Nov. 21, 2013, 7:07 PM), http://www.wsj.com/articles/SB10001424052702304337404579212553163071992.

demonstrate that its plan is authorized and not prohibited under state law.

Although the eligibility and confirmation standards are duplicative in many ways, concerns remain that the confirmation standards do not provide sufficiently robust protections for creditors. Therefore, creditors may raise inappropriate arguments at the eligibility stage, as alluded to by the judge in Jefferson County's bankruptcy, because they may feel that this is their best opportunity to protect their interests. Plan confirmation standards should indeed be strengthened and clarified so that creditors know that their interests are being given careful consideration. Indeed, scholars have already begun to propose changes for the chapter 9 plan confirmation standards,[147] and more robust confirmation rules certainly deserve attention. Although more work may be needed to further develop these standards,[148] of the two proceedings, confirmation is far better suited to protect creditors than eligibility. This is because, at the confirmation stage, the municipality has a plan of adjustment that it must justify to the judge. At confirmation, therefore, the judge has a detailed roadmap of which creditor interests will actually be impaired, which will be protected, and the municipality's reasons for its decisions. In contrast, at the eligibility stage, it is often too early to accurately determine the debtor's plans. As can be observed in the Detroit and Jefferson County bankruptcies, creditor objections raised at this stage may be speculative or may simply duplicate concerns raised at a later stage in the case.

Thus, the eligibility requirements largely replicate the process the municipality has to endure at the end of its bankruptcy, during the plan confirmation process. The best interests of creditors and fair and equitable tests for plan confirmation reflect many of the same concerns that arise in the insolvency analysis at the eligibility stage.[149] And the good faith

147. *See, e.g.*, Juliet M. Moringiello, *Chapter 9 Plan Confirmation Standards and the Role of State Choices*, 37 CAMPBELL L. REV. 71 (2015) (proposing a clearer role for state choices in the bankruptcy process while acknowledging that this role may not always help interpret the chapter 9 confirmation standards); Dawson, *supra* note 79 (arguing that a court should grant more flexibility to a municipal debtor with respect to the unfair discrimination standard in chapter 9); Richard M. Hynes & Steven D. Walt, *Fair and Unfair Discrimination in Municipal Bankruptcy*, 37 CAMPBELL L. REV. 25 (2015) (analyzing the law defining the unfair discrimination standard in chapter 9).

148. Some of this work has already begun in the court system. *See, e.g.*, Stephanie Cumings, *Stockton's Bankruptcy Plan Safe from Unhappy Creditors*, BNA BANKR. L. REP., Dec. 11, 2015, (stating the Ninth Circuit Bankruptcy Appellate Panel's determination that the best interests of the creditors test "considers the collective interests of all concerned creditors in a municipal plan of adjustment rather than focusing on the claims of individual creditors" (quoting Franklin High Yield Tax-Free Income Fund v. City of Stockton (*In re* City of Stockton), 542 B.R. 261, 286 (B.A.P. 9th Cir. 2015)).

149. *See* John Patrick Hunt, *Taxes and Ability to Pay in Municipal Bankruptcy*, 91 WASH. L. REV. 515, 539, 561 (2016) (footnotes omitted) ("The requirement that the composition be in the 'best interests of the creditors' also reflects the view that municipalities should pay all they can toward their debts. . . .

requirement strongly overlaps with many of the eligibility requirements as well.[150] Thus, even a municipality that makes a filing for opportunistic reasons will face significant costs and challenges throughout the bankruptcy process, and these debtors will face particular scrutiny at the confirmation stage.[151]

3. Unnecessary Deterrence

The core functions of municipal bankruptcy law—nonconsensual debt adjustment, relief from holdout creditors, and breathing space—all suggest that bankruptcy should not be the first option a struggling municipality invokes. These functions instead indicate that a municipality should be *unable* to work with or reach an agreement with its creditors prior to entering bankruptcy. The eligibility rules are designed to encourage this result, prohibiting entry into bankruptcy for those municipalities that have not first tried to reach a consensual resolution with creditors.

Yet, few if any municipalities are eager to rush into bankruptcy. Currently, concerns over stigma and other ill effects—real or perceived—resulting from a bankruptcy filing already make it a safe bet that municipalities will not turn to bankruptcy as an initial option. As Skeel and Gillette observe, "No mayor wants to be the one who has put his or her city in bankruptcy."[152] Additionally, the high costs of bankruptcy proceedings serve to deter many municipalities that cannot perceive benefits that outweigh the costs.[153] Finally, the standards in chapter 9 for plan

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Commentators have noted that the 'fair and equitable' standard may require more of taxpayers than the insolvency standard for bankruptcy eligibility . . . .").

150. *Cf. id.* at 552 ("[C]ourts *occasionally* have emphasized a distinction between insolvency and good faith.") (emphasis added). In the Stockton and Detroit bankruptcies, the courts found that the cities established a presumption of good faith once they had met the other eligibility requirements. *In re* City of Stockton, 493 B.R. 772, 795 (Bankr. E.D. Cal. 2013); *In re* City of Detroit, 594 B.R. 97, 180–81 (Bankr. E.D. Mich. 2013).

151. *See* Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 466 (1993) ("[U]nsecured creditors of municipalities are protected from the moral hazard problem of opportunistic bankruptcy filings . . . by the best interests of the creditors standard.").

152. *See* Gillette & Skeel, *supra* note 10, at 1183; *but see* Frank Shafroth, *Municipal Default & Consequences*, GMU MUN. SUSTAINABILITY PROJECT (Aug. 6, 2015), https://fiscalbankruptcy.wordpress.com/2015/08/06/municipal-default-consequences/ (quoting a statement from Moody's suggesting that there may be less stigma today).

153. For a fuller discussion of these costs, *see generally* Coordes, *supra* note 19; *see also* Frank Shafroth, *Fiscal & Physical Resilience in the Wake of Terrorism*, GMU MUN. SUSTAINABILITY PROJECT (Dec. 8, 2015), https://fiscalbankruptcy.wordpress.com/2015/12/08/fiscal-physical-resiliency-in-the-wake-of-terrorism/ ("We can too easily forget that while municipal bankruptcy provides a means for a municipality to shed some of its debt in order to ensure continuity in the provision of essential public services, it comes at a burdensome cost—and leaves residual fiscal challenges.").

confirmation direct the bankruptcy judge to thoroughly scrutinize a municipal debtor's plan of adjustment for opportunism. Duplicative scrutiny at the beginning of a municipal bankruptcy is not necessary.

The analysis in Part II indicates that bankruptcy is designed to address specific problems related to a municipality's fiscal health, problems that state solutions cannot adequately resolve. When a municipality is exhibiting these problems, its access to bankruptcy relief should be straightforward. Yet, this is not the case under present law. Instead of getting access to the relief they need, cities either wait to file until their troubles become more difficult to resolve from a bankruptcy standpoint, or they file and subsequently struggle to gain access to bankruptcy court due to the daunting eligibility requirements.[154]

This Article therefore contends that the eligibility requirements unnecessarily deter chapter 9 filings.[155] These requirements were designed to prevent federal relief from infringing on state power; however, in practice, they have enabled states to prohibit beneficial municipal bankruptcy filings out of pure fear.[156] Given the existing incentives state and municipal officials have to delay a bankruptcy filing,[157] the eligibility rules only provide further, unnecessary incentives to delay. This results in increased transaction costs for municipalities that are already financially strained.

Cities that wait to file for bankruptcy long after their creditors have dug in their heels may find their struggles intensifying. Relationships with creditors may grow acrimonious. Cities that resort to hasty asset sales have less to offer their creditors in bankruptcy.[158] And if a city reduces public services, its tax base (and key source of revenue) may ultimately decline,

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154. *See generally* John J. Rapisardi et al., *Chapter 9: A Big Stick, Rarely Used*, *in* CHAPTER 9 BANKRUPTCY STRATEGIES: LEADING LAWYERS ON NAVIGATING THE CHAPTER 9 FILING PROCESS, COUNSELING MUNICIPALITIES, AND ANALYZING RECENT TRENDS AND CASES 153 (Aspatore 2011), 2011 WL 5053639.

155. *See generally* Malito, *supra* note 17 (making a similar assertion with respect to two specific eligibility requirements).

156. *See* Rapisardi, *supra* note 154, at *8 (describing the situation in Harrisburg, Pennsylvania); *see also infra* Part III.C.

157. *See, e.g.*, Frank Shafroth, *The Importance of Being Earnest for a Municipality in Federal Bankruptcy Court*, GMU MUN. SUSTAINABILITY PROJECT (Sept. 21, 2015), https://fiscalbankruptcy.wordpress.com/2015/09/21/the-importance-of-being-earnest-for-a-municipality-in-federal-bankruptcy-court/ (describing the complications and costs inherent in San Bernardino's bankruptcy process).

158. *See, e.g.*, Anderson, *supra* note 40, at 1121–22 (citing hasty sales in Benton Harbor, Michigan, where twenty-two acres of the city's lakeshore and dunes were transferred in exchange for public space that required industrial decontamination prior to public use, and in Newark, New Jersey, where the mayor sold sixteen city buildings to plug an $80 hole in the budget but noting that the sale will ultimately cost the city $125 million to lease back the buildings).

making it even harder for the city to produce a viable plan of debt adjustment, whether inside bankruptcy or out.

Several cities have arguably waited too long to file for bankruptcy or are nearing the point where bankruptcy may become less effective for them. As discussed in the Introduction, the closure of multiple casinos in Atlantic City has resulted in a vast reduction of capital sources, meaning that Atlantic City might have little to offer creditors even if it were to file for bankruptcy. In Chicago, the combination of high debt and severe pension underfunding would seem to make the city a perfect candidate for bankruptcy, yet the city's proffered solution—tax hikes—may simply drive more residents (and revenue sources) out of the city once implemented.[159] And in North Las Vegas, Nevada, property tax revenue has decreased 70% since 2009, and the city has been frantically trying to strike deals with its unions over liabilities for back pay and raises in order to avert looming insolvency.[160] Each of these cities may well benefit from bankruptcy, but must quickly recognize bankruptcy's benefits in order to take advantage of the shrinking window of opportunity they will have to maximize those benefits.

B. Problems Stemming from Specific Eligibility Requirements

The eligibility rules provide fruitful avenues for creditor objections that may impede a municipality's access to needed relief. In the eligibility phase of the Detroit bankruptcy proceedings, the bankruptcy judge contended with many objections regarding whether Detroit's filing had been in good faith. In his analysis, Judge Rhodes examined correspondence indicating that Detroit had been contemplating a bankruptcy filing for a long time; however, the judge also noted that Detroit had delayed filing in order to engage in negotiations with creditors, negotiations that proved fruitless because the creditors refused to budge.[161] The judge thus observed that by putting off filing to go through the motions of negotiating with creditors who were refusing to make concessions, Detroit had likely done more harm than good. In Detroit's case, therefore, the good faith and creditor negotiation eligibility requirements had incentivized city officials to delay filing long after they recognized that the city needed federal relief.[162]

159. Dabrowski, *supra* note 9.

160. Nash, *supra* note 9.

161. Halcom, *supra* note 2.

162. Of course, waiting to file also provides officials with a rationale to support their moves toward impairing debt in bankruptcy: that they have tried everything else, but nothing else has worked. Nevertheless, this type of reasoning neglects an understanding of the distinct role that bankruptcy can play in resolving a discrete set of municipal problems. See *infra* Part III.D for further explanation of this

The creditor negotiation and plan requirements are also easily manipulated, to the point where they can become irrelevant. For example, when the city of San Bernardino, California filed for bankruptcy, the court found that it had filed in good faith despite also finding "that the city did not engage in meaningful" negotiations with creditors, made "significant cash-out payments to terminated employees" just prior to filing, and was not in any way prepared to formulate a plan of adjustment.[163] The state authorization requirement can also be manipulated, as illustrated by *In re New York City Off-Track Betting Corp*., where the state and the court permitted a corporation to file for chapter 9 because of the debtor corporation's "paramount importance to the public interest."[164]

In other cases, the insolvency requirement stands between a city and needed relief. The City of Bridgeport, Connecticut provides an example of a court struggling with the meaning of the insolvency requirement. The court determined that Bridgeport was "financially distressed," but ultimately not insolvent.[165] Yet, Bridgeport was in clear dire straits: its police force was overwhelmed, crime was high, its roads could not be maintained, and the city's trash could not be collected.[166] This was a situation that almost certainly would meet the more flexible definition of service-delivery insolvency embraced by some courts today.[167] Furthermore, Bridgeport residents at the time paid the highest taxes in the state,[168] meaning that raising taxes to alleviate insolvency would likely be quite difficult. The bankruptcy judge declared that "[c]hapter 9 is not available to a city simply because it is financially distressed," but a few sentences later stated that "[c]hapter 9 is intended to enable a financially distressed city to 'continue to provide its residents with essential services such as police protection, fire protection, sewage and garbage removal, and schools . . . ,' while it works out a plan to adjust its debts and obligations."[169] And the court ultimately concluded that "Bridgeport was undoubtedly in

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163. Ickowitz & McWorter, *supra* note 125, at *7.

164. *In re* N.Y.C. Off-Track Betting Corp., 434 B.R. 131, 145 (Bankr. S.D.N.Y. 2010) (quoting 2008 N.Y. LAWS 3083); *see also* Christine A. Schleppegrell, *Ad Hoc Legislation Creates Barriers to a Chapter 9 Filing*, AM. BANKR. INST. J., Mar. 2013, at 48, 89 (discussing the case); *infra* Part III. C (describing how Pennsylvania state officials changed the state's authorization law to prohibit Harrisburg from filing).

165. *In re* City of Bridgeport, 129 B.R. 332, 335, 338 (Bankr. D. Conn. 1991).

166. *Id.* at 335.

167. *See, e.g.*, *In re* City of Stockton, 493 B.R. 772, 781 (Bankr. E.D. Cal. 2013) (discussing "service delivery insolvency"); *In re* City of Detroit, 504 B.R. 97, 169 (Bankr. E.D. Mich. 2013) (same).

168. *Bridgeport*, 129 B.R. at 335.

169. *Id.* at 336–37 (alteration in original) (citation omitted) (citing H.R. REP. NO. 100-1011 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 4115, 4116.

deep financial trouble when it filed its [chapter 9] petition."[170] If chapter 9's purpose is to allow cities to continue to provide residents with basic public services, as the court suggested, it remains a puzzle as to why Bridgeport, a city that was clearly struggling to maintain these services at even a minimum level, was deemed ineligible to file.[171]

Even for cities that are ultimately found to be insolvent, the insolvency requirement is "fact-intensive and leaves considerable room for dispute and the potential for protracted litigation."[172] In the city of Vallejo, California's bankruptcy, for example, the city's unions argued that the city was not insolvent because it could have accepted the unions' offer and operated with a balanced budget for another year.[173] Although the court ultimately rejected this argument, it provided a fruitful avenue for the unions to object to and stall Vallejo's access to relief, as the unions appealed the bankruptcy court's initial decision in the city's favor to the Ninth Circuit Bankruptcy Appellate Panel, which ruled against the unions a year later.[174]

As illustrated in Parts I and II, bankruptcy relief may not be the solution for every municipality. Yet, the eligibility rules do not provide an accurate mechanism for determining when bankruptcy relief is appropriate. Instead, these requirements present an array of problems: they discourage relief when it may be suitable, are easily manipulated to allow relief when it may be inappropriate, and open the door to costly and time-consuming litigation in almost every case.

C. State Hurdles

Perhaps no eligibility rule is as daunting as the state authorization requirement, which enables a state to prohibit a municipality from filing for bankruptcy, regardless of its financial condition. For example, the Governor of Illinois has publicly stated that the Chicago school system may need to file for bankruptcy; however, under Illinois law, the school system is not authorized to file.[175] The school system's difficulties are also affecting the

170. *Id.* at 339.

171. For further discussion of the Bridgeport insolvency determination, see Vincent S.J. Buccola, *Law and Legislation in Municipal Bankruptcy*, 38 CARDOZO L. REV. (forthcoming 2016) (manuscript at 33), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2534856 (describing extra-statutory "temporal limitation" on insolvency imposed by court to block Bridgeport from filing for bankruptcy).

172. Denniston, *supra* note 45, at 267; *see also* Gillette & Skeel, *supra* note 10, at 1182 ("Since municipalities have access to tax revenues, the insolvency requirement can be very difficult to meet, even for a municipality in dire financial straits.").

173. Denniston, *supra* note 45, at 267.

174. *Id.*

175. Brian Chappatta, *Chicago Schools Haunted by Bankruptcy Chatter Ahead of Bond Sale*,

city of Chicago, which is now itself facing financial difficulty.[176] But Chicago may also have a hard time accessing bankruptcy relief, as Illinois law requires even eligible municipalities to clear several procedural hurdles before they file for bankruptcy, many of which are out of the municipality's control.[177] Illinois also requires municipalities to exhaust state relief mechanisms prior to filing for bankruptcy.[178] Given these restrictions on filing, it appears that Illinois, rather than embracing bankruptcy as a form of relief distinct from that which the state can provide, views bankruptcy as a threat to state action.[179]

The bankruptcy eligibility requirements are daunting for a reason: they are designed to ensure that municipal officials think carefully before putting a municipality into bankruptcy and to prevent unnecessary federal infringement on state affairs.[180] But many states have used the state authorization requirement to add their own conditions to the eligibility rules, making it nearly impossible for the municipality to access relief until after it has already begun to decline significantly.[181] As a result, chapter 9 is not used as much as it should be.[182]

States impose so many of their own requirements because they want to avoid a municipal bankruptcy if at all possible.[183] State governments may be concerned about contagion, or one municipal bankruptcy's negative effects on nearby communities.[184] Although there is minimal evidence of actual contagion when a municipality's fiscal health declines,[185] the

BLOOMBERG BUS. (Apr. 21, 2015, 2:02 PM), http://www.bloomberg.com/news/articles/2015-04-21/chicago-schools-haunted-by-bankruptcy-chatter-ahead-of-bond-sale.

176. *Id.*

177. *See* JAMES A. CHATZ, ARNSTEIN & LEHR LLP, FINANCIAL REFORM FOR MUNICIPALITIES IN ILLINOIS 2–4, http://www.iml.org/file.cfm?key=4115.

178. *Id.* at 4–6.

179. *But cf.* Moringiello, *supra* note 79, at 407–08 (arguing that states should view bankruptcy as complementary to state intervention rather than as an alternative).

180. *See* Mary L. Young, *Keeping a Municipal Foot in the Chapter 9 Door: Eligibility Requirements for Municipal Bankruptcies*, 23 CAL. BANKR. J. 309, 314 (1997) (noting that this provides a measure of protection for municipal investors).

181. *See generally* Frost, *supra* note17, at 267 (describing different "gatekeeper" roles for states).

182. *See* Barson & Lawall, *supra* note 118, at *6 ("Chapter 9 is arguably underutilized.").

183. Maria O'Brien Hylton, *Central Falls Retirees v. Bondholders: Assessing Fear of Contagion in Chapter 9 Proceedings*, 59 WAYNE L. REV. 525, 551–52 (2013) (citing Central Falls and Jefferson County as examples).

184. *Id.*; *see also* Schleppegrell, *supra* note 161, at 49 (discussing the Rhode Island governor's statement opposing a city's petition for a judicial receivership because it would create a "domino effect" among other struggling Rhode Island cities and towns).

185. *See* Stefano Rossi & Hayong Yun, What Drives Financial Reform? Economics and Politics of the State-Level Adoption of Municipal Bankruptcy Laws 27 (Dec. 2015) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2698665 [https://perma.cc/59NE-A2VK] (noting that municipalities actually enjoy lower borrowing costs after their state authorizes chapter 9).

perception of contagion is nevertheless quite powerful.[186] Unfortunately, this fear of contagion often pushes the municipality in the wrong direction, as contagion is more likely to arise in cases of severe fiscal distress as a result of *not* filing for chapter 9 and getting needed relief. This is because a domino effect occurs when a municipality is forced to cut services in order to repay creditors: lack of funding for essential public services, for example, results in higher crime and overcrowded hospitals and prisons.[187] High crime and overcrowding can in turn affect neighboring areas, and these problems may be more difficult to overcome than problems states may fear from a bankruptcy filing, such as a temporary credit downgrade.[188]

The specific authorization eligibility requirement allows states to play into the idea of bankruptcy as a failure and to erect whatever barriers or alternatives they can imagine.[189] When Congress amended the Bankruptcy Code in 1994, it required states to affirmatively create authorization mechanisms for their municipalities without giving them any guidance about when bankruptcy would help a municipality or what form those authorization mechanisms should take.[190] As a result, specific authorization more often bars an otherwise eligible municipality's entry into bankruptcy than facilitates it.[191]

Pennsylvania officials' behavior in the face of the city of Harrisburg's bankruptcy filing is a prime example of a state seeking to avoid municipal bankruptcy out of fear and misunderstanding. Knowing that Harrisburg was considering filing for chapter 9, Pennsylvania lawmakers quickly passed a law barring bankruptcy for all cities of the third class, which included

186. When bondholders in other municipalities observe an inability to make a promised payment, they might insist upon a higher interest rate to reflect the political risk. *See* Frank Shafroth, *Can Default be Contagious?*, GMU MUN. SUSTAINABILITY PROJECT (Aug. 7, 2015), https://fiscal bankruptcy.wordpress.com/2015/08/10/can-default-be-contagious/ (describing this practice in the context of Puerto Rico and Chicago).

187. *See, e.g.*, *supra* Part III.B (discussing the situation in Bridgeport, Connecticut).

188. For a fuller discussion on bankruptcy and credit downgrades, see STEPHEN A. STOWE ET AL., SAMSON CAPITAL ADVISORS, UPDATE ON MUNICIPAL BANKRUPTCIES AND MULTI-NOTCH DOWNGRADES (Nov. 29, 2011) http://www.fierausa.com/wp-content/uploads/2012/06/Bulletin-Update-on-Municipal-Bankruptcies-and-Multi-Notch-Downgrades-11.29.11.pdf.

189. *See* Coordes, *supra* note 19 for a fuller discussion of this issue.

190. Kentucky is a recent example of a state that has expressed a need for some guidance in this area. *See* Frank Shafroth, *On the Edge of Municipal Bankruptcy*, GMU MUN. SUSTAINABILITY PROJECT (Jan. 21, 2016), https://fiscalbankruptcy.wordpress.com/2016/01/21/on-the-edge-of-municipal-bankruptcy/ (describing one Kentucky official's proposal to conduct a study of municipal bankruptcy, including laws and practices used by other states).

191. *See, e.g.*, Charles E. Ramirez & Steve Pardo, *Evans to State: Declare Fiscal Emergency in Wayne County*, DETROIT NEWS (Jun. 17, 2015, 11:23 PM), http://www.detroitnews.com/story/news/local/wayne-county/2015/06/17/wayne-county-financial-emergency/28886293/ (quoting a local educator describing Michigan's authorization mechanisms as a "lengthy, complicated process").

Harrisburg.[192] Some observers speculated that the law's primary purpose was to serve as a stop-gap measure, preventing the "damage" Pennsylvania feared Harrisburg would have caused if it had been able to access chapter 9 relief.[193]

Harrisburg's story does not end there, however. In defiance of the law, Harrisburg's city council filed for bankruptcy anyway, but the state objected to Harrisburg's filing.[194] Despite the court's finding that Harrisburg was clearly not authorized to file for bankruptcy, it took six weeks (and plenty of lawyers) for Harrisburg's case to be dismissed.[195] Nine days after Harrisburg filed for chapter 9, Pennsylvania's governor amended the state's Municipalities Financial Recovery Act, giving Harrisburg's mayor and city council thirty days to come up with a state-approved recovery plan outside of bankruptcy.[196] If Harrisburg failed to implement a plan within that time, the act authorized the governor to appoint a receiver to take over the city's finances.[197] In essence, Pennsylvania officials desperately sought Harrisburg's extrication from the bankruptcy system and even went so far as to impose on the city a hastily created state substitute. In this way, Pennsylvania's government failed to recognize the unique form of help Harrisburg was seeking and the distinct benefits that bankruptcy could have provided for the city. By seeking to force Harrisburg out of bankruptcy at any cost, state officials passed several laws that lacked long-term perspective and will likely deter other Pennsylvania cities from considering bankruptcy in the future.

D. Rhetoric

The rhetoric surrounding a municipal bankruptcy filing further discourages municipalities from considering bankruptcy relief. As previously discussed, both chapter 9's legislative history and modern commentary consistently refer to chapter 9 as a "last resort."[198] Yet, as

192. 72 PA. CONS. STAT. § 1601-D.1(a) (2015); Schleppegrell, *supra* note 161, at 49. Pennsylvania law also provides that, if a city filed for bankruptcy, all funding from the state would be suspended. 72 PA. CONS. STAT. § 1601-D.1(c).

193. Schleppegrell, *supra* note 161, at 49 (noting that "[i]f there was a long-term strategy, it is not apparent").

194. *Id.*

195. *See generally* Moringiello, *supra* note 79 (describing Harrisburg's bankruptcy filing and noting that it was dismissed six weeks after the case was filed).

196. Mark G. Douglas, Jones Day, *Is Chapter 9 the Next Chapter in the Municipal Saga?*, JONES DAY PUBS. (Nov./Dec. 2011), http://www.jonesday.com/is-chapter-9-the-next-chapter-in-the-municipal-saga-12-01-2011/.

197. *Id.*

198. *See supra* Part II.A.

scholars have recently revealed in the context of chapter 11 bankruptcies, this "last resort" mentality can prevent debtors who need federal relief from pursuing it out of fear of failure.[199] Indeed, municipal bankruptcy, rather than being viewed as a discrete tool that can help a municipality *avoid* failure in some circumstances, is too often seen as an admission of failure itself.[200] Too many state, city, and even federal officials view bankruptcy as part of the problem rather than part of the solution. The fear of what would happen if the United States granted Puerto Rico or its municipalities access to bankruptcy represents this view exactly.

In fact, the debate around Puerto Rico captured both sides of the misunderstanding: Republicans argued that bankruptcy would not solve all of Puerto Rico's difficulties,[201] while Democrats suggested that bankruptcy would provide a "way out of Puerto Rico's economic crisis."[202] In fact, neither side is completely correct. Bankruptcy alone will not resolve the situation in Puerto Rico, which is facing problems far beyond those correctable by a debt adjustment, such as population loss, drought, and governmental mismanagement.[203] But just because bankruptcy is not a complete solution does not mean that it should not be considered as a viable way forward.[204] While both sides debated the merits of possible solutions, Puerto Rico, which was unable to use the possibility of a bankruptcy filing as leverage with its creditors, saw negotiations drag on, impeding the territory's economic recovery.[205]

Too often, bankruptcy is misconceived as a failure of municipal government. But in reality, bankruptcy is a mechanism that helps government overcome failure; it is not a failure in and of itself. Bankruptcy is a specific fix to specific problems, but if it is not utilized when needed, there can be devastating consequences. Bankruptcy takes time, effort,

199. Harner & Griffin, *supra* note 117, at 228.

200. Christopher J. Tyson, *Exploring the Boundaries of Municipal Bankruptcy*, 50 WILLAMETTE L. REV. 661, 663 (2014).

201. *See, e.g.*, Billy House, *Puerto Rico Advisory Board Backed by House Panel Leader*, BNA BANKR. L. REP. Oct. 8, 2015, 27 BKY 1339 ("It has to be clear that bankruptcy is not the panacea here." (quoting Rep. Tom Marino, Chairman, H. Judiciary Comm. on Regulatory Reform)).

202. Erica Werner, *Leading House Republicans Declare Opposition to Bankruptcy Protections for Puerto Rico*, U.S. NEWS & WORLD REPORT (July 8, 2015, 5:32 PM), http://www.usnews.com/news/politics/articles/2015/07/08/house-gop-opposes-bankruptcy-protections-for-puerto-rico.

203. *See* Shafroth, *supra* note 152 (raising some of these problems).

204. *Id.* (discussing bankruptcy for Puerto Rico).

205. Vicente Feliciano, *Detroit and Puerto Rico, A Tale of Two Issuers*, HILL, (Aug. 24, 2015, 7:00 AM), http://thehill.com/blogs/pundits-blog/finance/251771-detroit-and-puerto-rico-a-tale-of-two-issuers.

money, and resources in order to work.[206] As an analogy, consider the fact that in the chapter 11 context, law firm reorganizations are exceedingly rare.[207] This is because, once a law firm begins to struggle, employees leave the firm, taking their assets (clients) with them. By the time the firm is in truly desperate straits, it does not have the resources to reorganize in chapter 11 and must liquidate instead. A similar story is playing out in the municipal context: struggling municipalities are seeing residents, employees, and businesses walk away in the face of city distress, and if a municipality does not take specific steps to reverse course, there will be no resources left for the city to utilize in a bankruptcy proceeding.[208]

Even without the federal eligibility requirements, many municipalities that could benefit from chapter 9 will refrain from filing due to concerns over negative stigma, political roadblocks, or inability to meet state requirements.[209] The city of Flint, Michigan provides a vivid example of the extreme measures a municipality might take to avoid declaring bankruptcy. In a cost-saving attempt to avoid bankruptcy, Flint switched its water supply from a source in Detroit to the Flint River.[210] The cheaper supply, however, brought an unexpected cost of a different nature: high lead levels in the water that ended up in residents' taps created health problems for many residents, including children, and led the mayor to declare a state of emergency for the city.[211] Although deterrence of opportunistic bankruptcy filings and encouragement of careful deliberation prior to filing are worthy goals, the current eligibility rules elevate these goals to the point where access to bankruptcy is often blocked or desperately avoided, even when it is most needed.[212]

When Congress designed chapter 9, its members expressed concern

206. *Cf., e.g.*, Wayne State Univ., *Center for the Study of Citizenship – Detroit Bankruptcy Discussion*, YOUTUBE (Mar. 23, 2015), https://www.youtube.com/watch?v=jtBgJkxUsow ("Without a tax base, we're rearranging—once again!—the deck chairs on the Titanic.").

207. *See generally* Edward S. Adams, *Lessons from Law Firm Bankruptcies and Proposals for Reform*, 55 SANTA CLARA L. REV. 507 (2015) (describing five large law firms that ultimately collapsed or dissolved instead of reorganizing).

208. Indeed, rising pension expenditures often leave taxpayers in the position of having to effectively "pay more for past government services while getting less and less in the way of current services," potentially driving taxpayers out of the municipality. *See* Stephen Eide, *Pension Armageddon*, WKLY. STANDARD (Jun. 29, 2015), http://www.weeklystandard.com/articles/pension-armageddon_974083.html.

209. Vazquez, *supra* note 69, at *13.

210. *A Return to Flint, Where the Mayor Has Declared a State of Emergency*, KNKX 88.5 (Dec. 19, 2015, 3:26 PM), http://knkx.org/post/return-flint-where-mayor-has-declared-state-emergency.

211. *Id.*

212. Eide, *supra* note 208; *see also* Jacoby, *supra* note 139, at 851 ("The cloud of potential ineligibility can stall negotiations with creditors and make it impossible to complete some transactions.").

about preventing opportunistic filings.[213] To alleviate this concern, Congress erected multiple statutory safeguards.[214] However, given the harms that can arise from drawn-out eligibility battles, or the fear of them, it is time to recognize that some of Congress's precautions could be eliminated without opening the floodgates for opportunistic filers.[215]

There are often good reasons for a municipality to avoid filing for bankruptcy. Perhaps it has few creditors, and those creditors are willing to negotiate. Perhaps it has debts, but it can still provide basic services to its residents. Regardless, there are times when federal relief is needed, and when that is the case, the path to bankruptcy should be straightforward. This Part has shown that the current eligibility rules create unnecessary obstacles that can be insurmountable to even the neediest municipality and provide easy avenues for creditors and the state to create further roadblocks. On the other hand, to the extent that courts do interpret these rules to allow access to bankruptcy, the rules can be reduced to meaningless technicalities. Chapter 9 offers unique advantages that are not readily available at the state level.[216] The eligibility rules should thus be re-assessed in light of two goals: deterrence of federal relief when it is not necessary, and access to relief when it is needed. The next Part discusses specific modifications to the eligibility rules to achieve these results.

IV. A NEW PERSPECTIVE ON ELIGIBILITY

In a world without any eligibility requirements, a municipality still would not rush into bankruptcy due to the rigorous and resource-intensive challenges it will face once in chapter 9. It is therefore plausible that the eligibility rules might be eliminated entirely without raising concerns over opportunistic filings. This Part discusses the benefits and drawbacks of eliminating the eligibility rules and proposes a set of manageable reforms to the eligibility process. Drawing on the analyses from the previous Parts, this Part demonstrates how a fresh take on eligibility can match a bankruptcy solution with particular problems that distressed municipalities face.

As the previous Parts have shown, although chapter 9 is intended to be

213. *See generally* Hunt, *supra* note 149.

214. *See id.*at 522 (describing four such safeguards).

215. *See* Coordes, *supra* note 19 (describing the harms of chapter 9 eligibility proceedings).

216. Barson & Lawall, *supra* note 118, at *1 ("[I]n discrete instances, the obvious and compelling advantages of Chapter 9 from a distressed municipal finance perspective outweigh the disadvantages . . . the Chapter 9 process may offer a genuinely viable restructuring alternative for the adjustment of historical obligations that cannot otherwise be accomplished on a fully consensual basis.").

an orderly process,[217] the current eligibility rules complicate matters to the point where municipalities may decide to avoid seeking relief entirely rather than endure the onerous eligibility procedures. This result indicates that the chapter 9 system is not being used nearly as much as it could be. New eligibility rules should enable municipalities to harness bankruptcy's toolkit when they face problems that bankruptcy can best help them resolve. Additionally, the eligibility rules need not reinforce the concept of municipal bankruptcy as a last resort because strong incentives, including high transaction and political costs, already exist to discourage filing. The following subsections describe specific reforms for four of the five eligibility requirements. Because the municipality requirement is not an obstacle for the general-purpose municipalities that are the subject of this Article, no changes are recommended for that requirement.

A. The Insolvency Requirement

The insolvency requirement could be eliminated entirely if a few changes are made at the plan confirmation stage. Currently, the insolvency requirement is focused on the debtor's failure or inability to pay debts as they become due, an inquiry that is fact-intensive, time-consuming, and often leads to litigation.[218] The justification for the insolvency requirement is the concern that municipalities must be in serious financial distress that is unlikely to be resolved without the use of the bankruptcy power's exclusive ability to impair contracts.[219] Yet, if a city does not have debt that can be adjusted in chapter 9, it has little reason to file for bankruptcy in the first place.[220] The insolvency requirement may therefore not be doing much work at the eligibility stage.

Because the insolvency requirement tells the judge little about the municipality at the eligibility stage and is instead a prime source for delay

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217. *See* José Vázquez Barquet, *Puerto Rico's Private Sector Calls for Chapter 9*, HUFFINGTON POST: BLOG (Aug. 20, 2015, 6:11 PM), http://www.huffingtonpost.com/dr-josa-vazquez-barquet/puerto-ricos-private-sector-calls-for-chapter-9_b_8017848.html ("Chapter 9 would provide an orderly legal process—guided by a federal judge—to restructure . . . .").

218. Henry C. Kevane, *Chapter 9 Municipal Bankruptcy: The New "New Thing"? Part I*, BUS. L. TODAY, May 2011, at 1, 3.

219. *In re* City of Detroit, 504 B.R. 97, 168 (Bankr. E.D. Mich. 2013).

220. The imposition of the automatic stay would arguably help cities stop some bothersome lawsuits, even if they do not have a debt overhang problem. Thus, it is conceivable that a solvent city could take advantage of a filing to buy time even if it never intended on confirming a bankruptcy plan. This could give the city additional bargaining leverage against creditors before filing. Yet, the political costs associated with a bankruptcy filing may yet deter many cities in this position from filing. Furthermore, it is worth considering whether this sort of bargaining power, which is already available to corporations in chapter 11, ought to be made available to municipalities anyway.

and expense, insolvency should instead be examined at the confirmation stage, after additional information is disclosed about the municipality's financial position. Specifically, an additional confirmation standard could be included requiring the judge to approve a plan only if the debtor meets the definition of insolvency as defined in § 101(32)(C) of the Bankruptcy Code.[221] Adding this confirmation standard eliminates the need for an insolvency eligibility rule, because cities that do not meet the confirmation standard would have little to gain from filing.

Placing the insolvency consideration at the confirmation stage is sensible because a consideration of insolvency goes hand-in-hand with many of the other confirmation requirements.[222] For example, a determination of whether a plan is in the best interests of the creditors and is feasible within the meaning of § 943 requires a consideration of whether the city's existing debt payments leave the city ineligible to maintain basic services and whether the proposed plan payments put the city in a better position to do so. Thus, a determination of how much debt can be cut back at the confirmation stage necessitates a determination of the point at which the city will likely be able to provide basic services. The city of San Bernardino, California, has faced these exact inquiries as part of its plan disclosure and approval process.[223]

In short, confirmation requirements eliminate the need for an insolvency inquiry at the initial stage of a municipal bankruptcy. As the previous Part has illustrated, rather than encouraging careful deliberation before filing, the insolvency requirement may incentivize cities to file too late, after capital sources have begun to disappear.

The current insolvency requirement is also somewhat of a false hurdle,

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221. This section states: "The term 'insolvent' means . . . with reference to a municipality, financial condition such that the municipality is (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due." 11 U.S.C. § 101(32)(C) (2012).

222. *See, e.g.*, Ryan Hagen, *Bankruptcy Judge: San Bernardino Must Provide More Information*, SAN BERNARDINO CTY. SUN (Oct. 8, 2015), http://www.sbsun.com/article/LG/20151008/NEWS/151009506 (describing the common practice of hearings on the adequacy of the plan disclosure statement to conclude that more information is needed and how the judge in San Bernardino's case "wanted more information to show that the city's plan wouldn't lead to it collapsing into a second bankruptcy in a few years"); *see also In re* Mt. Carbon Metro. Dist., 242 B.R. 18, 34 (Bankr. D. Colo. 1999) ("The insolvency test measures whether a municipality can pay for the services it provides. . . . [I]t would make little sense to confirm a reorganization plan which does not remedy the problem.").

223. *See* Frank Shafroth, *Fiscal Chaos & Municipal Bankruptcy*, GMU MUN. SUSTAINABILITY PROJECT (Oct. 12, 2015), https://fiscalbankruptcy.wordpress.com/2015/10/12/fiscal-chaos-municipal-bankruptcy/ (describing bankruptcy judge Meredith Jury's warning that San Bernardino must provide more extensive fiscal information to demonstrate its ability to avoid insolvency and emerge from chapter 9).

because it is not rationally linked to the concerns driving a municipality's entry into bankruptcy.[224] Commentators today frequently refer to a "tipping point," a point at which a city must make a choice between funding essential public services or maintaining access to capital by paying bondholders on time.[225] Courts have also implicitly recognized the presence of a tipping point and the role chapter 9 can play in preventing a municipality from "tipping over."[226] Yet, the insolvency eligibility requirement, with its focus on a city's balance sheet, may not accurately capture the full situation a municipality is facing, and may therefore block access to relief that is otherwise desperately needed.

B. The Authorization Requirement

The analysis in the previous Parts shows that bankruptcy can provide specific and unique relief to municipalities. It follows from this analysis that municipalities should be able to access bankruptcy law when the relief that bankruptcy specifically can provide is needed.

The requirement that a municipality be specifically authorized by its state before it can file for bankruptcy creates, for many municipalities, two sets of hurdles: those the state erects as part of its authorization process, and the federal eligibility rules that are the subject of this Article. Complicating matters is the fact that the state approval process is often a political endeavor, meaning the municipality must receive approval to file from a political official or body, such as the governor or state finance council. Getting this approval can amplify the difficulties a municipality is facing because, as previously discussed, political actors are often inclined to delay or prohibit a bankruptcy filing. For this reason, making the state authorization process less of a political exercise would likely help municipalities gain access to bankruptcy relief.[227]

Although the state authorization requirement is primarily a result of the fact that municipalities' authority to operate derives from the state, the state authorization process can serve as a significant and expensive roadblock for

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224. *See* Hunt, *supra* note 149, at 546 (footnote omitted) ("Demonstrating insolvency under the Code requires something more than showing that the debtor is in financial trouble, but exactly what that 'something more' is has proven more difficult to define.").

225. *See, e.g.*, Frank Shafroth, *Is Puerto Rico at the Tipping Point?*, GMU MUN. SUSTAINABILITY PROJECT (Jun. 30, 2015), https://fiscalbankruptcy.wordpress.com/2015/06/30/971/.

226. See, for example, *supra* Part III.B, regarding the Bridgeport bankruptcy.

227. *See* FRUG & BARRON, *supra* note 45 at Ch. 2 (discussing preferences for state administrative, rather than state legislative, oversight of city decisionmaking); *see also* Buccola, *supra* note 171, (manuscript at 26) (noting instability of state law concerning eligibility).

bankruptcy relief. This Article therefore posits that the role of the state in the municipal eligibility process needs to be re-assessed. There are two possibilities this Article envisions: eliminate the state authorization process entirely, or modify the role of the state so that it is a predictor of a municipality's distress, rather than a gatekeeper into bankruptcy. As explained below, it would be preferable to remove the state authorization requirement altogether; however, concerns about federal law encroaching the powers of the states may make elimination of the authorization requirement practically unachievable.[228]

The plan confirmation requirement of authorization by law arguably eliminates the need for a state authorization consideration at the eligibility stage.[229] Specifically, chapter 9 allows a plan to be confirmed only if regulatory or electoral approval necessary under applicable nonbankruptcy law (state law) has been obtained.[230] The Supreme Court appeared to recognize the duplicative nature of the authorization eligibility and confirmation requirements in *Bekins v. United States*, noting that the confirmation safeguard required the debtor to be authorized by law to fulfill its plan of adjustment.[231] And indeed, sections 903 and 904 of the Bankruptcy Code require the municipality to act consistently with state law the entire time it is in chapter 9.[232] As Skeel and Gillette have noted, the legislative history to chapter 9 suggests that state authorization does not have its roots in a constitutional limitation but rather in a political effort to convince the Supreme Court that the federal government was not interested

228. Others have discussed the idea that the Supreme Court could permit the elimination of the state authorization requirement. *See, e.g.*, Buccola, *supra* note 171, (manuscript at 43).

229. *See* United States v. Bekins, 304 U.S. 27, 49 (1938) ("It is immaterial, if the consent of the State is not required to make the federal plan effective, and it is equally immaterial if the consent of the state has been given . . . . It should also be observed that [the bankruptcy statute] provides as a condition of confirmation of a plan…that it must appear that the petitioner 'is authorized by law to take all action necessary to be taken by it to carry out the plan,' and, if the judge is not satisfied on that point as well as on the others mentioned, he must enter an order dismissing the proceeding. The phrase 'authorized by law' manifestly refers to the law of the State."); *see also* James Spiotto, *Reducing Risk to Payment of State and Local Government Debt Obligations, Statutory Liens from Rhode Island to California SB222*, MUNINET GUIDE (Jul. 28, 2015), http://muninetguide.com/reducing-risk-to-payment-of-state-and-local-government-debt-obligations-statutory-liens-from-rhode-island-to-california-sb222/ ("Further, as the U.S. Supreme Court held in *United States v. Bekins* . . . in implementing any plan of debt adjustment, the municipality must comply with state law, and clearly the municipality cannot in its implementation of its plan or in taking action in the Chapter 9 act contrary to state law.").

230. 11 U.S.C. § 943(b)(6) (2012); *see also* Gillette & Skeel, *supra* note 10, at 1200–01 (discussing 11 U.S.C. § 943(b)(4)).

231. *Bekins*, 304 U.S. at 49.

232. Spiotto, *supra* note 229 ("The fact that a municipality may file for Chapter 9 does not allow the municipality to act contrary to that state law mandate as Section 903 of the Bankruptcy Code requires that state law be honored.").

in interfering with the states.[233] Thus, the concern driving the state authorization eligibility requirement—that bankruptcy threatens the state's authority over its municipalities and therefore, states must consent to municipal bankruptcy—is not, in fact, as great as it may seem.[234]

Arguments thus exist for eliminating the state authorization requirement entirely, as the state's interests are adequately protected throughout the chapter 9 process and particularly at the plan confirmation stage. Nevertheless, it is often critical, as a practical matter, for the municipality to have the support of the state in order for it to successfully navigate the bankruptcy process.[235] The case of Bridgeport, Connecticut, provides a visible example of what can happen if a city lacks state support in chapter 9: the state objected strenuously to Bridgeport's chapter 9 filing and ultimately, the case was dismissed.[236] Even if a state is unsuccessful in advocating for dismissal of a bankruptcy case, if the state and the municipality are working at cross purposes, the bankruptcy process as a whole may slow down.[237] In certain cases, as with Detroit's bankruptcy, the state's cooperation is essential to the municipality's ability to successfully exit bankruptcy.[238] Finally, as discussed in Part I, what happens at the state level necessarily impacts the municipality, so some state involvement in the municipality's bankruptcy is desirable so that the state can facilitate relief at the municipal level.

Although state involvement may be important in a municipal bankruptcy, the state's role as gatekeeper is largely unnecessary as a practical matter because the stigma on the municipality of filing for bankruptcy and the costs of the bankruptcy process itself already deter filings to a significant extent. If the state is to retain a role in determining a

233. Gillette & Skeel, *supra* note 10, at 1168–69.

234. *Id.* at 1221 ("[T]he threat that municipal restructuring poses to the state's plenary authority over its political subdivisions is perhaps more limited than initially appears to be the case.").

235. Additionally, it is not clear whether removal of the state authorization requirement entirely would comport with the Supreme Court's historically protective stance toward states' rights. Yet, the Court has been clear that the Bankruptcy Code preempts state bankruptcy processes for their municipalities, suggesting that the state's role in this area must be at least somewhat limited. *See generally* Puerto Rico v. Franklin Cal. Tax-Free Tr., 136 S. Ct. 1938 (2016). Additional analysis is needed to fully explore the extent to which the state's role may be reduced or eliminated; however, because this Article proposes only a *voluntary* reduction in a state's role through adoption of a model mechanism, such analysis is beyond the scope of this Article.

236. *See supra* Part III.B.

237. Gillette & Skeel, *supra* note 10, at 1221 ("Even within bankruptcy, the state is likely to play a significant role in formulating the plan . . . . [T]he state will typically be the source of substantial capital infusions that will be necessary to make any plan feasible.").

238. *See* Shafroth, *supra* note 186 (describing Michigan's assistance with Detroit's first post-bankruptcy bond issuance).

municipality's entry into bankruptcy, that role should be one of predictor of distress rather than gatekeeper. Although, as previously described, state officials may not be particularly well suited to facilitating a municipality's access to bankruptcy, they are in a good position to evaluate the distress of their cities and towns. This Article therefore proposes that the Uniform Law Commission (ULC) give the states better guidance on how to perform their predictor role by designing a model authorization mechanism that states can adopt and customize as needed.[239]

The proposed model mechanism would grant state authorization when there is a determination by a state-appointed bankruptcy expert (or panel of experts) that a municipality is in need of relief to overcome holdout creditors and collective action problems.[240] Once this expert[241] determines that a municipality is facing problems that bankruptcy can best resolve, the expert, on the State's behalf, should authorize the municipality's bankruptcy filing.[242]

The specific details of a model state authorization mechanism would undoubtedly be subject to extensive debate, and the costs that the state would bear would likely be determined on a state-by-state basis, depending on the desired involvement of the appointed expert. Yet, any model authorization mechanism should ideally have two key components: (1) an assessment of the municipality's problems by a bankruptcy expert; and (2)

239. *See* Buccola, *supra* note 171, (manuscript at 43) ("Under modern understandings, Congress might well be able to create universal eligibility as it has done with respect to another kind of state-chartered entity, namely the business corporation.").

240. The idea of using a panel of experts to oversee a municipality in distress is not new; however, the suggestions for such a panel's use to date have been concentrated on managing the municipality *after* it is in distress, rather than utilizing the panel as a predictor or preventer of distress. *See, e.g.*, OBAMA WHITE HOUSE ARCHIVES, ADDRESSING PUERTO RICO'S ECONOMIC AND FISCAL CRISIS AND CREATING A PATH TO RECOVERY: ROADMAP FOR CONGRESSIONAL ACTION 3 (2015), https://Obama whitehouse.archives.gov/sites/default/files/roadmap_for_congressional_action___puerto_rico_final.pdf (noting that "Congress should provide independent fiscal oversight" for Puerto Rico "to ensure Puerto Rico adheres to its plan and fully implements proposed reforms"); *History of OCFO*, OFFICE OF THE CHIEF FIN. OFFICER, http://cfo.dc.gov/page/history-ocfo (describing the creation of the District of Columbia Financial Control Board in 1995 to oversee the District's finances when it was in distress).

241. In terms of determining who this expert should be and how he or she is appointed, California's authorization statute may provide some guidance. The statute requires the appointment of an experienced neutral evaluator to oversee negotiations prior to a bankruptcy filing. Cal. Gov. Code § 53760, 53760.3 (Jan. 1, 2013). Although the statute has some drawbacks, the mechanism for identifying a neutral evaluator to predict distress may be useful to States in determining the appointment of a neutral expert.

242. Freyberg, *supra* note 17, at 1002, has advocated for the establishment of uniform laws "designed to avert bankruptcy under Chapter 9 before it occurs." A key difference between Freyberg's proposal and the model state authorization mechanism discussed here lies in the purpose of each proposed uniform law. While Freyberg's law would seek to avoid municipal bankruptcy, the model mechanisms proposed here would seek first to determine whether municipal bankruptcy is an appropriate relief mechanism and, if so, would then facilitate access to bankruptcy.

that expert's identification of the specific problems that bankruptcy relief can best alleviate as the trigger for authorization. Procedures for appointing the expert or expert panel could also be included in the model law. In this way, the use of a bankruptcy expert should provide some shield from political influences and will also help with the identification and classification of a municipality's problems, which will likely take numerous forms. Depending on the size of the state, a state may elect to utilize a panel of experts, or assign experts to particular regions. Questions that the bankruptcy expert should consider ought to reflect the survey of distress sources outlined in Part I and should specifically assess the type of debt the city has; how, if at all, the chapter 9 process would modify that debt; whether the city faced a choice of meeting debt payments or paying for services (thus further rendering an insolvency question moot); the size of the debt; and how much of the city's long-term problems would be resolved if the debt were reduced or eliminated.[243]

Model laws are not unusual; in fact, the ULC exists to provide states with legislation in areas of law that require uniformity among the states and territories.[244] Its members are appointed by the fifty states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.[245] The ULC drafts legislation and proposes model and uniform laws, such as the Uniform Commercial Code and the Uniform Probate Code, to the states.[246] States have the option of adopting these laws in full, adopting them with modifications, or rejecting them altogether. In the chapter 9 context, a model law on state authorization mechanisms would represent clear, much-needed guidance on when bankruptcy will best aid municipalities.[247] As discussed, current state authorization laws are often driven by fear and politics rather than sound strategy.

By establishing national rules, the ULC helps provide predictability and uniformity in areas where disparity creates problems.[248] The ULC drafters

243. Another possible option may be to allow for involuntary bankruptcy in chapter 9 by permitting creditors to petition the state for the municipality to file for bankruptcy. The expert/panel's approval process for the involuntary bankruptcy could incorporate elements of § 303 of the Bankruptcy Code, 11 U.S.C. § 303 (2012). I am grateful to Michelle Harner and Vince Buccola for these insights.

244. *See* Cam Ward, *Uniform Law Commission Concludes 116th Annual Meeting*, 68 ALA. LAW. 441, 441 (2007).

245. *Id.*

246. *Id.*

247. The specific development and promulgation of the model law should undergo a process similar to the development and promulgation of the Uniform Commercial Code. Legal organizations could aid in the further development of the model rule provided here, and once the rule is finalized and published, coordinated efforts could be made to encourage the states to adopt the rule.

248. Barbara A. Atwood, *The Uniform Law Commission: Its Continuing Relevance to Arizona*, ARIZ. ATT'Y, Apr. 2009, at 30.

have also demonstrated considerable prowess in balancing creditor and debtor rights in the specific context of commercial law, through the creation of the Uniform Commercial Code.[249] Similarly, the ULC, in creating uniform laws for state authorization, may also prove adept at incorporating some protections for creditors, so that creditor concerns about municipalities being given free rein to trample on their rights in bankruptcy proceedings are somewhat alleviated.

Although states may resist adopting a model law that casts them in the "lesser" role of predictor, the model law still provides for an active role for the state and gives the state concrete guideposts as to when a municipality is best-suited to file for bankruptcy. The proposed model law would also promote consistency across states. By encouraging experts to identify specific problems that bankruptcy is uniquely positioned to resolve, the model provision is designed to encourage states to accept, rather than fear, bankruptcy. This will arguably create a more desirable result than allowing states to devise their own debt composition laws in lieu of bankruptcy, as bankruptcy law provides a set of uniform standards and safeguards (e.g., requiring a neutral judge to oversee the process), which increase predictability and diminish concerns over moral hazard.

Any changes to the state authorization requirement necessitate a consideration of the federalism concerns underlying the requirement. The ULC is particularly well-suited to address these considerations as well, as it has a long and proven history of supporting principles of federalism and of addressing concerns about the distribution of power between the states and the federal government.[250] Indeed, the uniform and model acts promulgated by the ULC have helped to promote and preserve federalism across legal disciplines.[251] Thus, the ULC is particularly well-suited to intervene in this area of law, which has provoked federalism concerns from its inception.[252]

States currently have various, complicated authorization mechanisms in place due to largely unfounded fears of contagion and a lack of guidance as to the discrete role bankruptcy is supposed to play in the resolution of their municipalities' fiscal distress. As a result, many of the requirements states

249. *Id.*

250. ROBERT A. STEIN, FORMING A MORE PERFECT UNION: A HISTORY OF THE UNIFORM LAW COMMISSION 146 (2013) (describing the ULC"s "Federalism Committee").

251. *Id.* at 234 ("It is not an overstatement to say that the mission of the Uniform Law Commission is to maintain and strengthen 'federalism' in the United States.").

252. *See id.* ("When there is a need for federal legislation concerning matters that the states also regulate . . . the Conference works through interactive governmental processes to forge cooperative solutions that allocate power and responsibility in a way that maintains a healthy balance of federal and state law."); *see also* discussion of *Ashton* and *Bekins*, *supra* Part II.

have designed reflect a poor understanding of the role chapter 9 is supposed to play for a distressed municipality. These state programs and mechanisms block access to chapter 9 relief when such relief would be appropriate. Designing a model authorization mechanism that focuses on the core purposes of federal bankruptcy relief will provide guidance to states as to when bankruptcy can be a viable solution for a municipality's problems.

C. The Creditor Negotiation Requirement

The creditor negotiation requirement may be a large obstacle for a municipality, as when many creditors object that the debtor has not negotiated in good faith. Conversely, it may not be an obstacle at all, as when a judge determines that negotiation would be impractical for the municipality. At the heart of the creditor negotiation requirement is the question of whether a municipality is truly facing holdout and collective action problems, a question this Article posits is best determined by state-appointed experts.[253] Furthermore, the considerations used to determine whether this requirement is met primarily focus on the debtor's behavior, asking whether the debtor has negotiated in good faith, or whether the debtor has achieved an agreement with creditors. The bankruptcy judge already has ample opportunity to make a determination on the debtor's good faith, due both to the judge's ability to dismiss the case if it is not filed in good faith and to the confirmation requirements that the plan be proposed in good faith and be in the best interest of creditors.

Practically speaking, the creditor negotiation requirement primarily gives creditors a tool to further impede a municipality's entry into bankruptcy that is not rationally linked to the concerns driving the eligibility requirements.[254] Creditors can simply argue that a municipality has not negotiated enough while refusing to make any concessions themselves, and their arguments nearly always receive consideration, because there is almost always more that the debtor can do.[255] Although the creditor negotiation requirement was designed to ensure that municipalities do not rush into bankruptcy, evidence from current practice indicates that the opposite is occurring. Municipalities are delaying entry into bankruptcy to pursue negotiations that they know will be fruitless simply so that they will be able

253. See *supra* Part IV.B.

254. *See* John T. Gregg, *Eligibility of Municipalities for Relief Under 11 U.S.C. § 109(c)(5)*, AM. BANKR. INST. J., June 2011, at 30 (noting that municipalities have encountered great difficulty when attempting to prove that they have satisfied the creditor negotiation requirement).

255. *See, e.g.*, Galen, *supra* note 64, at 556 (describing SBPEA's objection to San Bernardino's bankruptcy). San Bernardino's eligibility fight dragged on for almost a year. *Id.* at 557.

to demonstrate that they have met this requirement once they file for chapter 9.[256]

Thus, the creditor negotiation requirement seems to encourage over-negotiation on the debtor's part, without any parallel requirement that creditors negotiate in good faith. The creditor negotiation requirement should therefore be eliminated because there are already sufficient tests in place for the judge to determine whether the debtor has acted in good faith.[257]

A "good faith negotiation" is typically interpreted to mean that the debtor has a plan, term sheet, or other outline when negotiating with creditors.[258] Yet, in practice, courts waive this requirement often enough that it lacks teeth.[259] Instead of measuring good faith with respect to the debtor's development of a plan, 11 U.S.C. § 921(c) should provide a check on any bad faith with respect to the debtor. This provision allows the judge to dismiss a bankruptcy petition if it is not filed in good faith. This provision serves the same concerns underlying the current creditor negotiation requirement: it protects against the notion of the debtor filing for bankruptcy to thwart creditors, rather than to work with them.

D. The Plan Requirement

The requirement that a municipality desire to effect a plan to adjust its debts should also be eliminated, because it too serves the concerns that both the creditor negotiation requirement and § 921(c)'s good faith requirement are designed to protect. This requirement was designed to "ensure that the municipality has a genuine willingness to propose a plan of adjustment as opposed to filing a petition under Chapter 9 designed to delay or frustrate its creditors."[260] Once again, however, the threat of dismissal from § 921(c) and the confirmation requirement that a plan be proposed in good faith already safeguard this result. An additional layer of protection only serves

256. *See* Tamar Frankel, *Municipalities in Distress: A Preventative View*, 33 REV. BANKING & FIN. L. 779, 793 (2014) (suggesting that negotiations be cabined within a time limit).

257. These tests include 11 U.S.C. § 921(c) (2012) (allowing the judge to dismiss the case if the debtor did not file the petition in good faith) and 11 U.S.C. § 943(b)(7) (requiring the plan to be in the best interests of the creditors).

258. Denniston, *supra* note 45, at 273–278 (describing the Bankruptcy Appellate Panel's review of Vallejo's compliance with this requirement).

259. *Id.* at 278 (noting that the Bankruptcy Appellate Panel effectively gave Vallejo a pass, saying labor costs were the largest piece of the city's budget, and "it would have been futile to negotiate with other creditors without an agreement with the unions" (quoting Int'l Assoc. of Firefighters, Local 1186 v. City of Vallejo (*In re* City of Vellejo), 408 B.R. 280, 298 (B.A.P. 9th Cir. 2009)). This is the embodiment of a collective action problem.

260. *Id.* at 267.

as fertile ground for creditor objections that unnecessarily delay the case.

In short, sufficient protections already exist for the concerns driving the eligibility requirements. The eligibility requirements, therefore, only serve to duplicate these protections and raise unnecessary roadblocks that impede access to bankruptcy and discourage qualified municipalities from filing. Regardless of whether this Article's specific proposals are adopted, the key point is that the limitations on a municipality's entry into bankruptcy must match up with the reasons the bankruptcy system exists. The current eligibility rules are far removed from chapter 9's underlying purposes. It is therefore time to eliminate these unnecessary gatekeepers for good.

E. Concerns and Criticisms

Sweeping changes to the eligibility rules will necessarily invite resistance. This Subsection addresses anticipated critiques, explaining why the proposed modifications in particular will better serve the goals of bankruptcy law than the status quo.

At the heart of this Article's analysis is the hypothesis that, if the right confirmation standards exist, the eligibility rules serve no valuable purpose. In large part, this Article has argued that the right confirmation standards do in fact exist; however, where necessary, this Article has also suggested changes to the confirmation and eligibility considerations to facilitate significant modifications to the eligibility rules. Although these proposals may seem substantial, they are far from unprecedented. Indeed, the insolvency, good faith, and plan proposal requirements are all rooted in the Bankruptcy Act and once applied to all debtors seeking to file for bankruptcy.[261] As times changed and the Bankruptcy Code replaced the Bankruptcy Act, these requirements were discarded for modern chapter 11 debtors.[262] Similarly, just because the eligibility requirements are rooted in legislative history does not mean that they cannot be modified if they no longer serve the purposes they were intended to serve for municipalities.

The differences among municipalities and the diverse purposes of

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261. *See* Susan Block-Lieb, *Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case*, 42 AM. U. L. REV. 337, 368–69 (1993).

262. A similar debate over entry rules for corporations is taking place in Europe. *See* Horst Eidenmueller & Kristin van Zwieten, *Restructuring the European Business Enterprise: The EU Commission Recommendation on a New Approach to Business Failure and Insolvency* 1 (European Corp. Governance Inst., Law Working Paper No. 301, 2015), http://ssrn.com/abstract=2662213 (arguing that proposed changes to European restructuring laws wrongly require evidence of financial difficulties or likelihood of insolvency as a condition of entry and noting that the restructuring process may be subject to abuse by sophisticated creditors).

bankruptcy law pose challenges to any modification of the eligibility rules. Even the general-purpose municipalities that serve as this Article's focus are incredibly varied. Furthermore, scholars may disagree over the purposes bankruptcy in general, and municipal bankruptcy in particular, are designed to serve. Bankruptcy arguably can and does play a role beyond the primary purposes highlighted in this Article, and scholars have debated the merits of bankruptcy's myriad roles for decades. Nevertheless, by focusing on municipal bankruptcy's core attributes, this Article has delineated what chapter 9 does *best* and has isolated bankruptcy's unique advantages. By focusing on bankruptcy's unique, strong attributes, this Article provides guidance on how to shape the conversation about bankruptcy going forward.

A related challenge lies in the dearth of chapter 9 cases to date. Only a handful of chapter 9 cases involving general-purpose municipalities has been filed, and each case, like each municipality, involves unique political considerations, judges, and problems. It is therefore admittedly difficult to draw generalizations about chapter 9's "standard features." Nevertheless, this Article has suggested concrete guidance for future cases and a novel attempt to provide stability and standardization going forward through the intervention of the ULC. If chapter 9 proves more useful in the future because of this Article's suggestions, scholars will have even more fertile ground to analyze its use and suggest further refinements. This Article therefore plays a key role in articulating concrete steps for moving chapter 9 into place as a viable and valuable bankruptcy tool.

Facilitating entry into chapter 9 could have some undesirable consequences. For example, a city's bond rating could drop.[263] Making chapter 9 a more viable option could also create or exacerbate a moral hazard problem, whereby the stigma of bankruptcy erodes over time and municipal officials come to see bankruptcy as an easy escape from their problems.[264] This in turn could raise the cost of capital, making it harder for cities to access funding sources. The transactional and political costs of a bankruptcy, however, should diminish concerns about moral hazard. Once a municipality enters bankruptcy, it faces a slew of costs and difficulties.

263. *See generally* Brown, *supra* note 110110 (discussing problems related to a lowered bond rating). Yet, studies of cities have also revealed that cooperation between the city and the state or between the city and its unions can actually have the opposite effect. For example, the city of Bridgeport, Connecticut's finances deteriorated when the state and the city engaged in a political struggle and improved when the state and the city worked together. *Id.* The eligibility rules proposed above encourage the state and the city to work together by delineating chapter 9's core, complementary function with respect to the state's role in resolving municipal fiscal distress.

264. *Cf.* McConnell & Picker, *supra* note 151, at 426 (describing the moral hazard problem and the need for a legal regime strong enough to overcome this problem).

For example, a municipality must still demonstrate to a bankruptcy judge that it has complied with the standards for, for example, rejecting a contract,[265] restructuring obligations, and otherwise compiling a plan of adjustment. This demonstration will take substantial effort and money in the form of payments to lawyers, financial experts, and other advisors. In essence, there are already numerous deterrence mechanisms in place, and eligibility rules do not need to serve as an additional source of deterrence.[266] Giving more access to the bankruptcy system itself, as this Article proposes, does not equate to giving municipalities a free ticket to bankruptcy *relief*. The confirmation proceedings and other statutory safeguards discussed in this Article will ensure that only those municipalities deserving of relief attain it.

Although the powers of the judge in a municipal bankruptcy case seem limited, in practice, bankruptcy judges can serve as an effective backstop against opportunistic debtors. In municipal bankruptcy, § 903 prohibits the bankruptcy judge from changing the way that the city conducts its affairs. Creditors are also extremely limited in their remedies outside of bankruptcy, meaning that chapter 9 does not necessarily leave creditors worse off than they would be outside of bankruptcy.[267] In fact, creditors may be better off with a bankruptcy solution, given that the judge must confirm a plan of adjustment that is fair, equitable, and in the best interests of creditors. These safeguards mean that there is no reason for a city to take advantage of bankruptcy if it does not really need it. Despite the judge's overall power in bankruptcy being limited, the judge nevertheless exercises a substantial check on opportunistic or bad faith debtors when it comes to plan confirmation. Furthermore, although eliminating or paring down the eligibility rules may seem to present fewer opportunities for judicial oversight, in practice, judges have demonstrated ample informal means of overseeing the municipal bankruptcy process, and mechanisms remain for

265. Concerns about a city filing simply to rid itself of collective bargaining agreements may at first glance indicate a need for eligibility rules to prevent that result. Yet, an alternative approach would simply be to strengthen the protections for unions by making § 1113 applicable in chapter 9. Other scholars have discussed treatment of collective bargaining agreements in chapter 9 at length. *See, e.g.*, Richard W. Trotter, *Running on Empty: Municipal Insolvency and Rejection of Collective Bargaining Agreements in Chapter 9 Bankruptcy*, 36 S. ILL. U. L.J. 45 (2011).

266. There is likely to be a marginal increase in concern over moral hazard with the elimination of eligibility rules because bankruptcy allows a city to avoid tough decisions, such as cutting luxury spending in order to fund basic needs. Still, this marginal increase will not entail a slew of new filings for the reasons described above.

267. For example, the public trust doctrine makes it very difficult for creditors to seize municipal assets. *See* John D. Echeverria, *The Public Trust Doctrine as a Background Principles Defense in Takings Litigation*, 45 U.C. DAVIS L. REV. 931 (2012).

creditors to appeal judicial decisions that they feel have needlessly harmed their rights.[268]

Therefore, even with substantially revised or eliminated eligibility rules, a municipality's journey through chapter 9 will not be costless. There are still sufficient mechanisms in the rest of chapter 9 for the municipality and the state to carefully contemplate the consequences of bankruptcy, and the role of the judge in safeguarding the municipality, its residents, and its creditors, is still very much preserved at the confirmation stage. Thus, despite facilitating entry into bankruptcy, the proposed eligibility modifications do not anticipate a frictionless journey through bankruptcy, nor do they reduce the costs of a bankruptcy exit.[269]

Although bankruptcy may be seen as a catalyst for raising borrowing costs, alternatives to bankruptcy, such as default, raise borrowing costs as well. In thinking about the effects of bankruptcy, it is therefore critical to separate these effects from the effects of municipal distress more generally. For example, the appointment of an emergency manager due to fiscal distress may be viewed as a riskier move by rating agencies because of the loss of autonomy it could represent for the city.[270] In bankruptcy, in contrast, municipal officials often remain in control of the municipality.[271]

Finally, facilitating access to bankruptcy may be seen as allowing municipalities to unrestrainedly trample on pension and other employee obligations. Yet, the bankruptcies filed to date tell a different story about

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268. *See, e.g.*, Jacoby, *supra* note 77 at 81–82 (describing the extensive oversight of Judge Rhodes and mediator Judge Rosen in the Detroit bankruptcy); Debra McElligott, *Post-Confirmation Powers: EDNY Bankruptcy Court Orders Government Entities to Act in* In re Suffolk Regional Off-Track Betting Corporation, WEIL BANKR. BLOG (Dec. 9, 2015), http://business-finance-restructuring.weil.com/chapter-9/post-confirmation-powers-edny-bankruptcy-court-orders-government-entities-to-act-in-in-re-suffolk-regional-off-track-betting-corporation/ (describing the court's expansive authority to help the debtor successfully implement its plan).

269. The same argument applies to concerns about eroding stable pensions and making it harder to attract good human capital. Although several courts have ruled that pensions can be cut in bankruptcy, the bankruptcies to date have been relatively gentle with pensions, either not touching them at all (as in Stockton) or making slight modifications (as in Detroit). *In re* City of Stockton, 526 B.R. 35 (Bankr. E.D. Cal. 2015); *In re* City of Detroit, 524 B.R. 147 (Bankr. E.D. Mich. 2014). Even if it was possible for easier access to bankruptcy to make it easier for pensions to be eroded, countervailing political pressures have not produced this result in municipal bankruptcies to date. Employees are not *disproportionately* hurt by municipal bankruptcies; if anything, as discussed *infra*, the bondholders often take a more significant cut than employees.

270. *See* Shafroth, *supra* note 225; *see also* Frank Shafroth, *Exceptional Governance & Intergovernmental Challenges*, GMU MUN. SUSTAINABILITY PROJECT (Apr. 12, 2016), https://fiscalbankruptcy.wordpress.com/2016/04/12/exceptional-governance-intergovernmental-challenges/ (noting that the Detroit public school system is suing emergency managers who are not responsive to constituents' needs).

271. Shafroth, *supra* note 270 (contrasting a possible bankruptcy filing by Atlantic City with the possibility of a state takeover and raising questions about the constitutionality of the latter approach).

the treatment of employee obligations in bankruptcy. In the bankruptcies of Detroit, Vallejo, Stockton, and San Bernardino, for example, "bondholders have faced losses of up to 99% of their holdings."[272] Meanwhile, all three California cities chose to preserve full pensions for their employees, while Detroit only cut pensions by approximately 18%.[273] Although pension cuts should not be minimized, it is notable that the most significant cuts fell on the bondholders, who, by virtue of their knowledge of the risks and ability to diversify their holdings, may arguably be better protected than employees.[274] Of course, pension debt is a significant problem for many municipalities, and recent decisions indicate that chapter 9 can help address that debt.[275] But chapter 9 does not provide a costless mechanism for municipalities to do so. And some have even suggested that a debtor's ability to restructure pension obligations in bankruptcy will create needed incentives for beneficiaries to pressure leaders to keep their promises with regard to pension funding outside of the bankruptcy context.[276]

CONCLUSION

Chapter 9 is not a solution to every type of municipal fiscal problem. Instead, the history and scholarship surrounding chapter 9 indicate that it can provide specific, targeted relief for certain types of fiscal distress. Modifying the eligibility rules in recognition of chapter 9's strengths will ultimately serve to make chapter 9 a more effective tool, as well as enable access to municipal bankruptcy when it is needed most.

The considerations underlying these modifications raise broader

272. Frank Shafroth, *Protecting the Ability to Provide Essential Public Services*, GMU MUN. SUSTAINABILITY PROJECT (July 1, 2015), https://fiscalbankruptcy.wordpress.com/2015/07/01/protecting-the-ability-to-provide-essential-public-services/.

273. *Id.*

274. *See* Shafroth, *supra* note 152 (describing comments from Moody's noting a greater effect on bondholders and a lesser effect on pensions for municipal bankruptcy); *see also* Joe Mathewson, Opinion, *Bankruptcy is the Only Way out*, CHI. SUN-TIMES (Aug. 18, 2015, 2:21 PM), http://chicago.suntimes.com/opinion/7/71/887897/opinion-bankruptcy-way. Some scholars argue that this should not be the case and is at odds with bankruptcy priority and distribution rules. *See, e.g.*, Hynes & Walt, *supra* note 147, at 25 (arguing that the law does not allow a judge to approve a plan of adjustment that provides retirees and active workers a greater recovery than other creditors).

275. Specifically, two courts, those overseeing the bankruptcies of Detroit and Stockton, have now ruled that pensions can be impaired or cut in bankruptcy. *In re* City of Detroit, 504 B.R. 97 (Bankr. E.D. Mich. 2013); *In re* City of Stockton, California, 526 B.R. 35 (Bankr. E.D. Cal. 2015).

276. David A. Skeel, Jr., *When Should Bankruptcy Be an Option (For People, Places, or Things)?*, 55 WM. & MARY L. REV. 2217, 2235 (2014) ("If . . . a debtor can restructure its pension obligations in bankruptcy, the beneficiaries and their representatives have an incentive to pay more attention to whether the promises are sustainable. They may put more pressure on politicians to fully fund the pensions than they do in a world where pensions cannot be altered.").

questions about timing and access to the bankruptcy system in general.[277] Scholars have recognized that the Bankruptcy Code as a whole is underutilized and could help entities struggling with financial difficulties more often.[278] By analyzing the role bankruptcy can play in conjunction with other fiscal relief mechanisms, scholars and policymakers can reach a better understanding of when and how bankruptcy should be utilized to resolve distress, whether municipal, corporate, or otherwise.

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277. *See generally* Laura Napoli Coordes, *The Geography of Bankruptcy*, 68 VAND. L. REV. 381 (2015) (discussing the need to ensure access to bankruptcy for all stakeholders).

278. *See* Harner & Griffin, *supra* note 117, at 243.