MUNICIPAL BANKRUPTCY AND THE LIMITS OF FEDERALISM

Colin McGrath *

During the 2008 financial crisis, general municipalities1 across the United States began considering bankruptcy as a means for resolving systemic budget crises. This signified a substantial shift in the relationship between municipalities and Chapter 9 of the federal bankruptcy code. Until 2008, few general municipalities filed under Chapter 9. Special utility districts filed most Chapter 9 petitions. During the recession following 2008, decreases in property value drained municipal tax revenue. Meanwhile, cities and counties maintained spending levels to meet contractual obligations and maintain basic services. General municipalities in the United States faced accumulating debt and the threat of budget deficits. Some used Chapter 9 debt adjustment in attempts to resolve structural budget crises. These events culminated in Detroit, Michigan, filing under Chapter 9 in 2013 for the largest debt adjustment in the nation’s history. Detroit exited bankruptcy on December 10, 2014.2

As general municipalities began filing Chapter 9 petitions, bankruptcy scholars noted that the municipal bankruptcy code did little to address systemic problems underlying fiscal distress. Two key proposals emerged from academic debate. The first contended that bankruptcy judges should use key points of leverage during bankruptcy proceedings to impose tax increases or spending reductions on municipalities. The second argued that judges should impose a restructuring of municipal governance to remedy governmental deficiencies that enable poor fiscal management.

These proposals raise substantial constitutional concerns. Doctrines of federalism, which broadly aim to preserve the dignity and autonomy of states and their political subdivisions, threaten to limit

* J.D., 2016, University of Pennsylvania Law School; Ph.D. Candidate, American Legal History, University of Pennsylvania. I am grateful for the generous and thoughtful guidance I received from Professors Seth Kreimer and David Skeel.
1 The term “general municipality” describes governmental jurisdictions like counties, cities, and towns. The bankruptcy code defines municipality more broadly to mean a “political subdivision or public agency or instrumentality of a State,” 11 U.S.C. 101(40) (2005), which encompasses an entity like a utility district or public authority.
the reach of proactive bankruptcy courts. The judicial imposition of tax increases and governance restructuring would allow federal power to reach core elements of local self-rule. But as this Comment contends, such imposition stands as a crucial amendment to current municipal bankruptcy practices.

Part I.A. of this Comment examines the heightened role municipal bankruptcy has played in aiding cities and counties in resolving debt crises in recent years. Part I.B. analyzes strategies that bankruptcy judges may pursue to better assist distressed municipalities in securing a "fresh start." Part II of this Comment analyzes the constitutional viability of judicial and legislative actions that would reformulate Chapter 9 as a viable tool for assisting fiscal crises. Part II.A. dissects theories motivating three of the Supreme Court’s core doctrines of federalism—commandeering, coercion, and comity—to assess the force with which they circumscribe the reach of federal bankruptcy courts. The part concludes that each doctrine has analytical instabilities that suggest bankruptcy courts may intervene in local taxation and governance.

Part II.B. proposes a more fundamental rethinking of the relationship between federalism and the Constitution’s Bankruptcy Clause. The Supreme Court’s recent decisions limiting the reach of state Eleventh Amendment immunity, as asserted during in rem proceedings, suggests that the Bankruptcy Clause contemplates a derogation of state autonomy. Principles of federalism should not apply in bankruptcy proceedings as they do to other positive grants of authority such as the Commerce Clause. This Comment argues that the Supreme Court’s decision in Central Virginia Community College v. Katz\(^3\) has implications beyond the Eleventh Amendment. Part II.B. thus argues that bankruptcy judges may not only require tax adjustments and governance structuring as a condition of Chapter 9 eligibility or confirmation. Judges may order these reconfigurations as means necessary for ensuring sound resolution of a municipality’s fiscal distress.\(^4\)

I. MUNICIPAL BANKRUPTCY

Congress passed the nation’s first municipal bankruptcy code in 1934.\(^5\) Since the 1930s, the composition of municipal budgets and

---

4 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.").
the nature of municipal finance practices underwent transformations that rendered Chapter 9 an inadequate tool for regulating the debt of general municipalities. In the late 1970s and 1980s, local revenue collapsed as the federal government withdrew grants to local governments. The proliferation of tax revolts across the United States during the same period further depressed local governments’ access to operating funds. In response to lost revenue, over the last three decades local governments became increasingly reliant on debt to finance their operations. In 1945, local and state outstanding municipal security and loan liability stood at $12 billion, or $146 billion in current dollars. Liability rose to over $2.9 trillion in 2014. In a municipality like the City of Philadelphia, outstanding general obligation debt exceeds annual tax revenue. In addition to relying on general

---

6 See, e.g., ROGER BILES, THE FATES OF CITIES: URBAN AMERICA AND THE FEDERAL GOVERNMENT, 1945-2000 267 (2011) (explaining that the Reagan Administration cut funding for housing programs more than funding to any other area of the federal budget, with funding cut to two-thirds of its 1981 level by 1987, and budget authority for the Community Development Block Grant cut from $3.7 billion to $3.1 billion in the same period). The administration also cut funding for transportation by 10% in 1986 and an additional 2.5% the next year. Id. During this period, the administration required the United States Department of Housing and Urban Development to reduce expenditures for assisted housing by 85% and Community Development Block Grant outlays by 29%. Id. at 278.

7 See generally ROBERT O. SELF, AMERICAN BABYLON: RACE AND THE STRUGGLE FOR POSTWAR OAKLAND 325-26 (2003) (explaining that in 1979, the year after California passed Proposition 13, over twenty additional states enacted "tax reform legislation" and over twenty states also passed laws reducing income tax). Proposition 13 established limits on real property taxation and required a two-thirds vote from the legislature to raise any tax. Id. at 321.


obligation and revenue bonds, municipalities began experimenting with novel financing techniques like Tax Increment Financing, investment in high-risk securities, and other novel debt-financing methods. Debt plays a central role in supporting redevelopment efforts and the ongoing functions of municipalities, placing cities and counties at risk of insolvency. The 2008 financial crisis revealed the extent of this risk.

The bankruptcy code aims to provide insolvent debtors a fresh start. But Chapter 9 also serves as a regulatory apparatus. Chapter 9's protections allow municipalities to assume the risk that accompanies massive debt. When a municipality's debt hits a critical level, Chapter 9 offers a tool allowing the municipality to restore its functions. Chapter 9 governs the necessary allocation of loss.

A bankruptcy code reflects normative judgments regarding who should bear the cost of debt. In the context of municipal bankruptcy, loss must be allocated among pensioners, institutional investors, corporate creditors, private creditors, taxpayers, and the municipality itself. As this part argues, Chapter 9 largely shifts the cost of municipal risk-taking to creditors, without requiring municipalities to internalize the cost of unsound fiscal judgment. In so doing, Chapter 9 fails to stabilize the finances of a distressed municipality. It provides a temporary solution to fiscal distress without resolving structural deficiencies that brought the municipality before a bankruptcy court. Judicial intervention in municipal functions during bankruptcy pro-

---


13 See, e.g., In re Cnty. of Orange, 183 B.R. 594, 598 (Bankr. C.D. Cal. 1995) (discussing the County's investment in "inverse floaters," a volatile type of derivative that based its value on a reference to the London Interbank Offer Rate).

14 See Christine Sgarlata Chung, Government Budgets as the Hunger Games: The Brutal Competition for State and Local Government Resources Given Municipal Securities Debt, Pension and OBEP Obligations, and Taxpayer Needs, 33 REV. BANKING & FIN. L. 663, 686–87 (2014) (discussing the use of "complex, non-traditional instruments such as variable rate demand obligations ("VRDO"), auction rate securities, and interest rate swaps . . .").

15 See, e.g., MANN, infra note 256, at 83 (quoting a 1754 pamphlet criticizing imprisonment of debtors, which asked whether "it is best for Society, that his Creditors receive a Proportion of their Debts . . . and his Person be sat at Liberty to seek new Employment; or that his Body be imprisoned for the Deficiency, until he pays the utmost Farthing, which is impossible?").
ceedings may balance the allocation of risk. It may also prove necessary for repairing broken elements of a municipality’s governance practices or fiscal policy that caused a debt burden to become crippling. With debt now a central component to municipal operations, bankruptcy courts must ensure that the cost of debt does not fall disproportionately on a municipality’s most vulnerable stakeholders.

A. The Shifting Landscape of Municipal Bankruptcy

The U.S. Congress enacted the nation’s modern bankruptcy code in 1978. Under Chapter 9 of the code, titled “Adjustment of Debts of a Municipality,” a municipality may file a petition with a federal bankruptcy court, which automatically places a stay on the enforcement of claims against a debtor municipality. The municipality retains sole power to submit a plan for the adjustment of its debts. Once the bankruptcy court confirms the filed plan, the municipality frees itself of all debts that the plan does not except from discharge. For the purposes of Chapter 9, the term “municipality” includes any political subdivision, public agency, or instrumentality of a State.

Through the end of the 1980s, special purpose districts initiated most Chapter 9 filings. General municipalities were responsible for only three of the ninety Chapter 9 petitions filed between 1972 through 1991. The three general municipalities—South Tuscon, Arizona; St. Louis, Missouri; and Wapanucka, Oklahoma—filed under Chapter 9 to stall enforcement of liabilities after single incidents exposed the cities to substantial judgments. In Wapanucka, for example, the town condemned a local water well to provide water for residents after an oil tanker crash marred the local water supply. The town anticipated that $5,000 would provide just compensation, but a court awarded $112,000. The town pursued damages against the oil company. But in the meantime, it filed a Chapter 9 petition to stall execution of the condemnation award while its damages suit pending. General municipalities did not turn to the bankruptcy code to resolve structural debt crises. Writing in 1993, Professors Michael

---

22 Id. at 470–71.
23 Id. at 471.
McConnell and Randal Picker noted that the three cities’ filings indicated no “need for corporate reorganization.”

This landscape began to change during the recession following the 2007-2008 financial crisis in the U.S. In the 1990s, few cities attempted to resolve structural budget crises through Chapter 9 filings. The City of Bridgeport, Connecticut, became an early exception when it filed for Chapter 9 protection in 1991, becoming the largest city to do so at that time. The City filed for protection with the aim of addressing deficits arising from “unaffordable employee union contracts” and an inability to raise taxes to pay for essential services. The Bankruptcy Court, however, dismissed the City’s petition, reasoning that because the City remained “solvent,” it could not meet the requirement for relief under Chapter 9. The Court concluded that a city is insolvent only if it cannot pay debts as they “become due in its current fiscal year” or the following year based on an “adopted budget.” Despite the City’s “deep financial trouble,” it could feasibly pay its debts.

Beginning in 2008, general municipalities increasingly filed under Chapter 9 to resolve structural budget deficits. The City of Vallejo, California, filed a petition after running an operating deficit exceeding $3 million in 2006 and $4 million in 2007. The national economic recession, which diminished the City’s property taxes, sales taxes, and other sources of municipal revenue, intensified the budget crisis. California laws restrained the City’s ability to raise tax rates: Proposition 13, for example, set a cap on property tax rates. Meanwhile, the City faced escalating labor costs, which the City projected as composing $79.4 million of its $95 million in outlays.

In 2011, Jefferson County, Alabama, filed under Chapter 9 to adjust a $4.1 billion long-term debt, the largest filing in the nation’s history at that time. The County faced $3.2 billion in debt resulting

24 Id. at 470–71.
27 Id.
28 Id. at 338.
29 Id. at 339.
30 In re City of Vallejo, Cal., No. 08-26813-A-9, 2008 WL 4180008, at *1 (Bankr. E.D. Cal. Sept. 5, 2008), aff’d sub nom., In re City of Vallejo, 408 B.R. 280 (B.A.P. 9th Cir. 2009).
31 Id. at *2.
32 In re City of Vallejo, 408 B.R. at 286.
33 Id. at 287.
from warrants the County issued between 1997 and 2003 to allow governments within the County to take on debt to rebuild and repair sewer systems. The County subsequently assumed the debt without compensation. When the U.S. municipal bond market’s diminished liquidity barred the County from auctioning high-interest, adjustable rate warrants, the County fell behind on principal payments, setting off the County’s fiscal crisis.

Following the collapse of the U.S. mortgage market in 2007, the City of Stockton, California, experienced one of the highest foreclosure rates in the nation. Commercial and residential property values fell 50%. Revenue from sales tax fell from $47 million in FY 2006 to $32.7 million in FY 2010; property tax and other sources of revenue also fell. Prior to 2008, the City had assumed long-term debt for financing new development and entered generous contracts with its employees, providing health care benefits at no cost to employees’ pensions based on the employee’s final year of compensation, which could include payment for accrued vacation and sick leave. In February 2012, the City could no longer meet debt payments as they came due, and faced a projected $700,000 deficit for FY 2012, which the City resolved by intentionally defaulting on over $2 million in bond payments. In June 2012, the City filed under Chapter 9 after cuts in expenditures failed to stem the crisis.

In August 2012, only two months after Stockton initiated bankruptcy proceedings, the City of San Bernardino filed a petition for


Shelly Sigo, Jefferson County, Ala., Takes Sewer Rating Hit, THE BOND BUYER, Feb. 26, 2008, http://www.bondbuyer.com/issues/117_36/-284135-1.html; Sigo, supra note 34. The bankruptcy court attributed the massive cost to the County’s failure to perform incremental repairs on the system. In re Jefferson Cnty., Ala., 474 B.R. at 237. The court also faulted the County for using warrants secured by the special revenue the sewer system generated, rather than using general obligation warrants. Id. at 238. The structure of the warrants “reduced, if not avoided, input from all of the inhabitants of the County.” Id. at 239. This limited the revenue streams available for repaying its sewer debt. Id.

In re City of Stockton, Cal., 493 B.R. 772, 778 (Bankr. E.D. Cal. 2013).

Id.

Id. at 779.

Id.

Id. at 781, 789.

Id. at 779–780, 783. The City attempted to resolve the crisis by decreasing the workforce by 25% between 2008 and 2011, eliminating medical benefits for new hires and reducing employees’ accrued sick leave. Id. at 780.
Chapter 9 with the Central District of California, Riverside Division. Similar to Stockton, San Bernardino's deficit largely derived from a significant drop in property tax revenue caused by the California housing market collapse in 2007. The City maintained outlays for essential services as its revenue base collapsed. The bankruptcy court granted eligibility to San Bernardino, reasoning that Chapter 9 served to "give a municipality a breathing space from a cash crunch and an opportunity to address its long term solvency..." The City had no alternative for resolving the $45.9 million cash deficit it faced in 2012-13.

Finally, in 2013 Detroit filed for bankruptcy. The City reached an agreement with creditors and filed a confirmation plan that the Bankruptcy Court for the Eastern District of Michigan confirmed in December 2014. The plan reduced the city's debt by $7 billion. Detroit's filing aimed to address a massive debt burden the City accumulated in part during the Kilpatrick and Bing administrations to cover the cost of the City's pension liabilities. The City's use of interest-rate swaps to lock in a fixed interest rate for its new debt gener-

43 City of San Bernardino, Cal., 499 B.R. 776, 780 (Bankr. C.D. Cal. 2013).
44 Id. at 778. Prior to 2007, relatively cheap housing and easy mortgage financing drew new homeowners to San Bernardino. San Bernardino had one of the nation's highest foreclosure rates after the financial crisis hit. Id.
45 Id. at 779. As property values fell, the City maintained its investment in public safety, street repair, and municipal employee salaries to meet the demands of a growing population. Id. Prior to the crisis, the City agreed to cover the employee's share of payments to the California Public Employee Retirement System ("CalPERS"), the State's pension management institution, which generated a significant debt the City owed to CalPERS. Id.
46 Id. at 791.
47 Id. One creditor, the CalPERS, objected to the City's Chapter 9 filing. CalPERS claimed that the City failed to meet two eligibility requirements: it did not file in good faith, and had no desire to establish a debt-adjustment plan. Id. at 786. See 11 U.S.C. § 109(c)(4) (providing that an entity may be a debtor under chapter 9 if and only if it "desires to effect a plan to adjust such debts"); 11 U.S.C. § 921(c) (permitting the court to dismiss a petition if a debtor does not "file the petition in good faith."). The bankruptcy court acknowledged that the City "got off to a slow start in getting its financial records in order," demonstrated "untidy disarray" of its finances, and lacked "direction toward long-term resolution of its admitted financial distress..." City of San Bernardino, Cal., 499 B.R. at 778. But the City's initial steps towards restructuring its debt after filing the petition allowed the court to conclude that the City met the eligibility threshold. Id. at 788.
49 Id. at 162.
ated substantial losses for the city. In fiscal year 2014, Detroit’s expenses exceeded its revenue by $198 million. Detroit’s filing marked the most recent, and by far the largest, of general municipalities filing under Chapter 9. Like other general municipalities, Detroit used bankruptcy proceedings to resolve budget crises that stemmed from structural sources, which included deficiencies in financial management and fiscal policy.

B. Judicial Intervention in Municipal Bankruptcy

The debt crises of general municipalities after 2008 prompted bankruptcy scholars to scrutinize the structure and theoretical underpinnings of Chapter 9. Chapter 9 filings from Vallejo, Jefferson, Stockton, San Bernardino, and Detroit indicated that general municipalities embraced debt adjustment as a means for resolving structural budget crises. But as scholars noted, Chapter 9 does not offer a suitable device for doing so. The code allows for debt restructuring without directly authorizing courts to interfere in political and governmental affairs that underlie structural deficits. In response, scholars began to theorize alternative models for debt adjustment. Broadly, they called for bankruptcy courts to intervene directly in municipal affairs as a means to bypass inefficiencies in local governance that generated high-risk budget structures.

52 Id. at 1.
53 Some scholarship predated 2008. See McConnell & Picker, supra note 21, at 472 (arguing that bankruptcy law should do more than provide for debt adjustment, and instead allow courts to address chronic financial difficulty, which indicates that “ordinary political processes are not functioning properly”). McConnell and Picker theorized in 1993 that a bankruptcy court should have four remedies available. First, the court should have power to require a municipality to levy or collect taxes within the municipality’s authority. Id. at 475–76. The authors suggested that a court have power to “increase taxes without a prior state authorization,” but noted that this would raise constitutional concerns. Id. at 476. Second, the court should have authority to “order reduction in wasteful expenditures as a condition for debt relief.” Id. Third, the court should have authority to “attach particular streams of income for the repayment of bonds” such that the city may obtain more favorable terms when refinancing debt. Id. Fourth, the court should have authority to sell municipal property when appropriate, for example property that has non-public use, like assets acquired for nonpayment of taxes. Id. at 476–77.

For a recent critique of Chapter 9, see Juliet M. Moringiello, Goals and Governance in Municipal Bankruptcy, 71 WASH. & LEE L. REV. 405, 410 (2014) (arguing that state policymakers should view Chapter 9 as “one component of an integrated approach to municipal financial distress” that requires a sophisticated state oversight structure to complement municipal debt adjustment); Clayton P. Gillette, Dictatorships for Democracy: Takeovers of Financially Failed Cities, 114 COLUM. L. REV. 1573, 1377 (2014).
1. Rethinking Chapter 9

Bankruptcy law serves two basic purposes. First, under a “contractual theory,” bankruptcy law aims to benefit creditors through using procedural protections that increase a debtor’s value to the creditor, as well as aid the debtor by reducing the cost of credit; bankruptcy provides a system for facilitating debt collection when the debtor becomes insolvent. State law generally “prioritizes the creditors’ rights to the debtor’s assets on a first come, first serve basis.” When a debtor nears insolvency, remedies at state law therefore incentivize creditors to act quickly to reclaim assets, creating a “common pool problem.” While the debtor is worth more to the creditors as a whole when it remains a viable entity, the race to claim a debtor’s assets would result in the debtor’s liquidation. A bankruptcy regime obviates the “common pool problem” by barring any one creditor from making a claim on assets at the exclusion of others, thus maximizing the debtor’s value to the group of creditors. This security has the added benefit of decreasing creditors’ risk, which in turn reduces the cost of debt.

Second, under a “fresh start theory,” bankruptcy provides the debtor an opportunity for financial rehabilitation. The debtor emerges from bankruptcy with decreased debt obligations. Historically, a fresh start in the seventeenth and eighteenth centuries also entailed the discharge of an individual debtor from a debtor’s prison. Bankruptcy thus aims to afford the debtor financial normalcy and the chance for a renewed economic life.

As Professor Omer Kimhi argues, neither theory supports Chapter 9. Municipal insolvency, unlike private insolvency, does not trigger a scramble to capture the debtor’s assets. Unlike a corporation’s creditors, a creditor to a municipality may not “execute” municipal property. In other words, the municipal creditor may not require

55 Id. at 370.
56 Id.
57 Id.
58 Id.
59 Id. at 354, 372.
60 Kimhi, supra note 54, at 354.
62 Kimhi, supra note 54, at 371.
63 Id.
the municipality to convey property in fulfillment of its obligations.\textsuperscript{64} No “common pool” problem arises. Chapter 9 therefore does not increase the municipality’s value to its creditors. Rather, debt adjustment diminishes the municipality’s value.\textsuperscript{65} Despite insolvency, municipal tax revenue may still allow the municipality to pay its obligations.\textsuperscript{66} In the event the municipality cannot meet its bills, state laws generally provide an avenue through which creditors may require the municipality to increase taxes to cover its obligations.\textsuperscript{67} Through Chapter 9, on the other hand, all creditors end up with less.\textsuperscript{68}

Nor does the “fresh start theory” justify Chapter 9, according to Professor Kimhi.\textsuperscript{69} In theory, debt adjustment affords the municipality relief. Chapter 9 allows the municipality to “negotiate a debt readjustment agreement from a position of power.”\textsuperscript{70} Adjustment allows the municipality to reduce its debt, which in turn allows the municipality to reduce tax rates or improve services.\textsuperscript{71} Productivity increases, as does economic activity.\textsuperscript{72} Increased economic activity in turn generates greater tax revenue.\textsuperscript{73}

The municipal “fresh start” rests on flawed assumptions. Professor Kimhi’s brief analysis of the reasons for local fiscal crises indicates that crises reflect structural problems, not single-instance shocks arising from accidents or the inept managerial work of a single bureaucrat. First, crises often track socioeconomic phenomena, which may include economic recessions or the outmigration of high-income households from a distressed city.\textsuperscript{74} Second, the structure of municipal politics plays a significant role in generating operating deficits. For example, municipalities that have politically fragmented populations and substantial interest group activity tend to have a higher risk of budget crisis.\textsuperscript{75}

\textsuperscript{64} Id. The only exception to the restriction on execution may include property that serves no public function of the municipality. Id. (citing ROBERT AMDURSKY & CLAYTON GILLETTE, MUNICIPAL DEBT FINANCE LAW: THEORY AND PRACTICE (1992)).

\textsuperscript{65} Id. at 371–72.

\textsuperscript{66} Id. at 372.

\textsuperscript{67} Id.

\textsuperscript{68} Id.

\textsuperscript{69} Id. at 374.

\textsuperscript{70} Kimhi, supra note 54, at 372–73.

\textsuperscript{71} Id. at 373.

\textsuperscript{72} Id.

\textsuperscript{73} Id.

\textsuperscript{74} Id. at 376.

\textsuperscript{75} Id. at 379. In New York, special interests assumed an increasingly significant role in the municipal budget-making process, giving rise to structural overspending as...
If municipal budget crises have structural origins, then Chapter 9 cannot afford municipalities a fresh start. Debt adjustment may reduce a municipality's obligations to creditors; it does not change the political or socioeconomic climate that obstructed payment of creditors. Thus, while Chapter 9 proves useful for a city facing a crippling single-instance liability, it is poorly suited for giving a municipality with a diminished tax base a "fresh start." Professor Kimhi contends that state intervention offers a superior means for rehabilitating distressed municipalities than Chapter 9, but other bankruptcy scholars have theorized that the bankruptcy code itself could provide adequate remedies for municipalities facing structural budget crises.

A bankruptcy court could feasibly assume an active role in a municipality's Chapter 9 proceedings to remedy structural problems generating excessive debt. Bankruptcy scholars have proposed two means for doing so: first, a bankruptcy court could impose tax increases on a municipality as a condition of Chapter 9 debt adjustment; second, a court could require that a municipality change its governance structure to insulate decision-making processes from interest group politics and other forces contributing to excessive outlays.

2. The Role of Resource Adjustments

Contrary to Professor Kimhi's proposal, a federal bankruptcy judge may be best positioned to aid a municipality in restoring its financial condition through the use of Chapter 9 proceedings. Chapter 9 presents the risk that municipalities may seek debt adjustments for lack of political will. Orange County, California, for example,

decisionmakers attempted to appease all interest groups. Id. at 379 n.157 (citing ESTER R. FUCHS, MAYORS AND MONEY: FISCAL POLICY IN NEW YORK AND CHICAGO 242-43 (1992) for the proposition that New York City's interest groups played a significant role in causing the City's fiscal crisis in the 1970s).

76 Id. at 380.
77 See, e.g., supra notes 21-24 and accompanying text (noting that most municipalities historically initiated Chapter 9 filings to deal with single incidents that exposed them to significant judgments, not to resolve structural debt crises).
78 Kimhi, supra note 54, at 385-87 (reasoning that a state is better situated to address socioeconomic and political factors contributing to local fiscal crises). A state has the authority to resolve matters external to the municipality, for example, by implementing a tax system to reduce the effects of suburbanization or using "countercyclical revenue-sharing aid" to soften the impact of national economic recessions. Id.
79 Clayton P. Gillette, Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy, 79 U. CHI. L. REV. 281, 283-84 (2012) (explaining that the default on municipal debt may stem from residents' refusal to accept onerous obligations incurred by political officials).
filed for debt adjustment after its $6.6 billion investment in derivatives collapsed.\textsuperscript{80} The County Treasurer’s management strategy introduced significant risk to the County’s investment portfolio, which produced losses that the County could have covered with a half-cent increase in the County sales tax lasting ten years. The County’s residents rejected the proposal.\textsuperscript{81} The decision meant that the County’s creditors, rather than taxpayers, bore the loss.\textsuperscript{82} As Orange County’s insolvency illustrates, the existing federal bankruptcy regime allows municipalities to shift costs to creditors. It may also shift costs to centralized governments responsible for effecting bailouts to protect the fiscal health of other subdivisions. This liability allocation means that municipalities avoid internalizing the costs of fiscal policymaking.\textsuperscript{83} Bankruptcy judges may help resolve this problem.

As a solution to this inefficiency, Professor Clayton Gillette proposes that federal bankruptcy courts “impose resource adjustments on defaulting municipalities that appear to lack political will as opposed to financial resources.”\textsuperscript{84} The term “resource adjustment” means an adjustment in tax or spending structure.\textsuperscript{85} By imposing resource adjustments, bankruptcy courts may cause municipalities to internalize the costs of fiscal policy, thereby reducing municipalities’ incentives to use bankruptcy proceedings “strategically.”\textsuperscript{86}

The language of Section 904 of Chapter 9 may seem to preclude such judicial interference. The law provides that “unless the debtor consents or the [debt adjustment] plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with ... any of the property or revenues of the debtor.”\textsuperscript{87} Nor may the court “interfere with ... any of the political or governmental powers of the debtor.”\textsuperscript{88} Yet, as Gillette proposes, bankruptcy judges

\textsuperscript{80} In re Cnty. of Orange, 183 B.R. 594, 598 (Bankr. C.D. Cal. 1995). The derivatives, called “inverse floaters,” generated yield when the interest rate on underlying assets decreased. \textit{Id.} at 598 n.5. \textit{See generally} PUB. POLICY INST. OF CAL., WHEN GOVERNMENT FAILS: THE ORANGE COUNTY BANKRUPTCY, A POLICY SUMMARY (1998) (detailing the county treasurer’s risky investment strategy that ultimately forced Orange County into filing for bankruptcy).

\textsuperscript{81} Gillette, \textit{supra} note 79, at 284.

\textsuperscript{82} \textit{Id.}

\textsuperscript{83} \textit{Id.} at 289 (noting that although fiscal federalism requires that municipalities internalize the costs of fiscal decisions, “[t]he current legal structure for addressing municipal fiscal distress ... reduces the need for distressed localities to internalize” these decisions).

\textsuperscript{84} \textit{Id.} at 327.

\textsuperscript{85} \textit{Id.} at 285.

\textsuperscript{86} \textit{Id.} at 290.

\textsuperscript{87} 11 U.S.C. § 904(2).

\textsuperscript{88} \textit{Id.} § 904(1).
retain discretion—primarily at three points during the course of Chapter 9 proceedings—that may allow for imposition of resource adjustments. 89

First, because only "insolvent" municipalities may file under Chapter 9, judges have the authority to interpret the municipality’s ability to "prospectively" pay its bills to require that default be "imminent and certain," meaning that the municipality would have no Chapter 9 eligibility until it exhausted resource adjustment options. 90 Second, a bankruptcy court could take into account whether the debtor entertained the possibility of resource adjustments during negotiations with creditors. 91 Chapter 9 requires that a municipality demonstrate it “negotiated in good faith with creditors” and “failed to obtain the agreement of creditors . . .”. A bankruptcy judge could consider the debtor’s willingness to implement resource adjustments as an element in assessing whether Section 109 negotiations occurred in good faith. 92 A decision to deny eligibility, or the threat of such denial, could pressure the municipality to implement resource adjustments. Third, a bankruptcy judge may incentivize resource adjustments

89 Gillette, supra note 79, at 295.
90 Id. (citing In re City of Bridgeport, 129 B.R. 332, 337-39 (Bankr. D. Conn. 1991), where the court denied the City of Bridgeport Chapter 9 eligibility because it had access to a bond proceed fund that could cover its $16 million deficit for the current fiscal year). As Gillette argues, the court could also have “agreed with Bridgeport that failure to provide immediate relief simply deferred to the near future the city’s inability to generate revenues sufficient to meet all its obligations,” which would have allowed the City to satisfy the insolvency test of Chapter 9. Id. See 11 U.S.C. § 109(c)(3) (requiring that a debtor under Chapter 9 be insolvent); 11 U.S.C § 101(32)(C)(i)-(ii) (defining “insolvent” for a municipality to mean a “financial condition such that the municipality is” “generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute,” or “unable to pay its debts as they become due”). See also City of Bridgeport, 129 B.R. at 338 (concluding “that to be found insolvent a city must prove that it will be unable to pay its debts as they become due in its current fiscal year or, based on an adopted budget, in its next fiscal year”).
91 Gillette, supra note 79, at 295.
93 Gillette notes that at least one bankruptcy court has employed this reasoning. Gillette, supra note 79, at 295–96. A bankruptcy court denied Chapter 9 eligibility to the Sullivan County Regional Refuse Disposal District because the debtors “never exercised their assessment powers prior to coming into the bankruptcy court” and attempted to “ignore[]” their assessment power when negotiating with creditors. In re Sullivan Cnty. Reg’l Refuse Disposal Dist., 165 B.R. 60, 78 (Bankr. D.N.H. 1994). The court noted that case law does not treat exhaustion of taxation power as a requirement for Chapter 9 eligibility, but found the debtors’ resource adjustment avoidance sufficiently egregious to support denial of eligibility. Id. (explaining that although municipal debtors are not required to establish “that they have exercised their taxing powers to the maximum extent possible,” the debtors’ inaction in this case established their failure to negotiate in good faith).
through the confirmation of a debt adjustment plan. A plan must serve the “best interests of creditors.” Resource adjustments could either remove the need for debt adjustment or lessen the degree of an adjustment. A bankruptcy judge may therefore take into consideration the feasibility of resource adjustments when assessing whether a plan serves creditors’ best interests.

This last theory has precedent in bankruptcy law preceding the enactment of the modern bankruptcy code. In 1940, the Ninth Circuit rejected an irrigation district’s proposed adjustment plan on grounds that it failed to serve the “best interests of the creditors.” Even though in the current fiscal year the district had inadequate funds for paying debts as they came due, it made no showing that its power of taxation could not produce revenue sufficient to meet its obligations. The court rejected the plan for failing to meet the creditors’ best interests. Some scholarship on municipal bankruptcy suggests that judicial intervention is unnecessary for remedying ostensible cost-shifting. Professor Kevin Kordana argues that Chapter 9’s failure to “compel tax increases is, in fact, appropriate.” First, the “moral hazard” rationale for tax increases fails because reputational concerns, and the need for a municipality to remain an attractive investment, reign in “municipal opportunism.” Second, he argues, investors are better suited to bear risk than a municipality’s residents.

But judicially-imposed tax increases, or other resource adjustments, do more than mitigate moral hazard. First, opportunism does not offer the sole explanation for a municipal decisionmaker’s attempt to avoid tax increases during crisis. Electoral politics, interest group politics, and sociopolitical fragmentation may stymie a munici-

94 Gillette, supra note 79, at 296.
95 See 11 U.S.C. § 943(b)(7) (“The court shall confirm the plan if [it] is in the best interests of creditors and is feasible.”).
96 Fano v. Newport Heights Irr. Dist., 114 F.2d 563, 566 (9th Cir. 1940).
97 See id. at 565–66 (“[W]e are unable to find any reason why the tax rate should not have been increased sufficiently to meet the District’s obligations or why it can be said that the plan is . . . for the ‘best interest of the creditors’ with no sufficient showing that the taxing power was inadequate to raise the taxes to pay them.”). See also In re Corcoran Hosp. Dist., 233 B.R. 449, 461 (Bankr. E.D. Cal. 1999) (confirming a hospital district’s debt adjustment plan because the debtor “could not raise taxes sufficient to pay more” to creditors).
98 Fano, 114 F.2d at 566.
100 Id. at 1038–39.
101 Id. at 1039.
pality's genuine efforts to increase revenue or cut expenditures. While a debt adjustment plan may not subvert a state law restricting tax increases, judicial intervention may place pressure on taxpayers to approve an otherwise disfavored tax increase. Political pressures may also block tax increases even where voter approval is not required, thus allowing adoption of a debt adjustment plan that requires a tax increase. A bankruptcy court, by conditioning Chapter 9 eligibility or confirmation on resource adjustments, may allow a municipality to implement adjustments that it could not achieve alone.\textsuperscript{103}

Second, as Professor Gillette argues, fiscal federalism provides a strong justification for judicial intervention.\textsuperscript{104} Fiscal federalism posits that centralized governments should protect the financial independence of local governments so they may pursue unique governmental preferences. The imposition of resource adjustments preserves fiscal self-governance by minimizing the ability of local governments to file strategically under Chapter 9. A municipality may use the threat of bankruptcy as a means for extracting bailouts from central governments, for example a state government. Central governments often impose stringent obligations on local governments as a condition of bailout. The availability of obligation-free bankruptcy proceedings, however, may allow the municipality to obtain a bailout from a centralized government at lower cost. Imposition of resource adjust-

\textsuperscript{102} See Kimhi, supra note 54, at 377–78 (explaining that state oversight restricts the fiscal decisions of local governments).

\textsuperscript{103} A court does not have authority to approve a tax increase if state law prohibits such action. See 11 U.S.C. § 943(b)(6) (conditioning a court’s confirmation of a debt adjustment plan on the debtor’s compliance with all applicable nonbankruptcy law). If state law requires voter approval to authorize a tax increase, bankruptcy judges must reject a plan that introduces taxes or bonds secured by tax assessments without an election as required under state law. \textit{See, e.g., In re City of Colorado Springs Spring Creek Gen. Improvement Dist., 177 B.R. 684, 693 (Bankr. D. Colo. 1995)} ("Though Congress intended Chapter 9 to be a forum for reorganization of municipalities, it is clear that Congress did not intend for federal bankruptcy law to supersede or impair the power of the state to create, limit, authorize or control a municipality in the exercise of its political or governmental powers."). The court in \textit{Spring Creek General Improvement District} noted that "[u]nlike any other chapter of the Bankruptcy Code, Chapter 9 places federal law in juxtaposition to the rights of states to create and govern their own subdivisions." \textit{Id.} Thus, the court reasoned that it could not confirm a plan that "proposes action not authorized by state law" or fails to meet the requirements of state law. \textit{Id.} at 694. To preserve state authority, the court rejected the debt adjustment plan because it required issuance of bonds secured by a tax increase that voters had not voted to approve. \textit{Id.} at 694–95 (concluding that, because Colorado law required electoral approval of a bond issuance, an election was necessary); \textit{see also In re Sanitary & Improvement Dist., No. 7, 98 B.R. 970, 975–76 (Bankr. D. Neb. 1989)} (denying confirmation of plan because it contained provisions in violation of state law).

\textsuperscript{104} See Gillette, supra note 79, at 300.
ments for municipalities filing under Chapter 9 thus limits a municipality's ability to use bankruptcy strategically. This in turn safeguards a central government's independence in administering its resources.\footnote{Id. at 288–90; 299–320 (demonstrating how, in a dual system of bailouts and bankruptcy, court-imposed resource adjustments may mitigate the strategic behavior of distressed municipalities).}

3. The Role of Governance Restructuring

For municipalities facing structural debt crises, debt adjustment alone may not return a municipality to fiscal health. Chapter 9 allows a municipality to reduce its debt obligations, but this may not fix political, socioeconomic, and governmental problems that caused fiscal distress. It does little to impact the failure of governmental structures to control municipal debt accumulation.

As a solution, Professors Gillette and David Skeel propose that municipal bankruptcy procedures enable courts “to address the core political failures that have generated financial failure.”\footnote{Id. at 3.} As they argue, the “logic of the municipal bankruptcy process requires governance reform.”\footnote{Id. at 3.} In Chapter 11 proceedings courts routinely intervene in corporate governance to address shortcomings in corporate decision-making processes that brought the debtor to bankruptcy.\footnote{Id. at 11–12 (noting that bankruptcy court intervention has become a regular part of Chapter 11 cases).} Courts have authority to reform a board of directors. They may also transfer voting control to a trustee or other institution for a specified amount of time to produce a centralized decision-making system.\footnote{Id. at 12–19 (explaining the various forms of judicial intervention that enable corporate debtors to achieve governance reform under Chapter 11).}

The anatomy of municipal fiscal crises indicates that deficiencies in governance play a substantial role in generating distress. First, governmental structure may expose a municipality to budgetary risk. For example, municipalities with a larger number of voting districts tend to assume a larger, and therefore more expensive, government.\footnote{See Reza Baqir, Districting and Government Overspending, 110 J. POL. ECON. 1318 (2002) (finding that increased districting corresponds with greater government activity).} Evidence also suggests that governance structures that concentrate authority with a mayor, especially through veto power, may
curtail government spending. These general observations suggest that fragmentation, a term describing the degree to which a government insulates decisionmakers from internalizing the costs of budgetary choices, plays a role in undermining sound fiscal management. Second, governmental structure also impacts the types of decisionmaking practices a municipality's leaders favor, which in turn impacts fiscal conditions.

To address governance deficiencies, Professors Gillette and Skeel propose that bankruptcy courts impose restructuring requirements on municipalities as a condition of plan confirmation. A bankruptcy plan must remedy problems arising from fragmented governance; a restructuring must subject officials to budget constraints and inter-

111 Id. at 1321 (finding that cities that concentrate power in the city mayor "are able to break the relationship between districting and the size of government spending").
112 In New York City, for example, the Board of Estimate exposed the budget-making process to contending interests by dividing budget authority among the mayor, the comptroller, the City Council president, and each borough president who belonged to the Board of Estimate. Through lack of control, interest groups influenced municipal budget decisions. See Ester R. Fuchs, Mayors and Money: Fiscal Policy in New York and Chicago 214–25 (1992) (comparing New York City's fragmented budget-making process with Chicago's highly centralized process, which concentrated budget control with the mayor, thus minimizing the involvement of interest groups). After New York City resolved its fiscal crisis in 1978, the City's fragmented interest groups continued to encourage leaders to serve parochial interests. As one urban scholar argues, Mayor Ed Koch's coalition built its municipal development decisions around the politics of serving constituency interests, rather than economic needs. John Hull Mollenkopf, A Phoenix in the Ashes: The Rise and Fall of the Koch Coalition in New York City Politics 44–49 (1992). The Koch administration favored pro-growth development policy in the years following 1978, for example, granting tax abatements to incentivize increased commercial development. Id. at 146–47. The City also used extensive off-the-budget measures, for example, through administration of zoning laws, to expand intensified commercial development. Id. at 146. By the early 1980s, the administration also increased spending on public employment to strengthen its alliance with public employee unions. Id. at 131–39, 161. While the administration consistently ran a balanced budget, id. at 138, its allocational decisions demonstrate how the City's budget remained exposed to demands from fragmented political constituencies that exerted forceful claims on municipal resources.

113 See, e.g., Rebecca M. Hendrick, Managing the Fiscal Metropolis: The Financial Policies, Practices, and Health of Suburban Municipalities (107–08) (2011) (explaining that while managers may ignore or work around rules that "affect the tools that are chosen from the fiscal toolbox," the municipality's "approach to governance can make certain tools or fiscal decisions more desirable than others"); id. at 9 (concluding that the "form of government is useful in predicting and explaining governments' choice of tools from the fiscal toolbox" because the "professionalization" of decisions is greater for governments with a "council-manager form and a finance director" as compared to governments with a "council-mayor form and with no finance director").

114 Gillette & Skeel, supra note 106, at 1–4. See id. at 30–31 ("[I]f a city's governance dysfunctions are severe, a bankruptcy judge should not confirm a restructuring plan that leaves the governance crisis unaddressed.").
nalize the ramifications of decisions. The precise nature of any restructuring requirement will vary on a case-by-case basis. But restructuring requirements will generally involve reformulation of municipal budget-making procedures, organizational relationships, and auditing policies.\textsuperscript{115}

II. FEDERALISM

Proposals calling for bankruptcy courts to exercise greater authority over municipal functions offer cursory analysis of the constitutional implications inherent to the proposed reforms.\textsuperscript{116} Yet, since the 1990s, doctrines of federalism have assumed a more forceful position.

\textsuperscript{115} See \textit{id.} at 27 (describing proposed amendments to the bankruptcy laws that recognized the need for municipal bankruptcy to facilitate governance reform). During New York City's 1970s fiscal crisis, Congress began considering amendments to the federal bankruptcy code to allow large municipalities like New York City to enter debt adjustment proceedings. A bankruptcy judge, Joseph Patchan, recommended amendments to the bankruptcy code that would facilitate governance restructuring. Judge Patchan proposed that federal courts allow individuals outside a municipality's administration to have "standing in court" to call for the "restructuring of local government functions." \textit{id.} (citing testimony of Judge Patchan in hearings before the House Judiciary Committee, Subcommittee on Civil and Constitutional Rights). Judge Patchan elaborated:

\begin{quote}
It may be necessary in particular cases for certain city functions to be shouldered by new, State-formed authorities; accordingly, new State legislation may be required. For example, an analysis of city financing may indicate that operation of perhaps a sewer system, or a transit company, or the airport burdens the city both financially and managerially. Obviously, these functions must be continued by someone else, perhaps by State, county, or regional authorities. In order to set up these new functioning units, State law may be necessary.
\end{quote}

\textit{Bankr. Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the H. Comm. on the Judiciary, 94th Cong. 649 (1975) } (testimony of Joseph Patchan, J.). Because state law could play a substantial role in restructuring, he deemed it important "to bring into the mix of plan formulation and responsibility parties who can deliver the necessary State or county support to make this transfer of obligations and duties possible." \textit{id.} To achieve this, Judge Patchan recommended that a bankruptcy court have authority to "appoint a committee of relevant officials," as appropriate for a given case, which would have power to propose a plan for restructuring governmental functions, and back the plan they endorse. \textit{id.} at 650.

in the Supreme Court’s review of congressional action. The Court’s heightened sensitivity to the nation’s balance of federalism raises substantial obstacles to more assertive municipal bankruptcy procedures. For bankruptcy courts to assume greater influence over municipal taxation or governance during the course of Chapter 9 proceedings, the exertion of federal authority must comport with doctrines securing the sovereignty, as well as dignity, of states and their subdivisions. The Supreme Court’s theories on commandeering, coercion, and comity together form the key impediments to increased judicial authority. The following analysis asks whether doctrines of federalism allow for judge-imposed resource adjustments and governance restructuring. It proposes that the basis for increased judicial authority rests in the Supreme Court’s recent decisions that interpreted the Bankruptcy Clause as circumscribing state sovereign immunity.

A. Commandeering

During Detroit’s Chapter 9 proceedings, creditors objected to the City’s eligibility on the theory that Chapter 9 unconstitutionally impinged on state sovereignty. Specifically, the American Federation of State, County and Municipal Employees (“AFSCME”) argued that while in 1938 the Supreme Court upheld a federal municipal bankruptcy law in United States v. Bekins, the Supreme Court’s reassertion of constitutional federalism in the 1990s undermined Bekins. Two cases, New York v. United States and Printz v. United States, together signaled the emergence of a new federalism regime proscribing the commandeering of local government functions. Prior to Bekins, the Supreme Court rejected Congress’s first attempt at a municipal bankruptcy law, reasoning that the law subjected the financial obligations

118 304 U.S. 27 (1938). Two years prior to Bekins, the Court held a municipal bankruptcy law unconstitutional, reasoning that the law subjected states and their political subdivisions to interferences that diminished their sovereignty. Ashton v. Cameron Cnty. Water Imp. Dist. No. One, 298 U.S. 513, 530-31 (1936) (concluding that if the federal government were able to act under the bankruptcy clause at issue, it would “impose its will and impair state powers—pass laws inconsistent with the idea of sovereignty”).
119 See AFSCME’s Objection to Eligibility, supra note 117, ¶ 46 (asserting that a series of Supreme Court opinions underscored the importance of individual liberty and the inability of the federal government to exercise control over powers within the state’s sphere).
of states and their political subdivisions to federal interference, depriving local governments of the right to self-management.\textsuperscript{122} The Supreme Court's commandeering cases, AFSCME argued, signaled that such reasoning should again govern the question of whether municipal bankruptcy law fell within Congress's authority.\textsuperscript{123}

The Court first took up the issue of commandeering in \textit{New York v. United States}.\textsuperscript{124} The case presented the question of whether provisions of the federal Low-Level Radioactive Waste Policy Amendments Act of 1985\textsuperscript{125} amounted to an unconstitutional interference in the "proper division of authority between the Federal Government and the States."\textsuperscript{126} Congress enacted the law to assist states in disposing of low-level radioactive waste after two of the nation's three remaining sites for radioactive waste storage closed, leaving South Carolina alone to store waste produced throughout the United States.\textsuperscript{127} After an earlier law failed to resolve the crisis,\textsuperscript{128} Congress passed the 1986 law, which allowed states to enter compacts, and established three incentives to encourage the formation of compacts. The first incentive allowed states maintaining disposal sites to impose a surcharge on other states' waste, placing a portion of the surcharge into an escrow account that states could receive allocations from if they met certain objectives.\textsuperscript{129} The second incentive allowed states and regional compacts that maintained disposal sites to deny access to states that failed

\begin{itemize}
\item \textsuperscript{122} Ashton v. Cameron Cnty. Water Imp. Dist. No. 1, 298 U.S. 513, 530-31 (1936) ("[The bankruptcy code] undertakes to extend the supposed power of the federal government incident to bankruptcy over any embarrassed district which may apply to the court."). The \textit{Ashton} Court held that a constitutional bar on taxation of states and their political subdivisions also compelled a bar on federal bankruptcy legislation. \textit{Id.} at 532 (citing United States v. Butler, 297 U.S. 1 (1936)).
\item \textsuperscript{123} AFSCME's Objection to Eligibility, \textit{supra} note 117 ¶ 14-52 ("By outsourcing to the federal judiciary the problem of a state reorganizing its obligations, chapter 9 provides states with unconstitutional—as well as unnecessary, given \textit{Asbury Park}—cover from its citizens by confusing them as to whom to accord 'blame' and 'credit' for the results."). AFSCME reasoned that states have authority to manage bankruptcy internally because the Court in \textit{Faisonite Iron & Steel Co. v. City of Asbury Park}, 316 U.S. 502 (1942), held that under certain circumstances, a state may adjust its obligations to creditors without violating the Contracts Clause of the Constitution, U.S. CONST. art. I, § 10, cl. 1. \textit{See AFSCME's Objection to Eligibility}, \textit{supra} note 117 ¶ 45.
\item \textsuperscript{124} 505 U.S. 144 (1992).
\item \textsuperscript{125} Pub. L. 99-240 (1986).
\item \textsuperscript{126} \textit{New York}, 505 U.S. at 149.
\item \textsuperscript{127} \textit{Id.} at 150.
\item \textsuperscript{128} Pub. L. 96-573 (1980). The law failed to resolve the crisis because it contained no penalties for states that declined to participate. Five years following the law's enactment, only three regional compacts had taken form. \textit{New York}, 505 U.S. at 151.
\item \textsuperscript{129} \textit{Id.} at 171-73.
\end{itemize}
to meet federal deadlines. The Court upheld these provisions as constitutional under Congress’s spending and commerce powers.

The Court however struck down the third incentive, called the “take title provision.” The incentive provided that for any low-level radioactive waste that a state cannot dispose, the state must, at the request of any waste generator, take title to the waste. The state would then become liable for any damages arising from failure to take possession of the waste. As an alternative to taking ownership over waste, a state could choose to implement regulations according to requirements Congress established. As Justice Sandra Day O’Connor wrote for the majority, each option standing alone exceeded Congress’s legislative authority. Under the doctrine Justice O’Connor developed throughout her opinion, Congress may not “require the States to govern according to Congress’ instructions.” Accordingly the Constitution did not allow Congress to instruct a state to take title to waste. Nor did it allow Congress to require state governments to enact regulations. Congress also exceeded the Constitution’s bounds by requiring a state to choose between the two unconstitutional provisions.

Justice O’Connor developed two bases for limiting congressional authority. First, she looked to the reasoning that motivated delegates at the 1787 Philadelphia Convention to choose the Constitution over alternative models. Justice O’Connor noted that the Convention entertained two models of federal government, the Virginia Plan and the New Jersey Plan. The Virginia Plan proposed giving Congress legislative authority over individuals; it would not use states as intermediaries. On the other hand, the New Jersey Plan would require states to approve Congress’s legislative enactments. Delegates objected to the New Jersey Plan. They feared it would require the federal government to force states into implementing legislation. Virginia delegate Edmund Randolph cautioned that the national government offered a superior model because coercion over states would prove

130 Id. at 173–74.
131 Id.
132 Id. at 177.
133 Id. at 153.
134 Id.
135 Id. at 174–75.
136 Id. at 175–76.
137 Id. at 162.
138 Id. at 176.
139 Id.
140 Id. at 164.
“impracticable, expensive, [and] cruel to individuals.” For this reason, Randolph favored national legislation. After the Convention decided in favor of the Virginia Plan, delegates faced the task of convincing state ratifying conventions of the Virginia Plan’s merits. They assured their conventions that the proposed Constitution made no attempt to “coerce sovereign bodies, states, in their political capacity”; the Constitution’s coercive power “single[d] out the . . . individual.” Justice O’Connor read this history to suggest that by “explicitly” opting for a Constitution that authorizes Congress to regulate individuals, the Framers intended to bar the regulation of states.

Second, Justice O’Connor considered the vital role that political accountability plays in a democratic system of government. Congress may influence state activity and legislative decisions through attaching requirements to the provision of federal funds. A state may agree to receive the funds and the requirements attached, or it may not. Voters may voice their disapproval of requirements attached to a spending program by replacing their representatives with individuals who similarly disfavor the federal requirements. But where a state has no choice but to follow Congress’s orders, state officials may “bear the brunt of public disapproval, while the federal officials who devised the regulatory program may remain insulated from the electoral ramifications of their decision.” To maintain a viable system of political accountability, Justice O’Connor reasoned, states must retain authority to regulate according to the will of the local electorate.

In Printz v. United States, the Court extended the reasoning of New York v. United States to bar Congress from compelling the executive functions, rather than legislative acts, of state and municipal officers. The United States in Printz argued that the Brady Handgun
Violence Prevention Act,\textsuperscript{151} which required chief law enforcement officers to check the backgrounds of prospective handgun purchasers, should fall outside New York's holding because it directed the actions of state and local enforcement officers, not state legislatures.\textsuperscript{152} Justice Antonin Scalia, writing for the majority, rejected this proposition. A law that directs the action of local executive officials "leaves no 'policymaking' discretion with the States."\textsuperscript{153} Thus, he reasoned, congressional action requiring states to implement policy in specified arenas, may in fact intrude less on state autonomy.\textsuperscript{154}

Printz expanded the reasoning undergirding commandeering doctrine. Justice Scalia's analysis drew on two structural features of the Constitution. First, the Constitution's establishment of "dual sovereignty"\textsuperscript{155} through the division of state and federal spheres aimed to ensure "structural protections of liberty."\textsuperscript{156} A federal order for a state official to perform a function would erode this division. Second, commandeering of local governments' executive officials would undermine "the separation and equilibration of powers between the three branches of the Federal Government itself."\textsuperscript{157} It would do so by requiring local officials, rather than the President, to execute federal law, effectively bypassing the executive branch and reducing the President's power.\textsuperscript{158}

Two elements of Justice O'Connor's discussion in New York v. United States have particular significance for municipal bankruptcy law. First, Justice O'Connor's analysis raises the issue of whether a municipality may waive its right to legislative autonomy by volunteering to participate in bankruptcy proceedings. State respondents who intervened to defend the law explained that officials from the State of New York supported the law's enactment.\textsuperscript{159} If state officials consent-

\textsuperscript{151} The law provided that a chief law enforcement officer must "make a reasonable effort to ascertain within 5 business days whether receipt or possession [of a handgun] would be in violation of the law, including research in whatever State and local recordkeeping systems are available and in a national system designated by the Attorney General." Brady Handgun Violence Prevention Act, Pub. L. No. 103-159, § 2, 107 Stat. 1536 (1993) (codified at 18 U.S.C. § 922) (quoted in Printz, 521 U.S. at 933) (alteration in brackets provided by the Court).

\textsuperscript{152} Id. at 927.

\textsuperscript{153} Id. at 928 (quoting Judge Joseph Sneed's expressed fear of reducing states to "puppets of a ventriloquist Congress" in Brown v. EPA, 521 F.2d 827, 839 (9th Cir. 1975)).

\textsuperscript{154} Printz, 521 U.S. at 928

\textsuperscript{155} Id. at 918 (quoting Gregory v. Ashcroft, 501 U.S. 452, 457 (1991)).

\textsuperscript{156} Printz, 521 U.S. at 921.

\textsuperscript{157} Id. at 922.

\textsuperscript{158} Id.

ed to the statute’s enactment, they argued, then it should follow that the take-title provision did not infringe on state sovereignty.\(^\text{160}\) Justice O’Connor’s response clarified that “[t]he Constitution does not protect the sovereignty of States for the benefit of the States,” but rather for “the protection of individuals.”\(^\text{161}\) The consent of state officials cannot authorize Congress to act beyond its authority under the Constitution. Justice O’Connor concluded: “The constitutional authority of Congress cannot be expanded by the ‘consent’ of the governmental unit whose domain is thereby narrowed, whether that unit is the Executive Branch or the States.”\(^\text{162}\)

This language raises problems for municipal bankruptcy. Congress amended the bankruptcy code in 1994 to require that state law “specifically authorize” a municipality filing under Chapter 9 “to be a debtor.”\(^\text{163}\) But Justice O’Connor’s language suggests that this provision will not solve constitutional issues. Additionally, while a municipality’s decision to file under Chapter 9 may amount to consent, a court could nonetheless deem unconstitutional federal actions requiring resource adjustments or changes in governance structure.

Second, Justice O’Connor’s defense of commandeering doctrine reveals its limits. Her opinion drew a distinction between congressional and judicial authority, indicating that bankruptcy judges could compel states and their subdivisions in ways that Congress cannot.\(^\text{164}\) To defend the take-title provision, the United States noted that federal courts exercised authority “to order state officials to comply with federal law.”\(^\text{165}\) In rejecting the United States’s theory, Justice O’Connor observed that the “text of the Constitution plainly confers this authority on the federal courts,” whereas the text lends no such authority to Congress.\(^\text{166}\) While it is not clear what limitations Justice O’Connor envisioned applying to judicial authority, her reasoning

\(^\text{160}\) Id.
\(^\text{161}\) Id.
\(^\text{164}\) New York, 505 U.S. at 179.
\(^\text{165}\) Id. (referencing the United States’ citation to Cooper v. Aaron, 358 U.S. 1, 18–19 (1958); Brown v. Board of Education, 349 U.S. 294 (1955); and Ex parte Young, 209 U.S. 123 (1908), among other cases).
\(^\text{166}\) New York, 505 U.S. at 179 (citing U.S. CONST. art. III, § 2). Justice O’Connor elaborated that because “the Supremacy Clause makes federal law paramount over the contrary positions of state officials,” the enforcement authority of federal courts “presumes some authority to order state officials to comply.” Id. (citing Puerto Rico v. Branstad, 483 U.S. 219, 227–28 (1987)).
suggests that coercive action arising from the exercise of judicial discretion may survive a commandeering challenge. The exercise of judicial discretion in bankruptcy proceedings, however, does not entail the enforcement of clear federal norms, as is the case with school desegregation orders or other actions resulting in injunctive relief that compels the operations of local governments.\footnote{167} A Chapter 9 debtor has not necessarily violated federal law, and thus the Supremacy Clause\footnote{168} may not help ensure broader authority for bankruptcy judges.

Most importantly, the theoretical justifications for the Court’s commandeering principles do not compel federal restraint in the context of municipal bankruptcy. As the opinions of Justices O’Connor and Scalia suggest, commandeering doctrine derives from the Court’s concern for preserving three features of a federalist system: local legislative autonomy, political accountability of federal representatives, and the separation of federal branches of government. The intervention of federal bankruptcy courts does not implicate these three concerns.

First, judicial intervention preserves legislative autonomy of states and municipalities. It would compel local governments only in narrow contexts, namely where a government faces insolvency. A bankruptcy code that contemplates judicially-compelled resource adjustments or governance restructuring therefore does not have the effect of broadly subverting local autonomy. Additionally, a bankruptcy judge may require legislative action without enumerating the exact features of the legislation, allowing a local government to decide how precisely to achieve necessary reforms.

Second, judicial intervention preserves political accountability. Local officials may retain discretion in how they conform with a judge’s order to effect reforms. Local officials, not federal officials, remain ultimately responsible for the ramifications of an enactment. Furthermore, the decision to file under Chapter 9 rests with local officials. Thus, local taxpayers may properly assign blame for the consequences of a filing to these officials.


\footnote{168} U.S. CONST. art. VI, cl. 2 (“This Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding.”).
Third, judicial intervention respects the Constitution’s allocation of power among the legislative, executive, and judicial branches. In *Printz*, Congress acted directly on local officials, thereby circumventing checks that the executive branch places on legislative authority. Judicial intervention in a bankruptcy proceeding, on the other hand, merely supplants the executive with the judiciary. A bankruptcy judge has no power to act without authorization from Congress. Nor does Congress receive independent power to compel local governments through Chapter 9. Congress may authorize authority to compel government action. But a bankruptcy judge retains discretion in evaluating how to use power that Congress delegates.

B. Coercion

By conditioning eligibility or approval of an adjustment plan on requirements that impinge on a municipality’s self-governance, a bankruptcy judge may raise the threat of undue influence. Bankruptcy courts may impose resource adjustments or changes in governance by denying a debtor Chapter 9 eligibility or rejecting adjustment plans based on the debtor’s failure to meet judge-imposed requirements. In this scenario, a debtor would amend the plan to meet the judge’s request as a condition for receiving confirmation, or implement tax increase as a condition of receiving eligibility. This judicial intervention runs the risk of falling under the rubric of coercion.

Congress may direct states and their subdivisions to legislate, or require executive officers of local governments to perform specified duties, by attaching stipulations to federal benefits. The Supreme Court has placed four limitations on this authority. First, the stipulation must serve the general welfare. Second, it must bear a relation to the federal interest in the program. Third, Congress must make

170 Helvering v. Davis, 301 U.S. 619, 640 (1937) (leaving Congress discretion to determine what constitutes the “general welfare”); see also Buckley v. Valeo, 424 U.S. 1, 91 (1976) (deferring to Congress’s judgment in determining what means are “necessary and proper” to promote the general welfare, and stating that “[w]hether the chosen means appear ‘bad,’ ‘unwise,’ or ‘unworkable’ to us is irrelevant”).
171 Massachusetts v. United States, 435 U.S. 444, 461 (1978) (“[T]he Federal Government may impose appropriate conditions on the use of federal property or privileges and may require that state instrumentalities comply with conditions that are reasonably related to the federal interest in particular national projects or programs.”); see also Ivanhoe Irrigation Dist. v. McCracken, 357 U.S. 275, 295 (1958) (“[T]he Federal Government may establish and impose reasonable conditions relevant to federal interest in the project . . . .”).
the stipulation an explicit condition such that a state may receive the benefit knowing that obligations come with it. The question, then, is whether Congress may use bankruptcy courts to impose resource adjustments or governance restructuring as a condition on the benefit of gaining access to federal bankruptcy protections.

The Supreme Court’s decision in National Federation of Independent Businesses v. Sibelius, which struck down Congress’s expansion of Medicaid, potentially impedes such intervention. The Medicaid expansion provided states the choice of (1) increasing Medicaid eligibility pursuant to federal regulations or (2) forfeiting federal aid that compensated 50-83% of state Medicaid spending, which composed over twenty percent of the average state budget. A state, by resisting the Medicaid expansion, would face a loss exceeding 10% of its budget.

Such penalty, Chief Justice John Roberts argued, left states with “no real option but to acquiesce in the Medicaid expansion.” States must retain a “genuine choice” of accepting an offer.

The issue, then, is whether a municipality facing insolvency may voluntarily file under Chapter 9, thereby subjecting itself to federal power to compel. As Gillette and Skeel point out, by incorporating governance reform into Chapter 9 proceedings, courts could help municipalities to effect politically unfavorable changes. Such reform would be possible precisely because the urgency of resolving fiscal distress may override dissent. Fiscal distress may prove so pressing that a municipality has no other choice but to avail itself of federal bankruptcy authority.

This does not appear to be a winning argument. If a bankruptcy judge conditions Chapter 9 confirmation on acceptance of an affirmative mandate, the municipality has a choice. It may accept the mandate, or suffer fiscal distress without federal aid. A municipality, even when facing crippling debt, has options that will allow it to weather a debt crisis without the benefit of Chapter 9. Municipal

---

173 Id. ("The legitimacy of Congress’ power to legislate under the spending power [] rests on whether the State voluntarily and knowingly accepts the terms of the 'contract.'").
175 See id. at 2566.
176 Id. at 2605.
177 Id.
178 Id. at 2608.
179 See Gillette & Skeel, supra note 106, at 36 ("Bankruptcy may thus create political openings that did not previously exist.").
decisionmakers may petition their state government for a bailout. Alternatively, they may intentionally default on obligations to resolve a budget deficit. Because a Chapter 9 filing amounts to a voluntary decision, affirmative conditions attached to the benefits of Chapter 9 likely fall within the permissions of South Dakota v. Dole.

C. Comity and Abstention in Bankruptcy Courts

Resource adjustments, imposed in the form of a tax increase, implicate the Supreme Court’s broad concern for the autonomy of local governments’ powers of taxation. The Tax Injunction Act (“TIA”) reflects this principle. It provides that “[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.” States receive protection far broader than the TIA; rather than regarding it as a freestanding piece of legislation, the Court regards the TIA as reflecting deeper principles that federal courts must uphold. The law reflects, in Justice Clarence Thomas’s words, “a partial codification of the federal reluctance to interfere with state taxation.” The Court’s “strong background presumption against interference with state taxation” stands to preserve the ability of states to raise their own revenue. Yet, the Court in Levin v. Commerce Energy, Inc. refused to extend its jurisdiction to a complaint of discriminatory state taxation where the plaintiff sought a remedy framed as a tax increase. Such a remedy would not impair state revenue collection; rather, it would increase state income.

The Court, applying “comity doctrine,” nonetheless decided that federal courts must allow Ohio courts to determine how to remedy an unequal tax. Comity, as a principle guiding federal equity jurisdi-

---

180 See, e.g., supra text accompanying notes 104-105. Before opting to file under Chapter 9, the City of Stockton intentionally defaulted on bonds to cover a deficit.
181 See In re City of Stockton, Cal., 493 B.R. 772 (Bankr. E.D. Cal. 2013) and supra text accompanying note 41.
185 See id. at 586 ("It is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments, and it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible.") (quoting Dows v. Chicago, 78 U.S. 108, 110 (1871)).
186 Levin v. Commerce Energy, Inc., 560 U.S. 413 (2010). Note that plaintiff could not seek an injunction to obtain tax relief; such a request would amount to restraint or suspension of tax assessment that fell within the TIA’s prohibition on federal jurisdiction. Id. at 429.
tion, ensures that the federal government does not interfere in legitimate state activity in its effort to secure federal rights and interests. As Justice Ruth Bader Ginsburg wrote, a judicial intervention that altered a tax code to ensure equal treatment would constitute "the very interference in state taxation the comity doctrine aims to avoid." Federal courts must allow the state, through its courts or legislature, to administer its tax laws.

Comity doctrine raises a barrier on federal equity jurisdiction. It is not clear what role this doctrine might play in a bankruptcy court. Under 28 U.S.C. § 1334, federal district courts have original and exclusive jurisdiction of all cases arising under Title 11, the federal bankruptcy code. The jurisdictional statute provides that "nothing in [Section 1334] prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding under title 11 or arising in or related to a case under title 11." Congress therefore left abstention within the bankruptcy court's power.

---

187 Id. at 431. See also Taylor v. Secor, 92 U.S. 575, 615 (1875) ("[T]he levy of taxes is not a judicial function. Its exercise, by the constitutions of all the States, and by the theory of our English origin, is exclusively legislative."). The Court in Taylor emphasized that injunctions against collection of state taxes should not issue without a "clear case" for equitable relief. Id. Municipal, county, and town taxation raised fewer concerns for the Court, which noted that judicial control over political subdivisions, or "corporations," would not give rise to the "evils" that accompany jurisdiction over state revenue. Id. But see Tomaiolo v. Transamerica Corp., 131 F. Supp. 2d 280, 291 (D.R.I. 2001), aff'd as modified sub nom. Tomaiolo v. Mallinoff, 281 F.3d 1 (1st Cir. 2002) (holding that comity doctrine barred the court from granting injunctive relief against municipal taxation in action under 42 U.S.C. 1983); Fair Assessment in Real Estate Ass'n v. McNary, 454 U.S. 100 (1981) (denying relief because comity barred injunction impacting county taxation).

188 Levin, 560 U.S. at 429.

189 Id. See also Davis v. Mich. Dep't of Treasury, 489 U.S. 803, 818 (1989) (awarding a tax refund to plaintiff who suffered discriminatory taxation). The Davis court declined to award injunctive relief barring future discriminatory taxation. Id. Relief would have consisted of either (1) eliminating an exemption for retired state and local government employees or (2) extending the exemption to retired federal employees. The court found Michigan courts better positioned to determine how best to achieve equal treatment. Id.

190 See Younger v. Harris, 401 U.S. 37, 44 (1971) (holding federal equity jurisdiction in a 42 U.S.C. 1983 action for injunctive relief improper when a state has initiated a criminal prosecution). The Younger court explained that the "notion of 'comity'" provides a "vital" underlying "reason for restraining courts of equity from interfering with criminal prosecutions . . . ." Comity entails "a proper respect for state functions, a recognition of the fact that the entire country is made up of a Union of separate state governments, and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways."


Comity principles also raise non-jurisdictional barriers to federal action. In *Missouri v. Jenkins*, a district court imposed a tax increase on the Kansas City, Missouri, School District ("KCMSD") in 1987 to ensure sufficient funding for a school desegregation plan. Specifically, the district court ordered the KCMSD to raise its property tax levy from $2.05 to $4.00 for every $100 of a property's assessed value. KCMSD appealed the order to the Supreme Court, which struck down the tax increase for violating the "principles of comity" that govern a federal court's "equitable discretion." In exercising equitable power, Justice Byron White wrote, a court must respect the "integrity and function" of local governments. The willingness of a local government to remedy a violation of federal law pushed the Court to regard the mandatory tax increase as exceedingly intrusive. Additionally, the district court had less intrusive means available for ensuring adequate funding. As the court of appeals observed, the district court could have "authorized or required KCMSD to levy property taxes" and have "enjoined the operation of state laws that would have prevented KCMSD from exercising this power." The district court's order violated principles of comity specifically because it left no discretion to local institutions. In proceedings below, the court of appeals held that the district court should "authorize KCMSD to submit a levy to the state tax collection authorities." The Court upheld the court of appeals, distinguishing the proposed requirement on its preservation of local government institutions. It directed institutions to devise and implement a remedy rather than prescribing the exact remedy. Since the 1960s, the Supreme Court has upheld district court orders requiring local governments to issue

---

193 In *National Private Truck Council v. Oklahoma Tax Commission*, 515 U.S. 582 (1995) and *Levin v. Commerce Energy, Inc.*, 560 U.S. 413 (2010), comity acted as a bar on federal jurisdiction over plaintiffs' petition for relief. In *Levin*, the Court also noted that while amendments to the TIA dropped language referring to the statute as "jurisdictional," the statute remained jurisdictional. *Levin*, 560 U.S. at 429 n.10 (stating that while "[p]revious language restricting the district courts' 'jurisdiction' was removed in the 1948 revision of Title 28," the Court "continued to regard the Act as jurisdictional").


195 *Id.* at 41–42.

196 *Id.* at 50.

197 *Id.* at 51.

198 *Id.*

199 *Id.*

200 *Id.* at 52 (citing *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 42 (1973) for the proposition that courts must respect a local government's efforts to resolve constitutional violations).

201 *Id.*

202 *Id.* at 51
tax increases in other desegregation cases. District courts retain expansive power to compel governmental actors in desegregation cases because the Tenth Amendment imposes no restraint on federal authority. The Fourteenth Amendment curtails the power of states.

Bankruptcy courts cannot claim Fourteenth Amendment authority to justify derogation of municipal sovereignty. But bankruptcy courts need not invoke the Fourteenth Amendment to claim such authority. First, the Supreme Court, from the 1860s through the early twentieth century, issued writs of mandamus to require that local officials levy taxes in fulfillment of debt obligations. Second, and most importantly, as the following analysis proposes, principles of federalism do not hold the same relationship with the Bankruptcy Clause as they do with other positive allocations of authority the Constitution lends to Congress. As the following analysis suggests, comity, along with other forms of federalism, may have limited application to municipal bankruptcy proceedings.

D. Theorizing a Bankruptcy Clause Carve-Out

Chapter 9’s constitutional authority derives from the Bankruptcy Clause of Article I, Section 8. Contours of federalism have largely formed in the context of legislation Congress enacted pursuant to its spending power and authority to regulate commerce. Because the Bankruptcy Clause creates distinct legislative authority, doctrines of federalism do not necessarily apply with equivalent force in the context of bankruptcy. In a recent pair of decisions, the Supreme Court addressed the capacity of the Eleventh Amendment to immunize

203 See, e.g., Griffin v. Cnty. Sch. Bd. of Prince Edward Cnty., 377 U.S. 218, 233 (1964) (holding that the district court had authority to require local officials to “exercise the power that is theirs to levy taxes to raise funds adequate to reopen, operate, and maintain without racial discrimination a public school system in Prince Edward County like that operated in other counties in Virginia”).

204 Missouri v. Jenkins, 495 U.S. 33, 55–56 (citing cases); see also Bylinski v. City of Allen Park, 8 F. Supp. 2d 965, 970 (E.D. Mich. 1998), aff’d, 169 F.3d 1001 (6th Cir. 1999) (ordering a municipality to increase taxes to fund cleanup to remedy violations of the Environmental Protection Act).

205 See U.S. CONST. art. I, § 8, cl. 4 (providing that Congress shall have Power to “establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States”).

states from lawsuits arising out of Chapter 7 and Chapter 11 bankruptcy proceedings.\textsuperscript{207} The Court’s reasoning on the relationship between the bankruptcy code and the Eleventh Amendment suggests that doctrines of federalism have limited scope as applied to Chapter 9.

In \textit{Central Virginia Community College v. Katz}, the Supreme Court held that sovereign immunity posed no bar to a proceeding a bankruptcy trustee brought against state agencies.\textsuperscript{208} Since the end of the nineteenth century, the Court has interpreted the Eleventh Amendment to immunize states from actions seeking retrospective relief brought by citizens of other states and their own citizens.\textsuperscript{209} In \textit{Katz}, the Court observed that

The history of the Bankruptcy Clause, the reasons it was inserted in the Constitution, and the legislation both proposed and enacted under its auspices immediately following ratification of the Constitution demonstrate that it was intended not just as a grant of legislative authority to Congress, but also to authorize limited subordination of state sovereign immunity in the bankruptcy arena.\textsuperscript{210} The Court’s reasoning rested on the power courts historically held when adjudicating bankruptcies.

Before the American Revolution, and through the early nineteenth century, American colonies and states incarcerated debtors in decrepit jails, called “debtors prisons.” The practice served to express moral condemnation of debtors.\textsuperscript{211} In 1800, Congress specifically authorized federal courts to “issue a writ of habeas corpus to release a debtor from state prison.”\textsuperscript{212} Congress enacted the bankruptcy statute in the midst of heated debate on the immunity of states following \textit{Chisholm v. Georgia}, which in 1793 held that federal courts had Article III jurisdiction to hear suits brought by citizens against their own states.\textsuperscript{213} The states ratified the Eleventh Amendment five years after \textit{Chisholm}. During this period, as state sovereignty was widely debated, Congress enacted the Bankruptcy Act of 1800. Despite authorizing writs of habeas corpus compelling states to release debtors from state

\begin{itemize}
\item \textsuperscript{208} 546 U.S. 356 (2006).
\item \textsuperscript{209} \textit{See} Hans v. Louisiana, 134 U.S. 1 (1890).
\item \textsuperscript{210} \textit{Katz}, 546 U.S. at 362–63.
\item \textsuperscript{212} \textit{Katz}, 546 U.S. at 374.
\item \textsuperscript{213} 2 U.S. 419, 420 (1793).
\end{itemize}
prisons, legislative records revealed no concern that this power improperly subjected states to suit.\textsuperscript{214}

For the Court, the Bankruptcy Act signaled an understanding that the Bankruptcy Clause subordinated state sovereignty. By ratifying the Bankruptcy Clause, states "acquiesced in a subordination of whatever sovereign immunity they might otherwise have asserted in proceedings necessary to effectuate the \textit{in rem} jurisdiction of the bankruptcy courts."\textsuperscript{215} As the Court noted, "States agreed in the plan of the Convention not to assert any sovereign immunity defense they might have had in proceedings brought pursuant to 'Laws on the subject of Bankruptcies.'"\textsuperscript{216}

Early bankruptcy proceedings, by authorizing writs of habeas corpus ordering the release of debtors from prison, subordinated state power. Federal courts received authority to compel state officials. Significantly, the Bankruptcy Act of 1800 preceded the Supreme Court's jurisprudence drawing distinctions between prospective and retrospective relief.\textsuperscript{217} Abrogation of immunity thus implicated a state's ability to be subject to injunctive relief, as well as liability for damages or other forms of retrospective relief. While ratification of the Bankruptcy Clause exposed states to proceedings requiring disbursement to a creditor, it also restricted the scope of a state's immunity to jurisdiction to compel its officers.\textsuperscript{218} Federal supremacy interests may not justify federal intrusion into the essential functions of states and their political subdivisions.\textsuperscript{219} However, ratification of the Bankruptcy Clause enabled this jurisdiction.

A theory of broad subordination hinges on two questions. First, it depends on whether \textit{Katz} has ramifications beyond the Eleventh Amendment. Second, it depends on whether \textit{Katz} applies to municipal bankruptcy proceedings.

1. \textit{Katz} Should Apply to Chapter 9 Proceedings

In adversarial proceedings arising from the City of San Bernardino's bankruptcy, the State of California raised the question of wheth-

\begin{thebibliography}{9}
\bibitem{214} \textit{Katz}, 546 U.S. at 374--75 (citing \textit{Hans}, 134 U.S. 1).
\bibitem{215} \textit{Id}. at 378.
\bibitem{216} \textit{Id}. at 377.
\bibitem{217} \textit{See Ex parte Young}, 209 U.S. 123 (1908).
\bibitem{218} \textit{See Katz}, 546 U.S. at 378 n.14 ("The \textit{Ex parte Young} doctrine was not finally settled until over a century after the framing and the enactment of the first bankruptcy statute.").
\bibitem{219} \textit{See}, e.g., \textit{Shelby Cnty., Ala. v. Holder}, 133 S. Ct. 2612, 2623 (2013) ("Outside the strictures of the Supremacy Clause, States retain broad autonomy in structuring their governments and pursuing legislative objectives.").
\end{thebibliography}
er Katz extends to municipal bankruptcy. On appeal from the Bankruptcy Court’s order sustaining the City’s automatic stay against state claims, the District Court for the Central District of California endeavored to limit the reach of the Supreme Court’s holding in Katz. Most significantly, the Court held Katz inapplicable to Chapter 9 proceedings.

The City of San Bernardino, after filing for bankruptcy in 2012, entered proceedings to compel the State of California to transfer tax revenue that it withheld. In 1945 the California legislature passed a law creating Community Redevelopment Agencies ("CRAs"), which it tasked with "remediat[ing] urban decay." In 1951, the legislature authorized CRAs to use tax increment financing to fund redevelopment plans, a practice through which the CRA received a portion of property tax revenue that a designated district produces in excess of an assessed base value. Before the City of San Bernardino entered bankruptcy, the legislature passed a bill that dissolved California’s CRAs, which at the time received 12% of the state’s property tax revenue, and established agencies to “wind down” the CRAs’ affairs. San Bernardino created a successor agency in 2012.

The bill that dissolved CRAs required the successor agencies to remit CRA funds to the county auditor-controller. The City of San Bernardino, however, attempted to use its Chapter 9 proceedings to bar the State’s claim to its CRA’s funds. In 2013, the California Department of Finance (“DOF”) ordered the San Bernardino successor agency to remit $15 million in transfers. In response, the City initiated proceedings based on its Chapter 9 filing to obstruct the State. The City filed a complaint seeking declaratory relief establishing the scope of its automatic stay as it applied to the withheld tax revenues, as well as an injunction barring the State from withholding the taxes.

The State argued in defense that the Tenth and Eleventh Amendments barred the City’s claims. The bankruptcy court sided

---

220 See supra notes 43–47 and accompanying text for background to the proceedings.
222 Id. at *1.
224 Id. at 591.
225 In re City of San Bernardino, 2014 WL 2511096, at *1.
226 Id. at *2.
227 Id.
228 Id.
229 Id.
with the City. Citing *Katz*, Judge Meredith Jury reasoned the automatic stay was appropriate because the Eleventh Amendment presented no bar to adversarial proceedings arising from the bankruptcy filing. On appeal, the District Court for the Central District of California reversed the bankruptcy court’s denial of the State’s Eleventh Amendment immunity. The district court distinguished San Bernardino’s adversarial proceedings from *Hood* and *Katz*, which involved private debtors, not a municipality. This difference mattered, the court reasoned, because a municipal bankruptcy implicated “a state’s sovereignty and Tenth Amendment rights to a greater degree than other bankruptcy contexts because of the special relationship between a state and its municipalities.”

Additionally, the court adopted a narrow reading of *Katz*. Only private debtors could file for bankruptcy when the Framers introduced the Bankruptcy Clause to the Constitution. Because municipal bankruptcy did not exist at the time of framing, with “no hint that these proceedings would one day be available to municipalities,” the Framers “could not have contemplated the impact that waiving their sovereign immunity would have” in the context of municipal bankruptcy. The court conceded that, according to *Katz*, the Framers contemplated the Bankruptcy Clause would subordinate state immunity under future bankruptcy laws that Congress enacts, not just those that existed at the time of framing. Yet, municipal bankruptcy threatened a “powerful interference with state sovereignty.” The Supreme Court aimed to avoid interference in a state’s control over its fiscal affairs when it upheld the nation’s first municipal bankruptcy law in *United States v. Bekins*. The district court therefore declined

---


231 See Transcript of Proceedings before the Honorable Meredith Jury at 19-21, *In re City of San Bernardino*, No. 6:12-BK-28006-MJ (Bankr. C.D. Cal. Aug. 22, 2013) (“[E]njoining the State is an in persona[m] action, but it supports or protects the [res], which is the property of the City, and therefore it is not all that different from the analysis that the Supreme Court presented in the *Katz* case . . . .”).


233 Id. at *12.

234 Id.

235 Id. at *13.

236 Id.

237 Id. at *13.

238 Id.

239 304 U.S. 27, 51 (1938).
to "[b]landly extending the historical analysis applied in Katz" to municipal proceedings.\textsuperscript{240}

The court distinguished the proceeding from that in Hood. San Bernardino’s property had a weaker "link" to the property disputed in the adversarial proceedings.\textsuperscript{241} Hood and Katz, the court noted, involved property over which bankruptcy courts exerted in rem jurisdiction.\textsuperscript{242} The disputed property in San Bernardino’s proceedings did not precisely belong to the City, but rather to its CRA successor agency.\textsuperscript{243} The City and the successor agency were not the same entity. The DOF’s threat to withhold taxes from the successor agency did not amount to a direct threat to the City’s revenue.\textsuperscript{244} The bankruptcy court did not have exclusive in rem jurisdiction over the disputed property.\textsuperscript{245} As the district court noted, the Supreme Court justified abrogation of sovereign immunity in Hood based on the theory that a bankruptcy court’s in rem jurisdiction derived from the “debtor and his estate,” not from “his creditors.”\textsuperscript{246} A bankruptcy court’s discharge order thus binds a state “no less than other creditors.”\textsuperscript{247} Under the reasoning of Hood, a strictly in rem proceeding did not implicate a state’s sovereign immunity.\textsuperscript{248} Because that was not the case in San Bernardino’s proceeding, the City’s contention implicated the State’s claim to sovereign immunity.\textsuperscript{249}

The district court failed to take seriously the City’s arguments. The City contended that, according to Katz, the Bankruptcy Clause subordinated immunity in proceedings that are “necessary to effectuate the in rem jurisdiction of the bankruptcy courts.”\textsuperscript{250} The district

\textsuperscript{240} In re City of San Bernardino, 2014 WL 2511096, at *13.
\textsuperscript{241} Id.
\textsuperscript{242} Id.
\textsuperscript{243} Id. at *14. Note that the district court upheld the Bankruptcy Court’s jurisdiction over the DOF’s withholding of tax revenue from a non-debtor, the successor agency. The court’s jurisdiction extended to actions involving third parties. 28 U.S.C. § 1334(b) authorizes “original but not exclusive jurisdiction” over all civil proceedings arising “in or related to cases under title 11.” Id. at *6. The DOF’s proceeding against the successor agency “could impact the administration of the City’s bankruptcy.” Id. at *7. The DOF’s proceedings against the successor agency would potentially damage the City by depriving the successor agency of funds. Id.
\textsuperscript{244} Id.
\textsuperscript{245} Id. at *14.
\textsuperscript{246} Id. at *13.
\textsuperscript{247} Id. (quoting Tenn. Student Assistance Corp. v. Hood, 541 U.S. 440, 448 (2004)).
\textsuperscript{248} Hood, 541 U.S. at 451.
\textsuperscript{249} In re City of San Bernardino, 2014 WL 2511096, at *14.
court, in declining to extend Katz's historical theory to Chapter 9 proceedings, relied on cursory analysis of the unique ways municipal bankruptcy shapes state fiscal management. The court argued that unlike an individual, even one whose bankruptcy implicates property interests of the state, a municipality retains no "privileges or immunities" that it may "invoke in opposition to the will of its creator," which is the state.251 A state may withhold the municipality's powers as it wishes.252

The court, however, did not make clear why a municipality's lack of privileges and immunities should render a municipal bankruptcy any more intrusive than a private bankruptcy. First, a municipality has no right to file under Chapter 9 without the state's consent.253 Second, while a state's subdivision may have no rights apart from those the state confers, the Supreme Court has sustained federal jurisdiction over conflicts between states and their instrumentalities.254 When a state consents to allow a municipality to file under Chapter 9, it confers on the municipality the rights and protections ensured under the federal bankruptcy code.255

2. Katz Has Implications Beyond the Eleventh Amendment

A broad reading of federal bankruptcy power remains susceptible to two additional critiques. First, Katz addressed only the nature of a state's sovereign immunity, not broader issues of federalism, especially as applied to local units of government. But the bankruptcy prac-

---


252 Id. (quoting Ysursa, 555 U.S. at 362 (quoting Trenton v. New Jersey, 262 U.S. 182, 187 (1923))).

253 See 11 U.S.C. § 109(c)(2) (providing that a municipality may qualify as a Chapter 9 debtor only if it "is specifically authorized, in its capacity as a municipality or by name, to be a debtor under [Chapter 9] by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter").

254 See Va. Office for Prot. & Advocacy v. Stewart, 131 S. Ct. 1632, 1640 (2011) ("[W]e do not understand how a State's stature could be diminished to any greater degree when its own agency polices its officers' compliance with their federal obligations, than when a private person hails those officers into federal court for that same purpose—something everyone agrees is proper.") (emphasis in original). In Stewart, the Supreme Court sustained jurisdiction over a state agency's suit against its state under Ex parte Young's exception to Eleventh Amendment immunity. The state agency, the Virginia Office for Protection and Advocacy sued to enforce rights conferred through federal law. However, like a municipality, VOPA was nonetheless a creature of the state. And like the right of action in Stewart, a municipal bankruptcy filing similarly rests on federal norms that the state, under 11 U.S.C. 109(c)(2), must have authorized the municipality to invoke.

tices that the Court found encompassed within the Bankruptcy Clause could compel local governments, as well as states. In the early republic, state laws governed bankruptcy.256 Yet, cities and counties assumed responsibility for operating facilities that served as debtors’ prisons. Moreover, localities set the terms on which a debtor could receive bail, as well as bail boundaries.257 Thus, a federal habeas action would compel local as well as state officials. Additionally, a federal habeas action compels local officers. It may, for example, require an officer to open a jail door to release a debtor, defying the state or locality’s will. This compelled action contravened principles secured under the Tenth Amendment, or the Court’s commandeering jurisprudence, just as it implicates the Eleventh Amendment. Thus, the Court’s analysis of the “plan of the convention” implicates principles of federalism more broadly. It also modifies the structure of federal power as it relates to local units of government.

Second, the Bankruptcy Clause arguably circumscribes sovereign immunity only when a court’s in rem jurisdiction implicates property belonging to a state. This contention would suggest that the Bankruptcy Clause should not impact the balance of federalism in other settings. Katz rested on the theory that the Bankruptcy Clause subordinated state immunity because its Framers contemplated federal habeas corpus actions compelling state officials to release debtors from prison.258 An individual’s release from debtor’s prison would be nec-


257 See id. at 86 (explaining that New York held its debtors in “the attic of city hall” prior to 1759). In Worcester, Massachusetts, the county government operated a jail that doubled as a facility for holding debtors. Id. at 86. The County confined its debtors in a small, fourteen-foot square room. Id. The County also assumed responsibility for developing a new, larger facility after 1785. Id. Professor Mann also notes that, perhaps with the aim of improving conditions in debtors’ prisons, cities and counties expanded opportunities available to debtors for receiving bail. Id. at 96. Some municipalities may also have allowed release, subject to bail limits, without any posting of security, termed “mercy” releases. Id. at 96 n.42.

258 Cent. Virginia Cmty. Coll. v. Katz, 546 U.S. 356, 378 (2006). Note that some commentators have sharply criticized the Supreme Court’s historical analysis, as well as its conception of in rem jurisdiction. Thomas E. Plank, State Sovereignty in Bankruptcy After Katz, 15 Am. Bankr. Inst. L. Rev. 59, 75–80 (2007) contends that that the Court’s historical analysis failed to demonstrate that the Bankruptcy Clause should receive different treatment from other positive grants of authority to Congress. Professor Thomas Plank argues that imprisonment for debt did not amount to a criminal proceeding for violation of state law, and thus did not implicate a colony or state’s immunity. Id. Professors Martin Reddish and Daniel Greenfield criticize the Court for rendering its decision based on “the result desired” rather than “on a principled, consistently applied analysis of the Eleventh Amendment . . . .” Martin H. Redish & Daniel M. Greenfield, Bankruptcy, Sovereign Immunity and
necessary to effectuate a fresh start, a foundational objective of bankruptcy law. Thus, the reasoning may go, the Bankruptcy Clause should not alter the balance of federalism where the intervention does not directly arise from jurisdiction over a disputed property interest. It may not circumscribe constitutional doctrines that bar undue judicial intervention in municipal fiscal management or governance.

Yet, the Supreme Court established separate bases for recognizing limitations to a state’s sovereign immunity. The first draws from the Court’s conception of a bankruptcy court’s exclusive in rem jurisdiction, the second from its analysis of historical bankruptcy practices. First, *Hood* established that the discharge of a debt resulting from an in rem proceeding does not infringe state sovereignty. *Hood* involved an insolvent student who sought the discharge of student loans. Federal law provided that a student may not discharge loans guaranteed by a governmental unit unless the bankruptcy court finds that excepting the loans from its discharge order would cause “undue hardship” to the student. *Hood* filed a complaint seeking a determination of undue hardship and included the Tennessee Student Assistance Corporation (“TSAC”), a state entity that guarantees student loans, as a defendant. TSAC moved to dismiss the complaint, con-

The Dilemma of Principled Decision Making: The Curious Case of Central Virginia Community College v. *Katz*, 15 AM. BANKR. INST. L. REV. 13, 19 (2007). They suspect that while Justice Stevens aimed to use *Katz* to overturn *Seminole Tribe of Fla. v. Fla.*, 517 U.S. 44 (1996) (holding that the Indian Commerce Clause does not confer authority on Congress to abrogate the States’ sovereign immunity), he could not organize a majority around this proposition and instead employed inconsistent logic to restrict the application of *Seminole Tribe* to the Bankruptcy Clause. Redish & Greenfield, *supra* note 258, at 17-19. Professor Ralph Brubaker posits that the Court’s analysis of the 1800 Act distorts “the historical pedigree of the habeas corpus power vis-à-vis the immunity of the sovereign against suit.” Ralph Brubaker, *Explaining Katz’s New Bankruptcy Exception to State Sovereign Immunity: The Bankruptcy Power As A Federal Forum Power*, 15 AM. BANKR. INST. L. REV. 95, 117 (2007). As Professor Brubaker explains, *habeas corpus ad subjiciendum* allowed remedies against a King’s officers without the King’s consent, thus suggesting that sovereign immunity did not implicate such writs. *Id.*


259 The District Court in *In re City of San Bernardino* recognized as much. See *In re City of San Bernardino*, No. 6:12-BK-28006-MJ, 15, 16 (C.D. Cal. June 4, 2014) (“Although the Supreme Court’s historical analysis conducted in *Katz* is not applicable here, the Court’s exercise of exclusive in rem jurisdiction over the City’s property may still preclude the State Agencies’ exercise of their sovereign immunity.”)


261 *Id.* at 444–45 (citing 11 U.S.C. § 523(a)(8) (exceptions to discharge)).

262 *Id.* at 443–45.
tending that its Eleventh Amendment immunity barred the action.\textsuperscript{263} The Supreme Court rejected TSAC’s argument. Through its exclusive jurisdiction over a debtor’s property, the Court held, a bankruptcy court may extinguish debts without threatening state sovereignty.\textsuperscript{264}

The Court’s second, broader basis draws from \textit{Katz’s} historical inquiry. \textit{Katz} addressed whether a debtor bookstore could institute proceedings against Virginia institutions of higher education to “avoid and recover” a “transfer of an interest of the debtor in property.”\textsuperscript{265} The state entities sought dismissal based on sovereign immunity.\textsuperscript{266} The Court in \textit{Hood} held that the bankruptcy court exercised in rem jurisdiction in considering a request for a “hardship determination.”\textsuperscript{267} The proceeding therefore did not implicate the state’s sovereign immunity; the Court had no need to resolve whether the Bankruptcy Clause modified the scope of a state’s sovereign immunity.\textsuperscript{268} While the proceeding in \textit{Hood} was clearly ancillary to in rem jurisdiction,\textsuperscript{269} the Court in \textit{Katz} decided that it had no need to “decide whether actions to recover preferential transfers . . . are themselves properly characterized as \textit{in rem}.”\textsuperscript{270} As Justice John Paul Stevens explained, “some exercises of bankruptcy courts’ powers—issuance of writs of habeas corpus included—unquestionably involved more than mere adjudication of rights in a res.”\textsuperscript{271} The Bankruptcy Clause bound states to subordinating sovereign immunity in “proceedings necessary to effectuate the \textit{in rem} adjudication of the bankruptcy courts,” regardless of whether a proceeding exceeds mere adjudication of in rem rights.\textsuperscript{272}

\begin{footnotes}
\footnotetext[263]{Id. at 445. See Tenn. Student Assistance Corp.’s Brief in Support of Motion to Dismiss at 10, Tenn. Student Assistance Corp. v. Hood, 541 U.S. 440 (2004) (explaining that adversary proceedings against a state for determination of dischargeability amounts to a suit for the purposes of the Eleventh Amendment).}
\footnotetext[264]{\textit{Hood}, 541 U.S. at 450–51.}
\footnotetext[266]{\textit{Katz}, 546 U.S. at 361.}
\footnotetext[267]{\textit{See Hood}, 541 U.S. at 451 ("We find no authority . . . that suggests a bankruptcy court’s exercise of its \textit{in rem} jurisdiction to discharge a student loan debt would infringe on state sovereignty . . .").}
\footnotetext[268]{See id. at 445 (declining to reach the question of whether the Bankruptcy Clause granted Congress authority to abrogate sovereign immunity).}
\footnotetext[269]{\textit{See Katz}, 546 U.S. at 371 (explaining that the proceeding in \textit{Hood} was “merely ancillary to the Bankruptcy Court’s exercise of its \textit{in rem} jurisdiction”).}
\footnotetext[270]{\textit{Id.} at 372.}
\footnotetext[271]{\textit{Id.} at 378.}
\footnotetext[272]{\textit{Id.} The Court noted that its analysis should not “suggest that every law labeled a ‘bankruptcy’ law could, consistent with the Bankruptcy Clause, properly impinge upon state sovereign immunity.” \textit{Id.} at 378 n.15. This caveat likely extends to elements of a bankruptcy action that do not serve a bankruptcy court’s jurisdictional needs. It also likely}
\end{footnotes}
The viability of a broad subordination theory then turns on how broadly a court may conceive of a “necessary” proceeding. A proceeding “necessary to effectuate the in rem jurisdiction of the bankruptcy courts” cannot only encompass practices that existed at the time of the Constitution’s ratification. Nor should it consist only of proceedings that directly implicate a debtor’s assets. For example, a federal habeas corpus action to compel a debtor’s discharge from prison adjudicates the debtor’s personal liberty, not the nature of any entity’s claim to his assets. Similarly, the Bankruptcy Act of 1800 included provisions that allowed federal authorities to seize the land of a bankrupt debtor and sell it under federal law, defying state laws that protected land against execution. The nature of a proceeding necessary to bankruptcy jurisdiction may change as the economic, social, and political fabric of society shifts. A proceeding becomes necessary based on context. In a contemporary municipal bankruptcy, this must encompass a bankruptcy court’s authority over, and enforcement of, a bankruptcy plan. In a municipal bankruptcy, a bankruptcy court adjudicates creditors’ rights as to the municipality’s assets. Modern bankruptcy courts need authority to reshape a municipality’s governance practices and budget structure. Such authority is necessary to guard the interests of a municipality’s residents and to protect the rights of creditors, be they pensioners or bondholders. As the Chapter 9 filings of general municipalities in recent years suggest, municipal bankruptcy cannot serve its core purpose unless bankruptcy judges secure broader jurisdiction.

CONCLUSION

The Bankruptcy Clause may authorize federal intervention in the core functions of local governments. The Supreme Court’s decision

stands to guard against federal overreach, for example through Congress relying on expansive readings of Katz to artificially label a new, constitutionally shaky federal law a “bankruptcy” law merely for the purposes of securing it against federalism challenges.

273 Katz, 546 U.S. at 378.

274 Brief of Historian Bruce H. Mann, Amicus Curiae in Support of Respondent at 23, Cent. Virginia Cmty. Coll. v. Katz, 546 U.S. 356 (2006) (No. 04-885). This contravention of state law, which Thomas Jefferson objected to, did not arise from an adjudication of a state’s claim to assets. See id. (quoting Jefferson writing to John Francis Mercer that the Bill “assumes the right of Seizing and selling lands, and so cuts the knotty question of the Constitution whether the general government may direct the transmission of land by descent [sic] or otherwise”). Rather, the Bill authorized contravention of state law itself, not merely a state’s immunity from suit. As Mann notes, no members of Congress raised doubts as to Congress’s authority to override state laws pertaining to seizure of land. Id. at 24.
in *Central Virginia Community College v. Katz* suggests that the imposition of resource adjustments or restructuring of governance practices, which in other contexts would violate federalism principles, may amount to a valid exercise of federal power in the context of a municipal bankruptcy. Furthermore, while the Constitution may tolerate heightened federal authority under the Bankruptcy Clause, such use of authority is also desirable. At the close of Detroit’s bankruptcy proceedings, as Judge Steven Rhodes reached the end of a two-hour reading of his confirmation opinion, he stated: “Your enduring and collective memory of what happened here, and your memory of your anger about it, will be exactly what will prevent this from ever happening again.” Detroit’s exit from bankruptcy marked a staggering achievement. Yet, memory alone will not heal a municipality like Detroit.

After decades of accumulating pension liability, accompanied with a declining population and tax base, Detroit fell into insolvency because the City entered transactions that used extensive borrowing to cover pension costs. Under Mayor Kwame Kilpatrick, the City in 2005 assumed $1.4 billion in debt to cover pensions liability, which amounted to a fifth of Detroit’s debt. It marked a fatal step reflecting the city’s continued willingness to assume massive debt. The City next purchased derivatives to secure a stable interest rate of 6% on its pension debt. Soon after floating $250 million in “fiscal stabilization bonds,” Detroit’s finance officer met with a Wall Street analyst about plans to issue revenue bonds for the water department. The officer’s conversation reflected the city leadership’s relaxed attitude towards debt and its attendant risks. The analyst asked, “[W]hat happens if Detroit goes bankrupt?” No such thing would happen, the officer explained: “The state will step in and ensure that they right the ship and that the bonds are paid.”

---


277 Id.

278 Id.

279 Id.

280 Id.

281 Id.
Detroit emerged from bankruptcy with a manageable level of debt. But like municipalities across the United States, Detroit will continue to struggle to secure revenue sufficient to cover the cost of daily operations, pensions, and redevelopment. The availability of credit will tempt administrators to again take on debt. Detroit’s bankruptcy plan contains vague measures to allow for “financial oversight.” But the plan has not cured deficiencies in urban governance that brought the City before Judge Steven Rhodes in 2013.

---

282 In re City of Detroit, 524 B.R. 147, 163 (Bankr. E.D. Mich. 2014) (“The plan also contemplates post-bankruptcy financial oversight of the City to ensure that the fiscal exigencies that resulted in the City’s chapter 9 bankruptcy never happen again.”).