University of Michigan Journal of Law Reform

Volume 53

2020

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Juliet M. Moringiello
Widener University Commonwealth Law School

https://doi.org/10.36646/mjlr.53.4.dispossessing.moringiello

DISPOSSESSING RESIDENT VOICE: MUNICIPAL RECEIVERSHIPS AND THE PUBLIC TRUST

Juliet M. Moringiello*

ABSTRACT

The residents of struggling cities suffer property dispossessions both as individual owners and as municipal residents. Their individual dispossessions are part of a cycle that often begins with industrial decline. In Detroit, for example, more than 100,000 residents have lost their homes to tax foreclosure over a four-year period that bracketed the city's bankruptcy filing. Falling property values, job losses, and foreclosures affect municipal budgets by reducing tax revenues. As individual dispossessions exacerbate municipal financial crises, residents can also face the loss of municipal property. Struggling cities and towns often sell publicly owned property—from parks to parking systems—to balance municipal budgets.

This article discusses the relationship between property dispossessions and proceedings to resolve municipal financial distress, with a focus on another important loss faced by residents of distressed municipalities—the loss of their voice in municipal government. A municipal financial crisis, by itself, has no effect on the property of any individuals who live in the city, and a city's bankruptcy does not take a city's assets in the same way that a corporate or personal bankruptcy can take the property of a business or individual. Yet even though creditors cannot force the sale of city-owned assets, the decision to transfer the property may be made by unelected officials appointed by the state government to replace city government in times of financial crisis. This results in another type of collective dispossession—the dispossession of resident voice in local government affairs. This article discusses how insolvency proceedings, including Chapter 9 bankruptcy, can deprive residents of their voice and, in turn, deprive them of the city's assets that the city holds for them in public trust and proposes some suggestions for states for balancing the need for resident voice with higher-level financial oversight as they determine how to manage the financial distress of their cities.

* Associate Dean for Research and Faculty Development, Widener University Commonwealth Law School. Many thanks to the editors and staff of the *Michigan Journal of Law Reform* for hosting the thought-provoking symposium, *Dispossessing Detroit,* for which this Article was written.

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INTRODUCTION

The residents of struggling cities suffer property dispossessions both as individual owners and as interested community members. Their individual dispossessions are part of a cycle that often begins with industrial decline.[1] In Detroit, for example, more than 100,000 residents have lost their homes to tax foreclosure over a four-year period that bracketed the city's bankruptcy filing.[2] Falling property values, job losses, and foreclosures affect municipal budgets by reducing tax revenues.[3] As individual dispossessions exacerbate municipal financial crises, residents can also face the loss of municipal property. Struggling cities and towns often sell publicly owned property—from parks to parking systems—to balance municipal budgets.[4]

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1. *See* Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118, 1133–39 (2014) (describing the effects of deindustrialization on the population of the affected cities).
2. *See* Bernadette Atuahene & Timothy R. Hodge, *Stategraft*, 91 S. CAL. L. REV. 263, 266–69 (2018) (explaining the tax foreclosures in Detroit between 2011 and 2015, and comparing demographic information of Detroit residents, such as income levels and unemployment rates, to national averages).
3. *See* John C. Philo, *Governance: Local Government Fiscal Emergencies and the Disenfranchisement of Victims of the Global Recession*, 13 J.L. SOC'Y 71, 72–80 (2011) (drawing connections between the global recession and government financial crises in Michigan and Rhode Island). *See also* Anderson, *supra* note 1.
4. *See* Anderson, *supra* note 1, at 1121–22 (explaining how financially struggling cities "shed their property – public assets like parks, pools, and government office buildings").

This Article discusses the relationship between property dispossessions and proceedings to resolve municipal financial distress, with a focus on another important loss faced by residents of distressed municipalities—the loss of their voice in municipal government. The conditions that lead to individual dispossessions, such as foreclosures, occur independently of any proceeding to resolve municipal financial distress, but likely foreshadow such a proceeding.[5] These proceedings can be purely state-managed proceedings such as those under Pennsylvania's Municipalities Financial Recovery Act, also known as Act 47, or purely federally managed, such as proceedings under Chapter 9 of the Bankruptcy Code. Sometimes, as was the case in Detroit's bankruptcy, the manager appointed pursuant to the state process directs the Chapter 9 process.[6] The proceeding to resolve the municipality's finances can in turn lead to dispossession of publicly owned property or collective dispossession.

A municipal financial crisis, by itself, has no effect on the property of any individuals who live in the city, and a city's bankruptcy does not take a city's assets in the same way that a corporate or personal bankruptcy can take the property of a business or individual.[7] Yet even though creditors cannot force the sale of city-owned assets, unelected officials appointed by the state government to replace city government officials in times of crisis may make the decision to transfer property. This results in another type of collective dispossession—the dispossession of resident voice in local government affairs.

In this article, I will discuss how insolvency proceedings, including Chapter 9 bankruptcy, can deprive residents of their voice and in turn deprive them of the city's assets that the city holds for them in public trust. I will first discuss municipal bankruptcy law under Chapter 9 to explain how, although it is silent on city governance, it permits states to impose financial oversight on their cities. After doing so, I will discuss models of state oversight. After discussing state oversight, I will discuss the status of municipal property and the reality that struggling municipalities sell or otherwise monetize property to balance their budgets. I will conclude by proposing some suggestions for states to preserve resident voice while maintaining higher-level financial oversight as they determine how to manage the financial distress of their cities. These suggestions re-

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5. *See* Philo, *supra* note 3, at 81–91 (explaining the legislative efforts to address municipal financial crises in Michigan and Rhode Island).

6. MICH. COMP. LAWS ANN. § 141.1558(1) (West 2020).

7. Creditors of municipalities have no right to force a sale of a municipality's assets. *See infra* notes 102–106 and accompanying text.

late to both state law and the Bankruptcy Code; as I have discussed elsewhere, Chapter 9 bankruptcy was designed to work with, not as an alternative to, state financial intervention processes.[8]

I. MUNICIPAL BANKRUPTCY AND MUNICIPAL GOVERNANCE

A. *The Skeletal Nature of Chapter 9*

Municipal bankruptcy became part of federal law in the 1930s in the wake of a wave of defaults on municipal debt. Thousands of municipalities had defaulted on their debt obligations during the Great Depression, and because by the 1930s municipal debt was held by investors throughout the country, municipal finance experts believed that a federal process to resolve municipal financial debt was necessary.[9] The enactment of the predecessor to today's Chapter 9 was not easy and took two trips to the U.S. Supreme Court to confirm that Congress had the power to enact a process to resolve municipal financial distress.[10] Such a power had been thrown into doubt by the Tenth Amendment to the Constitution, under which the powers "not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."[11]

A state has the first and last word on municipal powers. One long-standing theory of local government is Dillon's Rule, which posits that municipalities are creatures of their states and therefore have only the powers granted to them by their states.[12] Yet federal

8. *See generally* Juliet M. Moringiello, *Goals and Governance in Municipal Bankruptcy,* 71 WASH. & LEE L. REV. 403 (2014); *see also* Laura Napoli Coordes & Thom Reilly, *Predictors of Municipal Bankruptcies and State Intervention Programs: An Exploratory Study,* 105 KY. L.J. 493, 498 (2016) (illustrating that "Chapter 9 bankruptcy and state relief can work *together* and need not be viewed as mutually exclusive or working at cross-purposes") (emphasis in original).

9. *See* Moringiello, *supra* note 8, at 440–42 (describing the conditions that led to the enactment of the first municipal bankruptcy law).

10. Ashton v. Cameron Cty. Water Improvement Dist., 298 U.S. 513, 531 (1936) (holding that the first federal bankruptcy statute was unconstitutional as a violation of state sovereignty); United States v. Bekins, 304 U.S. 27, 52–54 (1938) (holding that a slightly modified statute was consistent with both the Fifth and Tenth Amendments to the Constitution because by authorizing a political subdivision to file for bankruptcy the state acts "in aid, and not in derogation of, its sovereign powers"); *see also* Andrew B. Dawson, *Beyond the Great Divide: Federalism Concerns in Municipal Insolvency,* 11 HARV. L. & POL'Y REV. 31, 40–44 (2017) (explaining the sovereignty concerns about the first federal municipal bankruptcy statutes).

11. U.S. CONST. amend. X.

12. Hunter v. City of Pittsburgh, 207 U.S. 161, 178–79 (1907) ("Municipal corporations are political subdivisions of the State, created as convenient agencies for exercising such of the governmental powers of the State as may be entrusted to them. . . . The state . . . at its pleasure may modify or withdraw all such powers . . . . without the consent of the citizens, or

courts opining on the relationship between municipalities and their states have sometimes treated local governments as extensions of their residents, recognizing the autonomy that local governments have in practice.[13] The constitutional status of states and cities drove the original structure of the municipal bankruptcy law, and that structure defines today's Chapter 9.[14] The rules in Chapter 9 recognize the state's relationship with the federal government, as well as the relationship between the municipality and its state, but Chapter 9 is silent with respect to the relationship between state government and the residents of those municipalities.

As the municipal bankruptcy law evolved, it increasingly drew from Chapter 11 of the Bankruptcy Code, the chapter used by business entities to reorganize.[15] Although Chapter 9 is based on Chapter 11 of the Bankruptcy Code, it is silent with respect to two types of governance controls that are an important part of Chapter 11. The first relates to management of the debtor entity. Chapter 11 gives a debtor's creditors and the bankruptcy judge control over how the debtor manages the bankruptcy case.[16] In a Chapter 11 proceeding, the management of a debtor entity becomes the "debtor in possession," with fiduciary duties towards the debtor's creditors.[17] If the debtor in possession mismanages the bankruptcy case, the court has the power to appoint an examiner or a trustee.[18]

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even against their protest."); *see also* Joan C. Williams, *The Constitutional Vulnerability of American Local Government: The Politics of City Status in American Law*, 1986 WIS. L. REV. 83, 88–89.

13. *See* RICHARD BRIFFAULT & LAURIE REYNOLDS, CASES AND MATERIALS ON STATE AND LOCAL GOVERNMENT LAW 74 (8th ed. 2016) (explaining that this approach is important in cases involving voting rights in local elections).

14. *See* Moringiello, *supra* note 8, at 446–61 (describing the history of municipal bankruptcy legislation).

15. *See generally* Joseph Patchan & Susan B. Collins, *The 1976 Municipal Bankruptcy Law*, 31 U. MIAMI L. REV. 287 (1977) (explaining that Congress amended the predecessor to Chapter 9 in 1976 to accommodate the possibility that larger cities might file for bankruptcy).

16. Commentators have observed that Chapter 9 gives the court few powers over the city. *See, e.g.*, Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 281, 291 (2012) (noting that Chapter 9 appears to preclude a court's ability to impose resource adjustments on a municipality); Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 472 (1993) (arguing that "municipal bankruptcy law strictly limits the powers—hence the utility—of the bankruptcy court"). *But see* Melissa B. Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, 33 YALE J. ON REG. 55, 59 (2016) (using an in-depth study of the court proceedings in Detroit's bankruptcy case to challenge the conventional account of judicial minimalism in Chapter 9).

17. 11 U.S.C. § 1101(a) (2018) (defining "debtor in possession" as the debtor); *Id.* § 1107(a) (2018) (imposing upon a debtor in possession all of the duties of a bankruptcy trustee); *Id.* § 704 (2018) (setting forth the duties of the bankruptcy trustee); *see generally* Steven Rhodes, *The Fiduciary and Institutional Obligations of a Chapter 7 Bankruptcy Trustee*, 80 AM. BANKR. L.J. 147 (2006); Martin J. Bienenstock, *Conflicts Between Management and the Debtor in Possession's Fiduciary Duties*, 61 U. CIN. L. REV. 543 (1992).

18. 11 U.S.C. § 1104(a) (2018).

These powers are missing from Chapter 9.[19] In the absence of bankruptcy controls, questions of managing the debtor municipality are questions of state law.

The second governance control relates to the debtor's assets. Chapter 11 gives a debtor's creditors and the court a governance role with respect to the debtor's property. In all types of bankruptcy other than Chapter 9, an estate is created at the moment of the bankruptcy filing, and that estate contains all interests in property that the debtor had at the time of the filing.[20] The estate forms the foundation of the bankruptcy case, and the court and creditors decide what happens to the estate property. For example, Chapter 11 requires that the court approve sales of property of the estate,[21] and the value of the estate property provides the baseline for creditor distributions in Chapter 11.[22] Creditors may request that the court convert the Chapter 11 case to a Chapter 7 case, thus forcing liquidation of the estate property.[23] The court and the creditors have none of those powers in a Chapter 9 case because there is no bankruptcy estate in a Chapter 9 case.[24] In addition, Chapter 9 explicitly denies to the court the power to interfere with the debtor's use of its property or revenues.[25]

B. *Chapter 9 as a Last Resort*

Unlike Chapter 11, Chapter 9 contains strict eligibility requirements. One is that the state specifically authorize a municipal bankruptcy filing.[26] Another is that the municipality be insolvent.[27]

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19. *See* 11 U.S.C. § 901(a) (2018) (listing the sections of other chapters of the Bankruptcy Code that apply in Chapter 9 cases). Chapter 11 also provides for the appointment of a creditors' committee as an additional level of oversight over the debtor in possession. 11 U.S.C. §§ 1102–03 (2018). There is a split among courts as to whether a creditors' committee can be appointed in a Chapter 9 case. Although § 901 makes § 1102, the section that directs the United States Trustee to appoint a creditors' committee, applicable in Chapter 9, § 1102 directs the U.S. Trustee to do so "as soon as practicable after an order for relief under *chapter 11*" (emphasis added). *See In re* City of Detroit, 519 B.R. 673, 678–79 (Bankr. E.D. Mich. 2014) (holding § 1102(a)(1) inapplicable in Chapter 9 as a matter of statutory interpretation); *In re* County of Orange, 219 B.R. 543, 558 (Bankr. C.D. Cal. 1997) (recognizing that the U.S. Trustee had appointed the creditors' committee under § 1102(a)(1)).

20. 11 U.S.C. § 541(a) (2018).

21. *See* 11 U.S.C. § 363 (2018) (allowing the trustee to use, sell, or lease property of the estate after notice and a hearing and allowing the court to condition such use, sale, or lease).

22. 11 U.S.C. § 1129(a)(7) (2018) (using the liquidation value of the estate as the baseline for creditor distributions).

23. 11 U.S.C. § 1112(b) (2018).

24. *See* 11 U.S.C. § 901 (2018) (omitting §§ 363 and 541 from the list of Bankruptcy Code sections that apply in Chapter 9).

25. 11 U.S.C. § 904(2) (2018).

26. 11 U.S.C. § 109(c)(2) (2018).

Insolvency in the municipal context is defined differently from insolvency in the business or individual context. A business or human debtor is insolvent when the debtor's debts exceed the debtor's assets.[28] Recognizing that a municipality has no assets that are available to creditors through a forced sale, the Bankruptcy Code states that a debtor is insolvent for Chapter 9 purposes when it is generally not paying its debts as they become due or is unable to pay its debts as they become due.[29] Because a municipality has taxing powers, it has not always been clear what insolvency means, despite the definition.[30] The insolvency requirement reinforces the idea that municipal bankruptcy is a last resort that should be used only when the federal bankruptcy power is necessary to resolve the municipality's financial distress.[31]

The litigation over Bridgeport, Connecticut's eligibility for Chapter 9 in 1991 illustrates how detrimental the insolvency requirement can be to city residents. When Bridgeport filed for bankruptcy, the city budget cuts had been so severe that the city employed ninety fewer police officers than it needed to provide "basic, adequate services," and the police department's detective staff was half as large as it should have been.[32] Its public works department was similarly stretched; the cuts in residential garbage collection had created a rodent and arson hazard, and the public works director testified that snow removal in the coming winter would be minimal.[33] Although the city had argued in its eligibility hearing that it was unable either to cut services further or raise the taxes to pay for them, the court found that Bridgeport was not insolvent and thus ineligible for bankruptcy.[34] According to the court, because Bridgeport could not prove that it could not pay its debts as they became due either in its current fiscal year or its next fiscal year, it was not insolvent for bankruptcy purposes.[35]

In the years since Bridgeport was denied bankruptcy protection, courts have applied a service delivery insolvency analysis to the insolvency calculation. The term first appeared in the eligibility opin-

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27. 11 U.S.C. § 109(c)(3) (2018).

28. 11 U.S.C. § 101(32)(A)–(B) (2018).

29. 11 U.S.C. § 101(32)(C) (2018). This definition has caused some headaches for courts. Recently judges have developed the concept of "service delivery insolvency."

30. *See* Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Rule in Municipal Bankruptcy,* 125 YALE L.J. 1150, 1182–83 (2016) (explaining that it can be difficult for a municipality to meet the insolvency requirement because they have access to tax revenues).

31. *In re* City of Stockton, 493 B.R. 772, 788 (Bankr. E.D. Cal. 2013).

32. *See In re* City of Bridgeport, 129 B. R. 332, 335 (Bankr. D. Conn. 1991) (setting forth the testimony of Bridgeport's police chief).

33. *Id.* at 335.

34. *Id.* at 339.

35. *Id.* at 338.

ion for Stockton, California, which filed for bankruptcy in June 2012.[36] If a city is unable to pay debts as they become due, it is cash insolvent. The idea of service delivery insolvency informs the cash insolvency analysis by supporting a municipality's contention that its cash deficiency is genuine.[37] A municipality is service delivery insolvent when it is unable to pay the costs of providing the services that are necessary for the community's health, safety, and welfare.[38] In determining Detroit's eligibility for Chapter 9, the court catalogued the city's various service deficiencies, including a thirty-minute "priority one" response time for the police department and the lack of standard fire equipment,[39] before concluding that, of all the types of insolvency, the city's service delivery insolvency was the "most strikingly disturbing."[40]

C. *What Can Chapter 9 Do for a Municipality?*

The skeletal nature of Chapter 9 of the Bankruptcy Code has led some observers to question the efficacy of the municipal bankruptcy process. In a comprehensive analysis of Chapter 9, Michael McConnell and Randal Picker posited that Chapter 9 assumes that a city will leave bankruptcy with the same governance structures with which it entered the process.[41] Others have expressed the same concern about the lack of governance controls and have suggested modifications to Chapter 9 to give a court more say over how a city is managed in bankruptcy.[42] A few scholars have posited that Chapter 9 is almost useless and have argued that federal law should have no role in resolving a municipality's financial distress.[43]

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36. *In re City of Stockton*, 493 B.R. at 789–90.
37. *Id.* at 791.
38. *Id.* at 789.
39. *In re* City of Detroit, 504 B.R. 191, 214 (Bankr. E.D. Mich. 2014).
40. *See id.* at 263–64 (comparing the deplorable condition of Detroit's public services to other financial markers that might "more neatly" establish that the city was either generally not paying its debts as they became due or unable to pay its debts as they became due).
41. McConnell & Picker, *supra* note 16, at 469–70 (observing that Chapter 9 does nothing to fundamentally reform a city's structure).
42. *See, e.g.*, Gillette & Skeel, *supra* note 30, at 1155 (arguing that bankruptcy court intervention in municipal governance should be an option when the state fails to intervene to address the structural difficulties that cause fiscal distress).
43. *See* Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 353–54 (2010) (arguing that bankruptcy law "is not a sensible solution for urban economic crises, and that municipal financial distress should be dealt with in other manners"); Samir D. Parikh, *A New Fulcrum Point for City Survival*, 57 WM. & MARY L. REV. 221, 228 (eschewing Chapter 9 as a key tool for municipal financial recovery and proposing that "state law can be the centralized point at which officials exert the necessary amount of pressure to gain concessions from unions and bondholders").

It is difficult to evaluate the success of Chapter 9. First, the number of Chapter 9 filings is minuscule as compared to the number of individual and corporate bankruptcies. Most of the Chapter 9 cases filed have not been filed by general-purpose municipalities, such as cities, counties, and towns, but rather have been filed by special purpose districts.[44] Some scholars have proposed metrics by which to judge the effectiveness of Chapter 9.[45]

Spirited debate aside, bankruptcy provides a key tool to struggling municipalities. The function of any bankruptcy proceeding, whether filed by an individual, a business entity, or a municipality, is to neutralize holdouts.[46] Only federal law can give a city the ability to force creditors to accept less than what they are owed on their debts.[47] The Contracts Clause of the U.S. Constitution prohibits state law from allowing this.[48]

Some have argued that the bar to filing Chapter 9 is set too high. General-purpose municipalities do not treat bankruptcy lightly, and the deliberations over whether to file unfold publicly. As a result, lowering some of the barriers to entry would not cause a flood of bankruptcies and would allow cities to receive relief sooner, more efficiently, and less expensively.[49]

There can be a cost to the residents to filing for Chapter 9 and that cost is their voice. Although the Bankruptcy Code contains no governance controls, federal law yields to, and invites, the participation of the state in governance matters in the Chapter 9 process.[50]

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44. *See* David A. Skeel, Jr., *When Should Bankruptcy be an Option (For People, Places, or Things)?*, 55 WM. & MARY L. REV. 2217, 2220 (2014) (explaining that most municipal bankruptcy filings involve special-purpose entities such as sewage or water districts).

45. *See* Vincent S. J. Buccola, *The Logic and Limits of Municipal Bankruptcy Law*, 86 U. CHI. L. REV. 817, 833 (2019) (suggesting that Chapter 9 is effective if it preserves spatial economies by writing down debts likely to discourage local investment).

46. *See* CHARLES JORDAN TABB, LAW OF BANKRUPTCY § 1.2 (4th ed. 2016).

47. *See* Laura Napoli Coordes, *Restructuring Municipal Bankruptcy,* 2016 UTAH L. REV. 307, 343 (explaining that Chapter 9 is designed to "embody bankruptcy's ability to carry out key functions, such as contract modification, elimination of debt overhang, and overcoming the holdout creditor").

48. U.S. CONST. art. I, § 10, cl. 1.

49. *See* Laura N. Coordes, *Gatekeepers Gone Wrong: Reforming the Chapter 9 Eligibility Rules*, 94 WASH. U. L. REV. 1191, 1195–96 (2017) (explaining that the Chapter 9 eligibility requirements require municipalities to wait to file for bankruptcy until long after they have begun to experience distress and that they result in costly litigation).

50. The Supreme Court recognized this state-federal cooperation in approving the original municipal bankruptcy legislation. *See* United States v. Bekins, 304 U.S. 27, 54 (1938) (explaining that by allowing a municipality to file for bankruptcy, a state acts "in aid, and not in derogation, of its sovereign powers").

D. *The State-Federal Bankruptcy Partnership*

The Bankruptcy Code codifies the role of the state in the Chapter 9 bankruptcy of its municipalities. Chapter 9 contains strict eligibility requirements and one of those requirements is that the state must specifically authorize the municipality to file for bankruptcy.[51] This requirement has become more stringent over the years in that authorization cannot be assumed from the general powers that a state gives to its municipalities.[52] Only about one-half of the states authorize their municipalities to file for bankruptcy, and one state, Georgia, explicitly prohibits it.[53]

The states that permit municipal bankruptcy vary in how they do so. In some states, the permission is unconditional.[54] In others, the authorization to file is conditional, sometimes on the approval of the governor or other public official,[55] and sometimes on participation in a financial oversight program.[56]

Other provisions of Chapter 9 that recognize the state's role in a municipal bankruptcy include § 903, which places an important limit on Chapter 9 by stating that it does not "limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such state in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise."[57] In addition to recognizing the power of the state,

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51. 11 U.S.C. § 109(c)(2) (2018).

52. *See* Moringiello, *supra* note 8, at 458–61 (detailing the history of the specific authorization requirement).

53. PEW CHARITABLE TRS., THE STATE ROLE IN LOCAL GOVERNMENT FINANCIAL DISTRESS 9–10 (July 23, 2013), https://www.pewtrusts.org/en/research-and-analysis/reports/2013/07/23/the-state-role-in-local-government-financial-distress (list of states that authorize their municipalities to file for bankruptcy); *see, e.g.*, GA. CODE ANN. § 36-80-5 (2019) (Georgia statute prohibiting municipalities from filing a bankruptcy petition); *see also* Christine Sgarlata Chung, *Municipal Distress: Municipal Bankruptcy, Essential Municipal Services, and Taxpayers' Voice*, 24 WIDENER L.J. 43, 51–53 (2015) (distinguishing among types of state authorization to file under Chapter 9).

54. *See, e.g.*, ALA. CODE § 11-81-3 (2020) (allowing municipalities in Alabama to file for bankruptcy).

55. *See, e.g.*, MICH. COMP. LAWS. ANN. § 141.1566 (West 2020) (Michigan statute requiring gubernatorial approval for a municipal bankruptcy filing and allowing the governor to appoint a person to act exclusively on behalf of the municipality in the bankruptcy proceedings); 53 PA. STAT. § 11701.261 (LEXIS through 2020 Sess.) (Pennsylvania statute requiring a municipality to both meet listed conditions and apply for approval to the Secretary of Community and Economic Development before filing for bankruptcy); R.I. GEN. LAWS § 45-9-7(b)(3) (2020) (allowing a Rhode Island municipality to file for bankruptcy only if the state has appointed a receiver for the municipality and giving the receiver the power to file the petition in the city's name).

56. A Pennsylvania municipality may file for Chapter 9 without first participating in the state resolution process for financially distressed municipalities, but if it does, it is placed into the state program and the state-appointed coordinator manages the bankruptcy process). *See* 53 PA. STAT. § 11701.262(a), (c) (LEXIS through 2020 Sess.).

57. 11 U.S.C. § 903 (2018).

the Bankruptcy Code limits the court's powers by prohibiting it from interfering with "any of the political or governmental powers of the debtor, any of the property or revenues of the debtor, or the debtor's use or enjoyment of any income-producing property."[58]

By constitutional necessity, the Bankruptcy Code recognizes an important difference between business entity governance and municipal governance. In a business entity bankruptcy, the residual owners stand to lose not only their voice but also their financial investment.[59] In a municipal bankruptcy, a political official manages the proceedings. That political official might be the elected city leader or he or she might be an official appointed by the state government. Residents of an insolvent municipality do not lose their financial investment in the same way that investors in an insolvent business entity lose theirs. Their investment is less tangible in that they do not have shares in the entity to sell, but it is more tangible in that the municipality is where the residents have established their homes. When the residents of an insolvent municipality lose their voice in the future of the municipality, they lose this investment.

II. MODELS OF OVERSIGHT

When states impose managerial oversight on municipalities, they affect the one type of government to which individuals are likely to feel connected. Residents feel connected to their local governments in a deeper way than they do to their more remote state governments. Local governments are the most visible and accessible type of government to most individuals. The vast majority of opportunities for participation in political life exist on the local level in terms of both running for office and participating in meetings.[60] Local governments also provide most of the services that people receive.[61] As a result, when a state steps in to manage a municipality's finances, residents view the intervention as a takeover, whether the elected officials are displaced or not.

Replacing, or appearing to replace, an elected municipal government is a controversial move. On the one hand, such a re-

58. 11 U.S.C. § 904 (2018).

59. 11 U.S.C. § 1129(b)(2)(B) (2018); *see also* David Gray Carlson & Jack F. Williams, *The Truth About the New Value Exception to Bankruptcy's Absolute Priority Rule*, 21 CARDOZO L. REV. 1303, 1303 (2000) ("According to Chapter 11's celebrated absolute priority rule, no junior creditor or equity participant may obtain property under a confirmed plan if a dissenting unsecured creditor class has not been paid in full.").

60. BRIFFAULT & REYNOLDS, *supra* note 13, at 2.

61. *Id.* at 9.

placement does not alleviate the root causes of financial distress, such as deindustrialization and the accompanying job losses.[62] A law that allows a state to take over the management of a local government assumes that political failure is a cause rather than a symptom of municipal financial distress.[63] On the other hand, many municipal decision makers come to their roles unprepared to manage a city's finances. Although the largest cities in the United States have full-time city councils, the vast majority of American cities are governed by part-time councils.[64] In smaller cities, city council members serve with little or no compensation.[65] Moreover, in all cities, elected officials are often focused on reelection and thus may lack the political will to make the necessary financial choices.[66] In some cases the elected city government engaged in opaque and complex financial transactions that may have been invisible or incomprehensible to the average resident.[67] Those transactions may have been incomprehensible to municipal officials as well; as one study has shown, well less than half of elected state and local government officials report any expertise in public finance.[68] As a result, some states intervene to provide financial oversight over their distressed cities.

There are several models for municipal financial oversight, and the financial crises that led to three municipal bankruptcy filings—those of Central Falls, Rhode Island; Detroit, Michigan; and Harrisburg, Pennsylvania—shaped three different models. The three states also illustrate the different types of oversight, with Michigan's and Rhode Island's highest level of oversight resulting in the replacement of elected officials and Pennsylvania's leaving elected officials in place.

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62. *See* Michelle Wilde Anderson, *Democratic Dissolution: Radical Experimentation in State Takeovers of Local Governments*, 39 FORDHAM URB. L.J. 577, 582 (2012) (criticizing the view that "it is only local government management that stands in the way of solvency").

63. *See* Richard C. Schragger, *The Attack on American Cities*, 96 TEX. L. REV. 1163, 1199 (2018) (observing that "[d]eindustrialization, white flight, disinvestment, and concentrated poverty are not caused by mismanagement, though they can be exacerbated by it").

64. *See* Kellen Zale, *Part-Time Government*, 80 OHIO ST. L.J. 987, 1016 (2019).

65. *See* Kellen Zale, *Compensating City Councils*, 70 STAN. L. REV. 839, 851 (2018).

66. *See* Marti Kopacz et al., *Democracy in Peril: What to Do When Elected Officials Haven't, Won't, or Can't*, 37 MUN. FIN. J., Winter 2017, at 21, 26 (remarks of Angel Taveras, former mayor of Providence, Rhode Island).

67. *See, e.g.*, Clayton P. Gillette, *Dictatorships for Democracy: Takeovers of Financially Failed Cities*, 114 COLUM. L. REV. 1373, 1402 (2014) ("[Municipal] fiscal distress is often accompanied by opaque budgeting tactics."); *see also* David Unkovic, *Municipal Distress: Reflections of a Receiver*, 24 WIDENER L.J. 9, 12–14 (2015) (explaining the complex financial instruments marketed to municipalities).

68. *See* Darien Shanske, *The (Now Urgent) Case for State-Level Monitoring of Local Government Finances: Protecting Localities from Trump's "Potemkin Village of Nothing,"* 20 N.Y.U. J. LEGIS. & PUB. POL'Y 773, 775 (2017) (citing a study that reports that only thirty-eight percent of such officials consider themselves "very knowledgeable" about public finance).

Rhode Island's model provides for increasing levels of oversight that respond to the needs of each financially distressed municipality. The state revised its municipal financial oversight regime and granted more powers to state-appointed overseers in response to the fiscal crisis in Central Falls. Central Falls ultimately filed for bankruptcy under the revised law in 2011.[69]

The first step in the Rhode Island model is the appointment of a fiscal overseer, either at the request of the municipal governing body or by the state director of revenue in the event that certain indicia of financial distress are present.[70] The fiscal overseer has an advisory role and provides assistance to the municipality in all matters related to its financial affairs.[71] If the fiscal overseer finds that the municipality either will not be able to present a balanced budget or faces a fiscal crisis that poses an imminent danger to its citizens, the state can appoint a budget commission.[72] The budget commission's role is more supervisory than advisory, and it has the authority to formulate and execute the municipality's annual budget and review and approve or disapprove all of the municipality's contracts for goods and services.[73] The last step is the appointment of a receiver for the municipality,[74] which the state can do if either the budget commission concludes that it cannot restore fiscal stability to the municipality[75] or if the director of revenue determines that the municipality is facing a fiscal emergency of such a nature that circumstances do not allow for the appointment of a fiscal overseer or budget commission. The receiver can exercise the power of any elected municipal official and has the power to file a Chapter 9 bankruptcy petition for the municipality.[76]

As is the case in Rhode Island, Michigan's municipal financial oversight law allows the state to replace the elected municipal government. Michigan strengthened its oversight law when both the City of Detroit and the Detroit Public Schools were facing severe financial crises.[77] In Michigan, the state financial authority can

69. *See* Anderson, *supra* note 62, at 595–97 (describing the history of Rhode Island's municipal financial oversight statute).

70. 45 R.I. GEN. LAWS § 45-9-3 (2020).

71. *Cf.* 45 R.I. GEN. LAWS § 45-9-3(d) (2020) (setting forth the responsibilities of the fiscal overseer).

72. 45 R.I. GEN. LAWS § 45-9-5 (2020).

73. *See* 45 R.I. GEN. LAWS § 45-9-6(d) (2020) (setting forth the powers of a budget commission).

74. 45 R.I. GEN. LAWS § 45-9-8 (2020).

75. 45 R.I. GEN. LAWS § 45-9-7 (2020).

76. 45 R.I. GEN. LAWS § 45-9-7(b) (2020).

77. *See* Anderson, *supra* note 62, at 586–87 (describing the history of Michigan's municipal financial oversight statute).

conduct a review to determine whether a local government is suffering from financial stress if the local government requests such a review or if one of a number of triggering financial events, such as the failure to pay salaries or retirement benefits, occurs.[78] If the Governor determines that the local government is suffering from a financial emergency, the Governor may appoint an emergency manager to "act for and in the place and stead of the governing body and the office of the chief administrative officer of the local government."[79] Michigan law gives the emergency manager the power to issue binding orders to the local elected and appointed officials, and if such an official does not comply with the emergency manager's orders, that person can be locked out of the local government offices and facilities, including e-mail and information systems.[80]

Pennsylvania's model is different from the Rhode Island and Michigan models. Although Harrisburg, the state capital, filed for bankruptcy, its case was dismissed six weeks later because the city was not authorized by the state to file.[81] The city worked to resolve its financial distress under the state Municipalities Financial Recovery Act, more commonly known as Act 47. Pennsylvania enacted Act 47 in 1987 in response to the financial distress faced by Pennsylvania municipalities in the wake of the steel industry's collapse.[82] By the time that Harrisburg filed for bankruptcy in 2011, Act 47 was in need of a reassessment. Harrisburg's financial collapse spurred the legislature to make several changes to the act with the goal of making it more effective.

As originally designed in the 1980s, Act 47's goal is to enable a city to help itself emerge from financial distress. To do so, the law leaves the principal responsibility for a municipality's financial affairs to its locally elected officials.[83] Pennsylvania's legislature did not prohibit an outright takeover of city government out of pure benevolence; the Pennsylvania Constitution prohibits a special commission from assuming the functions of city government.[84] Before 2011, however, Act 47 enabled the state to provide technical expertise, but not financial supervision, to a distressed local gov-

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78. MICH. COMP. LAWS. § 141.1544(1) (2012).
79. MICH. COMP. LAWS. § 141.1549 (2012).
80. MICH. COMP. LAWS. § 141.1550 (2012).
81. *In re* City of Harrisburg, 465 B.R. 744, 765 (Bankr. M.D. Pa. 2011).
82. *See* LOCAL GOV'T COMM'N, REPORT ON MUNICIPAL FISCAL DISTRESS: BACKGROUND AND LEGISLATIVE REMEDY, at 1 (Pa. 1987); *see also* Michelle Wilde Anderson, *Who Needs Local Government Anyway? Dissolution in Pennsylvania's Distressed Cities*, 24 WIDENER L.J. 149, 159–161 (2015) (describing the conditions that led Pennsylvania to develop Act 47).
83. LOCAL GOV'T COMM'N, *supra* note 82, at i.
84. PA. CONST. art. III, § 31.

ernment. When a city entered the Act 47 program, the state appointed an Act 47 coordinator for the city, but that coordinator's only duties were (and are)[85] to assist the city government in developing a financial recovery plan. In order for the plan to go into effect, the governing body of the municipality must approve it.[86] The law provided an incentive to municipalities to approve the plan; a municipality that did not approve a plan stood to lose funding from the state for which it would otherwise be eligible.[87] In Harrisburg's case, that proved to be a weak incentive.

As distasteful as financial supervision may seem to residents, Harrisburg's financial crisis illustrates why it is sometimes necessary. In July 2011, Harrisburg did something that no Act 47 municipality had ever done before—it rejected the coordinator's recovery plan.[88] Harrisburg's city government was famously dysfunctional at the time, with a majority of members on the city council intent on filing for bankruptcy regardless of what the mayor or the experts that it had hired to advise the city on its financial problems thought.[89] The squabbles at city hall and the council's rejection of the Act 47 plan led the legislature to do two things: prohibit Harrisburg from filing for bankruptcy[90] and revise Act 47. The revision provided for the appointment of a receiver for a municipality that refused to adopt an Act 47 plan proposed by its coordinator.[91]

By 2011, Act 47 was due for an overhaul. In the wake of Harrisburg's financial woes, the legislature revised the act three times.[92] One problem with Act 47 is that few municipalities succeeded in exiting the program. That remains a problem, with several cities

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85. *See* 53 PA. STAT. § 11701.221(d) (LEXIS through 2020 Sess.).
86. 53 PA. STAT. § 11701.245 (LEXISthrough 2020 Sess.).
87. LOCAL GOV'T COMM'N, 2013 TASK FORCE REPORT ON ACT 47 OF 1987 MUNICIPALITIES FINANCIAL RECOVERY ACT, at 14 (Pa. 2013).
88. *See* Juliet M. Moringiello, *Specific Authorization to File Under Chapter 9: Lessons from Harrisburg*, 32 CAL. BANKR. J. 237, 242 (2012) (detailing the contentious relationship between Harrisburg's mayor and the city council that led to the rejection of the Act 47 plan).
89. *See id.* (discussing the recommendations of Cravath, Swaine & Moore).
90. 72 PA. STAT. § 1601-D.1 (2012) (prohibiting distressed cities from filing for bankruptcy until November 30, 2012). After the City of Harrisburg filed for bankruptcy notwithstanding the statute, it unsuccessfully argued in the bankruptcy court that the statute was special legislation prohibited by the Pennsylvania Constitution. The court dismissed the bankruptcy case on the grounds that the filing was not authorized. *See In re* City of Harrisburg, 465 B.R. 744 (Bankr. M.D. Pa. 2011).
91. 53 PA. STAT. § 11701.702 (LEXIS through 2020 Sess.).
92. *See* LOCAL GOV'T COMM'N, *supra* note 87, at 16–17 (describing the 2011 and 2012 amendments); William C. Rhodes & Kimberly D. Magnini, *Act 47: Pennsylvania Says Enough is Enough. Or is It?*, BALLARD SPAHR (Oct. 31, 2014), https://www.ballardspahr.com/alertspublications/legalalerts/2014-10-31-act-47-pennsylvania-says-enough-is-enough-or-is-it (explaining the 2014 amendments).

marking their third decade in the program[93] despite a new provision that attempts to limit a municipality's stay in the Act 47 program to five years.[94] In addition, the state's Local Government Commission concluded that Act 47 did not adequately respond to situations where political dysfunction prevented the adoption and implementation of a recovery plan.[95] To address that flaw, the act now permits the Governor to appoint a receiver for a municipality that has failed to adopt its Act 47 coordinator's plan.[96] The receiver has the power to require the municipal government to implement the recovery plan and dispose of assets if necessary, but the municipal government remains in place.[97] As a result, the receiver must work with elected officials.

Rhode Island, Michigan, and Pennsylvania provide just three examples of municipal financial intervention. Regardless of how oversight is structured, residents are likely to view the supervision as a takeover of city government.[98] The appointment of a receiver for the City of Harrisburg was widely reported as a state takeover of the city despite the fact that the mayor remained in power.[99] How supervision is implemented is key to preserving the voting rights and voice of residents.

III. MUNICIPAL PROPERTY AND RESIDENT VOICE

A key challenge in a municipal bankruptcy and in municipal financial crises handled outside of Chapter 9 involves the disposition of municipal property. This challenge erupted into the international limelight in Detroit's bankruptcy when questions arose as to whether the renowned collection of the Detroit Institute of Art was

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93. The cities of Scranton, Chester, and Johnstown, as well as several smaller Pennsylvania municipalities have been in the Act 47 program for more than 20 years. *See* PA. DEP'T OF CMTY. & ECON. DEV., *Act 47 Financial Distress*, https://dced.pa.gov/local-government/act-47-financial-distress (last visited May 30, 2020).

94. 53 PA. STAT. § 11701.254 (LEXIS through 2020 Sess.).

95. LOCAL GOV'T COMM'N, *supra* note 87, at 26.

96. 53 PA. STAT. §§ 11701.602, 11701.702 (LEXIS through 2020 Sess.).

97. 53 PA. STAT. §§ 11701.706, 11701. 708 (LEXIS through 2020 Sess.).

98. *See* Gillette, *supra* note 67, at 1379 (explaining that the appointment of an entity charged with financial intervention is likely to generate hostility among municipal residents regardless of whether the state appointed entity has the authority to displace city officials).

99. *See, e.g.*, Marc Levy, *Corbett Taps Retired General to Steer Pa. Capital*, THE TRIBUNE-DEMOCRAT (May 11, 2012), https://www.tribdem.com/news/local_news/corbett-taps-retired-general-to-steer-pa-capital/article_c3b2f283-942a-54d6-9712-74aa48c2bf0c.html (describing the appointment of a receiver for Harrisburg as "an unprecedented takeover of one of [Pennsylvania's] cities."); *see also* Eric Veronikis, Bankruptcy Hearing Affects More Than Harrisburg, Finance Experts Say, PENNLIVE (Nov. 23, 2011), https://www.pennlive.com/midstate/2011/11/bankruptcy_hearing_affects_mor.html ("Debt-hobbled Harrisburg's options might soon be whittled down to one: a state takeover.").

up for grabs by creditors.[100] If the collection had been owned by an individual or a business entity in bankruptcy, there would have been no question that the creditors were entitled to the value of the collection in bankruptcy.[101] Municipal bankruptcy is different because municipalities hold their property in public trust for their residents.

The rule that a municipality holds property in trust for its residents has its roots in the 1880 Supreme Court opinion in *Meriwether v. Garrett*.[102] The *Meriwether* opinion lays out clearly the web of relationships with respect to municipal property. The case arose from a municipal financial crisis involving Memphis, Tennessee. In response to the crisis, the state repealed the city's charter and appointed a receiver to take control of the city's property and collect taxes due to the city.[103] A group of the city's creditors then sued in state court to force the receiver to apply the city's property to the debts owed to them, and the state court granted the request.[104] In rejecting the rulings of the lower courts, the Supreme Court acknowledged that although the residents of the city had no vested right in the city charter, they were the beneficiaries of a trust imposed on property held by the city for public use, and therefore the creditors were not entitled to force the sale of such property.[105] In recognizing a trust structure, the Court implied that a municipality is akin to the trustee of a private trust in that it has "no proprietary rights distinct from the trust for the public."[106] As a result, even when a state takes over a city, it is holding the city property for the residents, not for the creditors.

Although a municipality cannot lose property by forced sale, the municipal government can decide to sell property for the benefit of the municipality's creditors. Here is where municipal bankruptcy or non-bankruptcy insolvency might cause a dispossession as we commonly think of it. Whether a city files for bankruptcy or not, a city in distress is likely to sell property to alleviate its debt burden. In order to emerge from its distress, a city needs to balance its budget, and that can be done only by increasing revenue and reducing expenses. Yet the obvious method of increasing revenue, raising taxes, may be futile. Another method is selling property.

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100. *See generally* Brian L. Frye, *Art & the "Public Trust" in Municipal Bankruptcy*, 93 U. DET. MERCY L. REV. 629 (2016) (describing the history of the Detroit Institute of Art and describing the dispute over the art in the bankruptcy case).
101. *See supra* notes 20–22 and accompanying text.
102. 102 U.S. 472 (1880).
103. *Id.* at 503–05.
104. *Id.* at 510.
105. *Id.* at 511–13.
106. *Id.* at 513.

Some have argued that a municipality may be required to sell property in order to prove to a court that its Chapter 9 plan of adjustment meets all requirements for plan confirmation.[107] In recent years, cities have monetized assets such as parking systems, ice arenas, airports, and waterworks.[108] Whether or not a municipality sold assets to alleviate budget problems might be a consideration in determining whether a municipality is even eligible to file for Chapter 9.[109]

In the case of an ordinary trust, a trustee holds property as a fiduciary for the beneficiaries of that trust. As a result, the trustee must "administer the trust solely in the interest of the beneficiaries."[110] Likewise, corporate directors are bound to act in the best interests of the corporation that they serve.[111] Few have explored how that trust concept translates to the municipal environment when a public official disposes of property held in the public trust. Courts impose fiduciary duties on elected officials, requiring them to act for the good of others rather than their own good.[112] This fiduciary duty runs to the public in general because a public official acts as a "trustee for the citizens and the state . . . ."[113] Yet when the City of Chicago transferred seventy-five years of revenue from its parking system in a transaction described as "hasty [and] uninformed," neither the litigants nor the court raised any issue of fiduciary duties.[114] Two scholars have made a compelling argument that the legal history of cities supports the application of a corporate-style duty of care to municipal officials when they transact in property held in the public trust.[115] Imposing such a duty would al-

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107. *See* B. Summer Chandler & Mark S. Kaufman, *Maybe Taxes Aren't So Certain: What is Fair and Equitable in a Chapter 9 Plan*, 32 AM. BANKR. INST. J. 12, 12–13 (2013).

108. Max Schanzenbach & Nadav Shoked, *Reclaiming Fiduciary Law for the City*, 70 STAN. L. REV. 565, 567–72 (2018).

109. *See In re* City of Detroit, 504 B.R. 191, 264 (Bankr. E.D. Mich. 2013) (rejecting objecting creditors' argument that the city should have monetized assets to alleviate its cash flow insolvency because "a one-time infusion of cash, whether from an asset sale or a borrowing, only delays the inevitable failure"); *In re* City of Stockton, 493 B.R. 772, 790 (Bankr. E.D. Cal. 2013) (acknowledging, in analyzing the city's budget insolvency, that "[f]ew fixed assets are available to be sold or otherwise monetized").

110. WILLIAM M. MCGOVERN, JR. ET AL., WILLS, TRUSTS, AND ESTATES INCLUDING TAXATION AND FUTURE INTERESTS § 14.1 (5th ed. 2017).

111. JAMES D. COX & THOMAS LEE HAZEN, BUSINESS ORGANIZATIONS LAW § 10.2 (4th ed. 2016).

112. Vincent R. Johnson, *The Fiduciary Obligations of Public Officials*, 9 ST. MARY'S J. LEGAL MALPRACTICE & ETHICS 298, 315 (2019); *see also* Ethan J. Leib et al., *Translating Fiduciary Principles into Public Law*, 126 HARV. L. REV. F. 91, 93–96 (2013) (describing the difficulties inherent in translating private fiduciary concepts to the duties of elected officials).

113. *See* Johnson, *supra* note 112, at 317–18.

114. *See* Schanzenbach & Shoked, *supra* note 108, at 567–69 (describing the Chicago parking system deal and the lack of fiduciary analysis applied to it).

115. *See id.* at 573–74.

low courts to review the city's decision-making process in monetizing assets held in the public trust.[116]

A city government always has the right to dispose of property held in the public trust. When a city becomes unable to pay its debts, however, the leadership of the municipal government can be replaced by unelected officials. This is not a function of bankruptcy law, rather, it is a function of state law. As noted above, it is unclear what the duties of elected officials are to the public when they monetize public property. It is even less clear what the duties of appointed receivers and emergency managers are.[117] In replacing city government officials, a state dispossesses citizens of their voice in choosing the people who determine the future of the property held for them in the public trust.

IV. SUGGESTIONS FOR REFORM

There are several legal changes that can preserve the voices of city residents in resolving municipal financial distress. They range from those that are in state hands to those that can only be implemented by amendments to the Bankruptcy Code.

A. *Proactive Approach to Municipal Finance*

As the discussion above illustrates, states tend to be reactive in their approaches to managing municipal financial distress. When bankruptcy appears to be a realistic threat, states ratchet up their supervision, often in ways that deprive the distressed municipality's residents of a voice in what happens to municipal property. Technical assistance in the form of early intervention in financial distress is useful for several reasons. Most obviously, it can head off a potential bankruptcy filing. It also permits the municipality to work in a cooperative and positive environment with state appointed players in furtherance of a common goal.[118]

Even better than early intervention is oversight over municipal borrowing at all stages. North Carolina has an effective system for

116. *See id.* at 574.

117. For example, Pennsylvania's Act 47 is silent as to what a receiver must consider before monetizing public trust assets. *See e.g.*, 53 PA. STAT. § 11701.706 (LEXIS through 2020 Sess.) (setting forth the powers and duties of an appointed receiver).

118. LOCAL GOV'T COMM'N, 2013 TASK FORCE REPORT ON ACT 47 OF 1987 MUNICIPALITIES FINANCIAL RECOVERY ACT, at 23–24 (Pa. 2013) (advocating for an "effective and timely early warning system . . . to trigger the offer of technical assistance and training to pre-distressed municipalities); *see also* 53 PA. STAT. §§ 11701.101-A–11701.108-A (LEXIS through 2020 Sess.) (codifying an early intervention program in Pennsylvania).

supervising municipal borrowing.[119] North Carolina requires the approval of its Local Government Commission for all municipal borrowings. This approach, adopted in the 1930s after numerous bond defaults in the state, has largely kept its municipalities out of financial distress. In North Carolina, a municipal official can be removed from office for not complying with the law governing approvals of municipal borrowing.[120] Proponents of North Carolina's approach credit the Local Government Commission with giving local governments "the flexibility to make decisions to positively affect their communities."[121]

B. *Reject Takeover for Cooperative Oversight*

The residents of a municipality are the ones who are going to have to live with the long-term consequences of any recovery plan. Their voice in the process should therefore be preserved. Although as explained above, any act of state oversight is often considered to be a takeover, there are ways to soften that perception.

In implementing cooperative oversight, states should consider the prerequisites for serving in an oversight position. In Pennsylvania, the person appointed as receiver must have experience in business, state, or local budgetary matters and must also have been a resident of Pennsylvania for at least a year prior to appointment.[122] In Michigan, the Emergency Manager must likewise have financial expertise, but the appointee "may, but need not, be a resident of the local government" for which the Emergency Manager is appointed.[123] For example, Kevyn Orr, the Emergency Manager appointed for Detroit, came to the job from Washington, D.C.[124]

C. *Permit Municipalities to File for Bankruptcy*

Bankruptcy is an important implement in the financial recovery toolbox. As explained above, a municipality can file for Chapter 9

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119. *See generally* Adam C. Parker, *Positive Liberty in Public Finance: State Oversight of Local-Government Debt and the North Carolina Model,* 37 CAMPBELL L. REV. 107, 160 ("North Carolina's experience has shown that such a system keeps local-government interest rates low and helps avert fiscal crises.") (2015).
120. N.C. GEN. STAT. § 159-182 (West, Westlaw through 2019 Sess.).
121. Parker, *supra* note 119.
122. 53 PA. STAT. § 11701.705(b) (LEXIS, through 2020 Sess.).
123. MICH. COMP. LAWS § 141.1549(3) (West 2020).
124. Chad Livengood, *In Detroit and Flint, Two Tales of Emergency Management*, CRAIN'S DETROIT BUS. (Apr. 29, 2018), https://www.crainsdetroit.com/article/20180429/blog026/659321/in-detroit-and-flint-two-tales-of-emergency-management.

only if its state specifically permits such a filing.[125] Prohibiting a municipality from filing for bankruptcy deprives a municipality of a key tool in resolving its financial distress. Even if a municipality does not ultimately file for bankruptcy, the threat to do so is a potent tool in creditor negotiations. For example, the Receiver for Harrisburg made clear that a key part of his strategy for negotiating with creditors was to prepare to file for bankruptcy.[126] Combined with the cooperative oversight suggested above, allowing municipalities the use of the full municipal financial recovery toolkit gives residents important control over their municipality's destiny.

D. *On the Federal Level: Formalize Service Delivery Insolvency*

Many people would be surprised to learn that neither a business entity nor an individual must be insolvent before filing for bankruptcy. As discussed above, however, that is not the case for a municipality. This requirement has prevented some municipalities from seeking bankruptcy protection.[127] Although the Bankruptcy Code defines insolvency for a municipality as the inability to pay debts as they come due,[128] it is not always clear how dire a municipality's situation must be in order to file.

The fact that a city must be out of money to take advantage of bankruptcy runs counter to the idea that a city exists to provide public services to its residents. As discussed above, the courts in several recent high-profile municipal bankruptcy cases, including that of Detroit, have recognized the concept of service delivery insolvency.[129] A city is insolvent in that sense when it can no longer effectively provide the necessary public services. Combining service delivery insolvency with primary decision-making by elected officials would allow residents to have some voice in their city's destiny before public services fall below an acceptable level.[130]

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125. *See supra* notes 51–56 and accompanying text.

126. Donald Gilliland, *Why Not Bankruptcy for Harrisburg's Debt? A Closer Look at the Receiver's Strategy*, PENNLIVE (July 24, 2013), https://www.pennlive.com/midstate/2013/07/why_not_bankruptcy_for_harrisb.html.

127. *See* Coordes, *supra* note 49, at 1224–25 (explaining that the insolvency requirement deprives struggling cities of needed relief).

128. 11 U.S.C. § 101(32)(C) (2018).

129. *See supra* notes 36–40 and accompanying text.

130. *See* Chung, *supra* note 53, at 69 (opining that Judge Rhodes' consideration of service delivery insolvency in deciding that Detroit was eligible for Chapter 9 "opened the door to consideration of taxpayer interests at the eligibility stage").

CONCLUSION

At the time of this writing, the municipal bankruptcy scene is quiet with no new filings by cities, counties, or towns. The municipal bankruptcy cases in the past ten years involving Detroit, Stockton, and Central Falls, and the insolvency case of Harrisburg, provide valuable lessons if lawmakers reassess their approaches to mumunicipal insolvency. While state oversight of municipal finances can be effective, it should be effectuated in such a way as to preserve resident voice as much as possible so that residents are not dispossessed of their voice, nor of property held in trust for them.