

MUNICIPAL BANKRUPTCY, ESSENTIAL MUNICIPAL SERVICES, AND TAXPAYERS' VOICE

Christine Sgarlata Chung\*

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\* Christine Sgarlata Chung is an Associate Professor of Law at Albany Law School and Co-director of the Albany Institute for Financial Market Regulation at Albany Law School/University. She received her J.D. from Harvard Law School and B.A. from Amherst College.

## I. INTRODUCTION

More than fifty years ago, Charles Tiebout explained local governments in market terms.<sup>1</sup> In Tiebout's telling, mobile consumer-voters choose to live in communities that "best satisf[y] [their] preference pattern for public goods."<sup>2</sup> To attract these preference-maximizing and mobile consumer-voters, local governments compete with one another to provide a desired mix of amenities (for example, schools, parks, and police protection) at an acceptable price.<sup>3</sup> Under a Tieboutian regime, local governments compete for residents by "keeping taxes relatively low, not redistributing monies from rich people to poor people, keeping crime down, and by otherwise providing an environment conducive to capital attraction and retention."<sup>4</sup>

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<sup>1</sup> Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418 (1956) (discussing the role of local government in providing and paying for public goods using set revenue patterns as compared to central level government which adjusts to the preferences of voters); *see also* Barry Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J. L. ECON. & ORG. 1, 5 (1995) (analogizing municipalities to businesses by noting that "jurisdictions must compete for capital, labor, and economic activity by offering menus of public policies (e.g. levels of taxation, security of private rights, social amenities, and public goods)").

<sup>2</sup> Tiebout, *supra* note 1, at 418.

<sup>3</sup> *Id.* ("Consider for a moment the case of the city resident about to move to the suburbs. What variables will influence his choice of a municipality? If he has children, a high level of expenditures on schools may be important. Another person may prefer a community with a municipal golf course. The availability and quality of such facilities and services as beaches, parks, police protection, roads, and parking facilities will enter into the decision-making process."); *see also id.* at 419-20 (discussing efforts to attract new residents by expanding suburban housing); Richard C. Schragger, *Rethinking the Theory and Practice of Local Economic Development*, 77 U. CHI. L. REV. 311, 314-15 (2010).

<sup>4</sup> Schragger, *supra* note 3, at 315 (citation omitted); *see also* WILLIAM A. FISCHER, *THE HOMEVOTER HYPOTHESIS* 58-61 (Harvard University Press 2001) (arguing that knowledgeable mobile homebuyers shop for a community that best fits preferences for services and amenities); Weingast, *supra* note 1, at 5 (noting that the mobility of capital gives rise to a diverse array of public goods packages); Wallace Oates, *Fiscal Federalism* 49-50 (Harcourt Brace Jovanovich 1972).

Scholars such as Gerald Frug and David Barron take a different approach to the relationship between local governments and communities.<sup>5</sup> Focusing on the city, Frug and his colleagues argue that local government law and structural forces constrain cities,<sup>6</sup> making it difficult for them to innovate.<sup>7</sup> If cities had additional legal power to innovate—to annex suburban land to share in regional economic growth, for example, or to prevent suburbs from offloading the needs of regional poor—they could govern more effectively and "pursue prosperity unconstrained."<sup>8</sup> Still other urban theorists (notably, Paul Krugman) have advanced an "economic geography" concept of local government formation and development.<sup>9</sup> Krugman and his colleagues argue that local communities are "self-organizing" systems characterized by forces which encourage people and businesses to congregate, as well as forces which encourage people and businesses to disperse.<sup>10</sup> In this telling, even small, uncoordinated decisions by public and private actors (for example, whether and where to build a road, or whether to open or close a store) can contribute to a neighborhood's or a community's prosperity or decline.<sup>11</sup>

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<sup>5</sup> GERALD E. FRUG & DAVID BARRON, CITY BOUND: HOW STATES STIFLE URBAN INNOVATION 3-5, 7-8, 14-16 (Cornell 2009) (discussing the impact of state imposed limits on city structures in regards to city governments' abilities to improve cities); *id.* at 9-11, 34-36 (introducing and explaining the logic behind the focus on legal and structural constraints on city power); *see also* Richard Schragger, *Can Strong Mayors Empower Weak Cities? On the Power of Local Executives in a Federal System*, 115 YALE L.J. 2542, 2564 (2006); Gerald Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1059, 1062 (1980) (arguing that cities cannot "solve their current problems or . . . control their future development" because their governing power is restricted by state law).

<sup>6</sup> FRUG & BARRON, *supra* note 5, at 9-11.

<sup>7</sup> *Id.* at 20.

<sup>8</sup> Schragger, *supra* note 3, at 316.

<sup>9</sup> *See, e.g.*, PAUL KRUGMAN, THE SELF-ORGANIZING ECONOMY 22-30, 49 (Blackwell 1996).

<sup>10</sup> *See, e.g., id.*

<sup>11</sup> *See, e.g.*, JANE JACOBS, THE DEATH AND LIFE OF GREAT AMERICAN CITIES, 241-42, 245-46, 249-50, 258-59 (Random House 1961).

Under all of these theories, however, local governments are intimately involved with public health and safety.<sup>12</sup> This role for local governments fits with how we build, pay for, and provide public services and infrastructure in this country.<sup>13</sup> Local governments build our local roads, water and sewer facilities, hospitals, schools, and other local public infrastructure.<sup>14</sup> Local governments employ local police officers, fire fighters, teachers, and other local public health and safety workers.<sup>15</sup> And, local governments assess property and use taxes, issue bonds, seek funding from higher levels of government, and otherwise raise revenue to pay for this work.<sup>16</sup>

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<sup>12</sup> See FRUG & BARRON *supra* note 5, at 92-95, 150 (discussing a local government's responsibility to provide police and fire protection requiring cities to spend a large portion of revenue on these services).

<sup>13</sup> See generally *id.* at 92-95, 108-09 (discussing how state imposed limits on city finances affect land use policies and how cities raise tax revenue).

<sup>14</sup> For example, according to the United States Census Bureau statistics, in 2011, education and utility (principally water and gas) expenditures "topped their [local government] spending at \$599.3 billion and \$183.7 billion, respectively." JEFFREY L. BARNETT & PHILLIP M. VIDAL, U.S. CENSUS BUREAU, STATE AND LOCAL GOVERNMENT FINANCES SUMMARY: 2011, at 4 (2013), available at [http://www2.census.gov/govs/local/summary\\_report.pdf](http://www2.census.gov/govs/local/summary_report.pdf); see also *id.* ("Utility spending was also dominated by local governments, with spending on water supply and gas supply almost entirely conducted by local governments, at 99.4% and 99.8%, respectively.").

<sup>15</sup> According to statistics published by the Department of Labor, Bureau of Labor Statistics (BLS), in 2012, there were approximately 14,045,000 local government workers in the United States (compared to only 5,0550,000 state government workers). *Current Employment Statistics (National)*, BUREAU OF LABOR STATISTICS, <http://bls.gov/ces/data.htm> (data portal). The data reported above is seasonally adjusted, and spreadsheets obtained through the BLS reflecting the cited figures are on file with the author. Census Bureau data reflects that the largest share of the local public workforce is comprised of teachers, aides, and support staff working at public schools. DEIRDRE BAKER, U.S. CENSUS BUREAU, ANNUAL SURVEY OF PUBLIC EMPLOYMENT & PAYROLL SUMMARY REPORT: 2011, 3-4, 7-8, tbls.1-2 (2013), available at <http://www.census.gov/prod/2013pubs/g11-aspep.pdf>. Other categories with comparatively large numbers of workers include protective services (police, fire, EMS, correctional officers), health care, and transportation. *Id.* at 7-8, tbls.1-2.

<sup>16</sup> See BARNETT & VIDAL, *supra* note 14, at 6, app.tbl.A-1 (listing sources of local government revenue). For a discussion of the municipal bond market as a source of funding for public infrastructure and services, see Christine Sgarlata Chung, *Municipal Securities: The Crisis of State and Local Government*

This role for local governments also is embedded in the law. As Judge Stephen Rhodes has opined in the context of municipal bankruptcy, for example, the "purpose of municipalities (i.e., police protection, fire protection, sewage, garbage removal, schools, hospitals) is to provide essential services to residents."<sup>17</sup> Likewise, when Harrisburg, Pennsylvania was placed in receivership following Pennsylvania's declaration of fiscal emergency,<sup>18</sup> the receiver commented, in announcing the city's intention to miss payments due on certain bonds, that his "first

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*Indebtedness, Systemic Costs of Low Default Rates, and Opportunities for Reform*, 34 CARDOZO L. REV. 1455, 1458-60 (2013). For an explanation of why the municipal securities market has become so important to local governments as a source of funding see W. Bartley Hildreth & C. Kurt Zorn, *The Evolution of the State and Local Government Municipal Debt Market Over the Past Quarter Century*, PUB. BUDGET & FIN. 127, 132-33 (2005) (arguing that local governments turned to the municipal securities markets to fund public infrastructure and services and to meet day-to-day funding needs as a matter of "necessity" beginning in the late 1970s and early 1980s, because state and local governments were facing "mounting capital need and fewer degrees of freedom to deal with these needs because of high interest rates, inflation and a slowing economy, reduction in federal aid as a result of concern over mounting federal budget deficits, and tax and expenditure limitations on state and local governments"); GEN. ACCOUNTING OFFICE, TRENDS AND CHANGES IN THE MUNICIPAL BOND MARKET AS THEY RELATE TO FINANCING STATE AND LOCAL PUBLIC INFRASTRUCTURE i-ii (1983) [hereinafter GAO REPORT] ("[R]ecent cutbacks in Federal grants for infrastructure and the deterioration of State and local fiscal conditions have increased the importance of the municipal bond market as a source of infrastructure finance."), available at <http://archive.gao.gov/f0102/122366.pdf>. Today, there are approximately \$3,660.8 billion of municipal bonds estimated to be outstanding, and annual issuances in excess of \$200 billion for the past fifteen years. See *Statistics, General—U.S. Bond Market Outstanding*, SEC. INDUS. & FIN. MKTS. ASS'N (SIFMA), available at <http://www.sifma.org/research/statistics.aspx> (last updated August 20, 2014); *Statistics, Municipal—U.S. Municipal Issuance*, SIFMA, available at <http://www.sifma.org/research/statistics.aspx> (last updated August 4, 2014).

<sup>17</sup> *In re Addison Cnty. Comm. Hosp. Auth.*, 175 B.R. 646, 648 (Bankr. E.D. Mich. 1994).

<sup>18</sup> See PA. GOVERNOR'S OFFICE, DECLARATION OF FISCAL EMERGENCY – CITY OF HARRISBURG, PENNSYLVANIA (Oct. 24, 2010), available at <http://www.portal.state.pa.us/portal/server.pt?open=514&objID=1053490&parentname=ObjMgr&parentid=24&mode=2>; *Walker v. City of Harrisburg*, No. 569 M.D. 2011, 2012 WL 3661779 at \*1-2 (Pa. Commw. Ct. Aug. 27, 2012) (Memorandum and Order).

priority as receiver is to ensure that vital and necessary services such as police and fire are maintained within Harrisburg during the state of fiscal emergency."<sup>19</sup> The idea that local governments should use public resources to serve the public good lies at the heart of the compact between government and those governed, and local governments that neglect this tenant risk fiscal distress and legal, political, and economic sanction.<sup>20</sup>

For example, Detroit, Michigan declared bankruptcy after years of corruption and alleged financial mismanagement laid waste to the city's finances.<sup>21</sup> According to federal prosecutors, Detroit's former mayor, Kwame Kilpatrick, used the "power and authority of [the mayor's] office . . . to 'extort' municipal contractors by 'coercing' them to include [a co-conspirator] in public contracts, and to rig the awarding of public contracts to ensure that [the co-conspirator] obtained a portion of the revenue from [the rigged] contracts."<sup>22</sup> Kilpatrick was convicted on dozens

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<sup>19</sup> See, e.g., *GOB-Smacked: Harrisburg to Default on General Obligation Bonds*, INVESTMENTNEWS.COM (March 9, 2012) [hereinafter *Harrisburg Default*], <http://www.investmentnews.com/article/20120309/FREE/120309870>. For a discussion of state intervention regimes generally, see THE PEW CHARITABLE TRUSTS, *THE STATE ROLE IN LOCAL GOVERNMENT FINANCIAL DISTRESS*, (July 2013), available at [http://www.pewtrusts.org/~media/Assets/2013/07/23/Pew\\_State\\_Role\\_in\\_Local\\_Government\\_Financial\\_Distress.pdf?la=en](http://www.pewtrusts.org/~media/Assets/2013/07/23/Pew_State_Role_in_Local_Government_Financial_Distress.pdf?la=en). For a discussion of Pennsylvania law and Harrisburg, or Pennsylvania's experiences in receivership, see Juliet M. Moringiello, *Goals and Governance in Municipal Bankruptcy*, 71 WASH. & LEE L. REV. 403, 475-78 (2014).

<sup>20</sup> See, e.g., Alicia H. Munnell, et al., *Are City Fiscal Woes Widespread? Are Pensions the Cause?*, 36 CTR. FOR RET. RES. AT BOS. COLL. at 5 (Dec. 2013) (citing mismanagement as a key driver of fiscal distress), available at [http://crr.bc.edu/wp-content/uploads/2013/12/slp\\_36.pdf](http://crr.bc.edu/wp-content/uploads/2013/12/slp_36.pdf).

<sup>21</sup> Steve Yaccino, *Kwame M. Kilpatrick, Former Detroit Mayor, Sentenced to 28 Years in Corruption Case*, N.Y. TIMES (Oct. 10, 2013), [http://www.nytimes.com/2013/10/11/us/former-detroit-mayor-kwame-kilpatrick-sentencing.html?\\_r=0](http://www.nytimes.com/2013/10/11/us/former-detroit-mayor-kwame-kilpatrick-sentencing.html?_r=0).<sup>22</sup> See U.S. ATTORNEY'S OFFICE, EAST. DIST. OF MICH., News Release, *Former Detroit Mayor Kwame Kilpatrick, Contractor Bobby Ferguson and Bernard Kilpatrick Sentenced on Racketeering, Extortion, Bribery, Fraud and Tax Charges* (Oct. 17, 2014), [http://www.justice.gov/usao/mie/news/2013/2013\\_10\\_17\\_kkilpatrick\\_et\\_al.html](http://www.justice.gov/usao/mie/news/2013/2013_10_17_kkilpatrick_et_al.html).

<sup>22</sup> See U.S. ATTORNEY'S OFFICE, EAST. DIST. OF MICH., News Release, *Former Detroit Mayor Kwame Kilpatrick, Contractor Bobby Ferguson and*

of counts of racketeering and extortion in connection with this scheme, and sentenced to twenty-eight years in prison,<sup>23</sup> making him one of eighteen public officials convicted of corruption during his tenure.<sup>24</sup> In addition to Kilpatrick's corruption, decades of economic and demographic headwinds, coupled with "fiscal mismanagement . . . and excessive borrowing that provided short term band-aids at the cost of deepening insolvency," strained the city's finances to the breaking point,<sup>25</sup> leaving the city deeply in debt and unable to meet even basic health and safety needs.<sup>26</sup>

Once a municipality falls on hard times,<sup>27</sup> deciding what bills to pay becomes a Gordian Knot for municipalities, even when public officials in good faith seek to serve the public good.<sup>28</sup> For example, pension-related obligations represent more than half of Detroit's \$18 billion debt.<sup>29</sup> Would it serve the public good for

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*Bernard Kilpatrick Sentenced on Racketeering, Extortion, Bribery, Fraud and Tax Charges* (Oct. 17, 2014), [http://www.justice.gov/usao/mie/news/2013/2013\\_10\\_17\\_kkilpatrick\\_et\\_al.html](http://www.justice.gov/usao/mie/news/2013/2013_10_17_kkilpatrick_et_al.html).

<sup>23</sup> *Id.*

<sup>24</sup> See, e.g., *id.*; see also Yaccino, *supra* note 21; United States v. Kilpatrick, No. CR-10-200403-NGE (E.D. Mich. (Dec. 15, 2010), available at <http://tellusdetroit.com/city-gov/fed/court/KILPATRICK-RICO-Indictment.pdf>.

<sup>25</sup> See Declaration of Kevyn D. Orr in Support of City of Detroit, Mich.'s Statement of Qualifications Pursuant to Section 109(c) of the Bankruptcy Code at 4-5, *In re City of Detroit*, 504 B.R. 97 (Bankr. E.D. Mich. 2013) (No. 13-53846) [hereinafter Orr Declaration]; accord *In re City of Detroit (Eligibility Opinion)*, 504 B.R. 97, 112, 120-21 (Bankr. E.D. Mich. 2013); see also Michael A. Fletcher, *Detroit Goes Bankrupt, Largest Municipal Filing in U.S. History*, WASH. POST (July 18, 2013), [http://washingtonpost.com/business/economy/detroit-files-largest-municipal-bankruptcy-in-us-history/2013/07/18/a8db3f0e-efe6-11e2-bed3-b9b6fe264871\\_story.html](http://washingtonpost.com/business/economy/detroit-files-largest-municipal-bankruptcy-in-us-history/2013/07/18/a8db3f0e-efe6-11e2-bed3-b9b6fe264871_story.html).

<sup>26</sup> See *Eligibility Opinion*, 504 B.R. at 112, 120, 169-70.

<sup>27</sup> See generally Chung, *supra* note 16, at 1458-60, 1469-73 (discussing causes and consequences of municipal financial distress).

<sup>28</sup> *Id.* at 469-73; see also *Harrisburg Default*, *supra* note 19.

<sup>29</sup> The City's debts, which are comprised of \$11.9 billion in unsecured debt and \$6.4 billion in secured debt, include the following: (a) \$5.85 billion in special revenue obligations; (b) \$6.4 billion in other post-employment benefits, or "OPEB" liabilities; (c) \$3.5 billion in underfunded pension liabilities based on current actuarial estimates; (d) \$1.13 billion in securities and unsecured general obligation ("GO") liabilities; (e) \$1.43 billion in liabilities under pension-related certifications of participation ("COPs"); (f) \$296.5 million in swap liabilities

Detroit to use its limited resources to pay these obligations? After all, the workers entitled to these benefits (who reportedly receive on average \$18,000 per year)<sup>30</sup> lived up to their end of the bargain during their terms of employment.<sup>31</sup> In addition, the Michigan Constitution contains non-impairment and contract clauses which prohibit the state or the city from impairing accrued pension rights.<sup>32</sup> But, what if paying pension-related obligations means emptying the city's coffers, increasing taxes (despite statutory tax caps), and making further cuts to the City's already-decimated public services?

Likewise, would it serve the public good for Detroit to pay its bondholders, especially those bonds backed by the city's pledge of taxing power and authorizing votes?<sup>33</sup> After all, Detroit promised to devote *ad valorem* taxes to bond repayment when it authorized these offerings and went to market.<sup>34</sup> What if paying bondholders means defaulting on pension-related obligations, implementing

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related to the COPs; and (g) \$300 million in other liabilities. Orr Declaration, *supra* note 25, at 5-6, 6 n.3-4.

<sup>30</sup> See *Eligibility Opinion*, 504 B.R. at 114 ("The average annual benefit received by retired pensioners or their beneficiaries is about \$18,000.").

<sup>31</sup> *Detroit's City Retirees Worry Pensions Won't Be Paid*, HERE & NOW (July 19, 2013), <http://hereandnow.wbur.org/2013/07/19/Detroit-workers-pension> (transcript statement of Cynthia Falska, Detroit Police Department retiree).

<sup>32</sup> See generally Christine Sgarlata Chung, *Zombieland / The Detroit Bankruptcy: Why Debts Associated with Pensions, Benefits, and Municipal Securities Never Die . . . And How They Are Killing Cities Like Detroit*, 41 *FORDHAM URB. L.J.* 771, 771, 817-34 (March 2014) (discussing the Michigan Constitution's non-impairment and contract clauses).

<sup>33</sup> See Complaint of Ambac Assurance Corp. for Declaratory Judgment and Order, *Ambac Assurance Corp. v. City of Detroit (In re Detroit)*, No. 13-53846, ¶ 2 (E.D. Mich. Nov. 8, 2013) (arguing city's failure to devote *ad valorem* taxes to repayment of unlimited tax bonds is unlawful, when bonds were issued "only after authorizing resolutions by the City Council, the legislative body of the City, and approval by a majority of the voters in a city-wide election establishing a pledge of *ad valorem* taxes, as security, to repay these obligations exclusively"); see also Complaint for Declaratory Judgment and Order, *Nat'l Pub. Fin. Guarantee Corp. v. City of Detroit (In re City of Detroit, Mich.)*, No. 13-53846, ¶ 10 [hereinafter National Complaint] (Bankr. E.D. Mich. Nov. 13, 2013). Details regarding the issuances in dispute are set forth at ¶¶ 10-32 and ¶¶ 26-32 of the National Complaint, respectively.

<sup>34</sup> See *In re Detroit*, No. 13-53846 (E.D. Mich. Nov. 8, 2013).



legally suspect tax increases, and additional punishing service cuts?

Finally, would it serve the public good for Detroit to prioritize the health, safety, and educational needs of current citizens? After all, Detroit's public health and safety infrastructure and services are severely inadequate.<sup>35</sup> But, what if meeting current needs causes Detroit to break promises made to public workers and bondholders?<sup>36</sup> And, what if breaking these promises makes it difficult for Detroit (or other Michigan municipalities) to access public markets for needed financing?<sup>37</sup>

State and federal laws governing financially distressed and insolvent municipalities offer a partial roadmap for sorting out competing stakeholder claims during periods of fiscal strain.<sup>38</sup> At the federal level, Chapter 9 of the Bankruptcy Code provides a mechanism for eligible debtor municipalities to adjust their debts through a court-supervised proceeding.<sup>39</sup> Currently, twelve states have statutory provisions which specifically authorize bankruptcy filings (AL, AZ, AR, ID, MN, MO, MT, NE, OK, SC, TX, and WA) for their municipalities (though authorization language is

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<sup>35</sup> See generally *Eligibility Opinion*, 504 B.R. at 119-20, 168-70 (explaining the many deteriorations of various services and conditions of the city of Detroit).

<sup>36</sup> For example, see *In re Detroit*, No. 13-53846 (E.D. Mich. Nov. 8, 2013), for a discussion of authorization for bond issuances; and see *Eligibility Opinion*, 504 B.R. at 149-50 for a discussion of accrued pension benefits and Michigan law.

<sup>37</sup> In the wake of Detroit's bankruptcy filing, other Michigan municipalities reportedly were forced to delay planned securities offerings. Emily Freeman, *Kellogg Home Is Second Michigan Issuer to Delay Bond Sale*, BLOOMBERG (Aug. 6, 2013), <http://www.bloomberg.com/news/print/2013-08-06/kellogg-hometown-is-2nd-michigan-muni-to-delay-bond-sale.html>; John Gallagher, *Saginaw Is Third Michigan Community in a Week to Withdraw Bond Sale*, DETROIT FREE PRESS (Aug. 8, 2013, 5:45 PM), <http://freep.com/article/20130808/BUSINESS06/308080135/Detroit-Saginaw-municipal-bonds-bankruptcy>.

<sup>38</sup> See, e.g., JAMES E. SPIOTTO, PRIMER ON MUNICIPAL DEBT ADJUSTMENT, CHAPTER 9: THE LAST RESORT FOR FINANCIALLY DISTRESSED MUNICIPALITIES, at D-1, app.D (1st ed. 2012); THE PEW CHARITABLE TRUSTS, *supra* note 19, at 4.

<sup>39</sup> See generally JAMES E. SPIOTTO, ANN E. ACKER & LAURA E. APPELBY, MUNICIPALITIES IN DISTRESS: HOW STATES AND INVESTORS DEAL WITH LOCAL GOVERNMENT FINANCIAL EMERGENCIES (1st ed. 2012).

neither uniform nor comprehensive, even within a single state);<sup>40</sup> another twelve authorize filing conditioned on a further act of the state or designed official or entity (CA, CT, KY, LA, MI, NJ, NC, NY, OH, PA, and RI);<sup>41</sup> and three grant limited authorization for filing (CO, OR, and IL).<sup>42</sup> One state, Iowa, has no specific authorization but allows Chapter 9 filings if a municipality is rendered insolvent as the result of a debt involuntarily incurred.<sup>43</sup> One state, Georgia, prohibits filings,<sup>44</sup> and the remaining twenty-one states are "either unclear or do not have specific authorization" for Chapter 9 filings.<sup>45</sup> At the state level, nineteen states have laws allowing the state to intervene in response to municipal financial distress according to the Pew Charitable Trusts.<sup>46</sup> Although practices vary widely among the states, state statutes which authorize intervention tend to provide for (i) an intervenor in the form of a receiver, emergency manager, state agency head or financial control board; and (ii) some mechanism for the intervenor to facilitate debt relief/restructuring and/or revenue enhancement.<sup>47</sup>

While important, these regimes are limited.<sup>48</sup> First, they are not comprehensive: as noted, not all states have an intervention

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<sup>40</sup> SPIOTTO, *supra* note 38.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> See SPIOTTO ET AL., *supra* note 39, at 51-52. Note that in Pennsylvania, for example, the governor signed into law a provision which prevents any "city of the third class" that has been identified as financially distressed under Pennsylvania's Municipalities Financial Recovery Act from declaring bankruptcy. See Act of June 30, 2011, P.L. 159, No. 26 (printer's no. 1452), art. XVI-D.1, sec. 1601-D.1(a)-(b) (amending the Act of April 9, 1929 (P.L. 343, No.176), known as Pennsylvania's Fiscal Code). That provision, however, was only a temporary measure, expiring on November 30, 2012. Act of Jul. 2, 2012, P.L. 823, No. 87 (codified at 72 P.S. § 1601-D.1).

<sup>44</sup> See SPIOTTO ET AL., *supra* note 39, at 51.

<sup>45</sup> *Id.*; see also SPIOTTO, *supra* note 38.

<sup>46</sup> For a detailed consideration of state intervention regimes (a topic outside the scope of this essay), see THE PEW CHARITABLE TRUSTS, *supra* note 19, at 4.

<sup>47</sup> *Id.* at 7 ("States first designate an intervenor: a receiver, emergency manager, state agency head, or financial control board. Depending on the state, the intervenor is allowed to choose among restructuring debt and labor contracts, raising taxes and fees, offering state-backed loans and grants, providing technical advice, and even dissolving the local government.").

<sup>48</sup> *Id.* at 4, 7.

regime, and the federal municipal bankruptcy regime is available in just over 50 percent of states.<sup>49</sup> Second, there are gaps and complexities in coverage: in Detroit, which is covered by both a state and the Federal Chapter 9 regime, there have been costly debates over the role of intervenors, the power of the bankruptcy judge and the relationship between state and federal law.<sup>50</sup> Finally, distress and insolvency regimes raise knotty questions about the role of democratic local self-governance.<sup>51</sup> What does it mean for democratic self-governance, for example, if a state insolvency regime authorizes an emergency manager to act for, and in place of, elected officials, as has happened in Detroit?<sup>52</sup> Likewise, what does it mean for self-governance if a United States bankruptcy judge holds that accrued pension benefits can be reduced or restructured in Chapter 9 proceedings, even though state law prohibits pension impairment, as also has happened in Detroit?<sup>53</sup>

In earlier work, I argued that municipal securities regulation, with its focus on default risk, prioritizes investors' interest in repayment over taxpayers' interest in providing for essential public infrastructure and services.<sup>54</sup> I further argued that as a result of its focus on default risk, municipal securities regulation externalizes and does not adequately address risks and costs that taxpayers face when local governments direct resources away from public

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<sup>49</sup> SPIOTTO, *supra* note 38.

<sup>50</sup> *See generally* Moringiello, *supra* note 19, at 480-83 (noting that because there are so few Chapter 9 cases, there are few clear answers respecting the boundaries of state and federal regimes).

<sup>51</sup> *See Eligibility Opinion*, 504 B.R. at 129.

<sup>52</sup> *See id.* (observing that individuals who spoke at hearings "expressed another deeply held concern, and even anger, that became a major theme of the hearing—the concern and anger that the State's appointment of an emergency manager over the City of Detroit violated their fundamental democratic right to self-governance").

<sup>53</sup> *See id.* at 150 (explaining that even though Michigan state law prevents the state itself from impairing pensions, this does not preclude a federal bankruptcy court from impairing pensions in a bankruptcy proceeding); *see also* Moringiello, *supra* note 19, at 478-85.

<sup>54</sup> Chung, *supra* note 16, at 1457-60 (explaining how in the mid-1970s, the municipal securities market became more complex as issuers began to search for new ways to pay for public service and infrastructure needs in the midst of financial constraints).

services and infrastructure to repay municipal bond debt.<sup>55</sup> Building upon this work, this essay examines how municipal bankruptcy law addresses taxpayers' interest in devoting resources to public services and infrastructure during periods of insolvency. In Part II, I discuss the goals and constraints of Chapter 9 municipal bankruptcy law, noting the law's interest in ensuring an insolvent municipality's continued existence so that it can provide essential public health and safety services. In Part III, I discuss how the Chapter 9 regime tracks to individual resident/taxpayers, and observe that while taxpayers may not have standing at all stages of Chapter 9 proceedings, the requirement of insolvency (together with judicial discretion) may open the door to a consideration of taxpayer concerns.

## II. THE GOALS AND CONSTRAINTS OF MUNICIPAL BANKRUPTCY LAW

Like its sister chapters, Chapter 9 (the municipal<sup>56</sup> bankruptcy section of the Bankruptcy Code) is designed to give eligible debtors<sup>57</sup> a breathing spell from debt collection efforts through the automatic stay,<sup>58</sup> followed by a court-supervised debt adjustment

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<sup>55</sup> *Id.*

<sup>56</sup> Under Chapter 9, municipality is defined broadly to include a "political division or public agency or instrumentality of a State." 11 U.S.C. § 101(40) (2012). In addition to villages, towns, cities and counties, this definition has been held to include school districts, sanitary and irrigation districts, public authorities, hospitals, and public utilities.

<sup>57</sup> To be eligible for Chapter 9, an entity must meet five criteria. *Id.* § 109(c)(1)-(5). Specifically, the entity must (i) be a municipality, as defined by the code; (ii) be "specifically authorized" to be a bankruptcy debtor; (iii) be "insolvent" as defined by section 101(32)(C); (iv) genuinely "desire[] to effect a plan to adjust [its] debts" that exist as of the commencement of the case; and (v) satisfy one of the four alternative statutory requirements for negotiating with its creditors before filing its petition. *Id.* The debtor bears the burden of establishing that it meets each of these statutory requirements. *See, e.g., In re Cnty. of Orange, Cal.*, 183 B.R. 594, 599 (Bankr. C.D. Cal. 1995).

<sup>58</sup> Like its sister regimes, section 362 (the automatic stay provision) applies in full to Chapter 9 cases. *See In re Jefferson Cnty., Ala.*, 474 B.R. 228, 246 (Bankr. N.D. Ala. 2012); *see also Soares v. Brockton Credit Union (In re Soares)*, 107 F.3d 969, 975 (1st Cir. 1997) ("The automatic stay is among the most basic of debtor protections under bankruptcy law."); *Midlantic Nat'l Bank*

process.<sup>59</sup> Yet, because Chapter 9 reflects two concerns not present in other bankruptcy regimes—for example, a municipality's need to provide essential services despite insolvency<sup>60</sup> and Tenth Amendment concerns<sup>61</sup>—there are important differences between Chapter 9 and non-municipal bankruptcy regimes that have implications for individual resident/taxpayer rights.<sup>62</sup>

First, because municipalities (unlike private actors) must continue to provide essential public health and safety services despite insolvency,<sup>63</sup> Chapter 9 is designed to "foster the continuation of municipalities rather than their dissolution."<sup>64</sup> New York Representative Herman Badillo cited the obligation to

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v. N.J. Dep't of Env'tl. Prot., 474 U.S. 494, 503 (1986); S. REP. NO. 95-989, at 54 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5840. It is intended to give the debtor breathing room by "stop[ping] all collection efforts, all harassment, and all foreclosure actions." H.R. REP. NO. 95-595, at 340 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6296-97; *see also* Interstate Commerce Comm'n v. Holmes Transp., Inc., 931 F.2d 984, 987 (1st Cir. 1991); *In re Smith Corset Shops, Inc.*, 696 F.2d 971, 977 (1st Cir. 1982). In addition, section 922 precludes "all entities," including a state or the United States, from taking action to collect a prepetition debt owed by a municipal debtor. *See* 6 COLLIER ON BANKRUPTCY, ¶ 922.03 at 922-5. Sections 922(a)(1) and (2) stay actions against entities other than a municipal debtor, including actions against an "officer or inhabitant of the debtor that seeks to enforce a claim against the debtor," and actions by a creditor to enforce "a lien on or arising out of taxes or assessments owed to the debtor." Finally, section 922(b) makes the provisions of section 362(c)-(g) applicable to the stay provided by section 922(a). 11 U.S.C. § 922(a)-(b).

<sup>59</sup> Chapter 9 provides for a plan of adjustment, which is similar to a plan of reorganization under Chapter 11. *See* 11 U.S.C. § 941. It also provides that a debtor municipality may assume or reject executory contracts, and further provides that creditors may vote on the plan of adjustment based on voting requirements which are similar to those found in Chapter 11. *See id.* § 901(a) (incorporating 11 U.S.C. § 365); *id.* (incorporating voting requirements set forth in § 1126 save for those dealing with holders of equity interests).

<sup>60</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. 646, 648 (Bankr. E.D. Mich. 1994).

<sup>61</sup> SPIOTTO, *supra* note 38, at 3, 25-26.

<sup>62</sup> *See, e.g., In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 648.

<sup>63</sup> *See, e.g., Bankruptcy Act Revision: Hearing on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong. 634 (1975) [hereinafter *Bankruptcy Act Revision*] (statement of Rep. Badillo).

<sup>64</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 648.

provide essential services when arguing for bankruptcy reform in the mid-1970s, in the wake of New York City's bond crisis.<sup>65</sup>

The reason it is urgent to make this amendment is that the existing bankruptcy law would put the city which is faced with default completely at the mercy of creditors. The city would not be able to go to court unless it could first get the consent of 51 percent of the creditors. A city would not be able to prepare a plan for the reorganization of the debt unless it would first get the consent of two-thirds of the creditors. There is no provision at all on the public interest; there is no recognition of it at all in the existing law that a municipality is not a private enterprise, that one of its most essential functions of government is provide for the public interest; that there have to be essential services provided during the period of transition; that provisions for those essential services must come before the interests of any one creditor.<sup>66</sup>

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<sup>65</sup> In 1975, New York City nearly defaulted on \$600 billion of bonds. Though the city ultimately was saved by the combined effort of unions and the state and federal governments, investigations into the crisis raised significant questions about regulatory regime applicable to municipal securities. The New York City debt crisis and its consequences are discussed in detail in numerous reports and publications. *See, e.g.*, ROGER DUNSTAN, CAL. RESEARCH BUREAU, OVERVIEW OF NEW YORK CITY'S FINANCIAL CRISIS 1 (1995); STAFF OF SEC. & EXCHANGE COMM'N, 95TH CONG., TRANSACTIONS IN SECURITIES OF THE CITY OF NEW YORK (Comm. Print 1977), available at <http://www.sec.gov/info/municipal/staffreport0877.pdf>; STAFF OF J. ECON. COMM., 94TH CONG., NEW YORK CITY'S FINANCIAL CRISIS: AN EVALUATION OF ITS ECONOMIC IMPACT AND OF PROPOSED POLICY SOLUTIONS (Comm. Print 1975) (prepared by Ralph Schlosstein). For a discussion of conditions and developments in the bond market during this period, see generally STAFF OF J. ECON. COMM., 94TH CONG., CHANGING CONDITIONS IN THE MARKET FOR STATE AND LOCAL GOVERNMENT DEBT (Comm. Print 1976) (prepared by John Petersen). As Petersen notes, in addition to the New York City bond crisis, the municipal securities market was unsettled during this period due to a variety of factors, including declining economic and fiscal circumstances in a number of cities and states, questions about the enforceability or sanctity of municipal debt contracts, changes to the bankruptcy code, declining institutional demand for municipal securities, and the institution of the 1975 regulatory regime. *Id.*

<sup>66</sup> *Bankruptcy Act Revision, supra* note 63.

With these concerns in mind, Representative Badillo argued that Chapter 9 must foster the debtor's continued existence and its ability to devote municipal assets to residents' needs.<sup>67</sup> (i) municipal governments must be permitted to seek bankruptcy protection without having to get consent from creditors;<sup>68</sup> (ii) there must be "a provision for municipal services, police, fire, sanitation, health services, and all of those services which are necessary for the continuation of the life of the government, and for the protection of the citizens of the city;"<sup>69</sup> and (iii) there must be a "cram-down" provision "to insure that a group of creditors does not paralyze the interests of the citizens, and if a creditor were to try to do so, the court would act in the public interest."<sup>70</sup>

Second, Chapter 9 is informed by Tenth Amendment concerns, which limit the power of the federal court and prohibit interference with state and municipal power to direct municipal affairs.<sup>71</sup> As Judge Rhodes has observed, for example, "chapter 9 was created to give courts only enough jurisdiction to provide meaningful assistance to municipalities that require it, not to address the policy matters that such municipalities control."<sup>72</sup> Taken together, these two organizing principles mean that Chapter 9 debtors enjoy "an array of bankruptcy powers to enable [them] to achieve financial rehabilitation with very few, if any, corresponding limitations and duties of the type to which a Chapter 11 (for example) debtor is subject."<sup>73</sup>

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<sup>67</sup> *Id.* at 634-35.

<sup>68</sup> *See* 11 U.S.C. § 109(c) (2012) (listing alternatives to receiving creditor consent in filing under Chapter 9).

<sup>69</sup> *See id.* § 904 (providing that "the court may not . . . interfere with any political or governmental powers of the debtor"); *see also* H.R. REP. NO. 95-595, at 530 (2012) ("This section makes clear that the court may not interfere with the choices a municipality makes as to what services and benefits it will provide to its inhabitants.").

<sup>70</sup> *See* 11 U.S.C. § 1129(b)(1) (made applicable to Chapter 9 by operation of 11 U.S.C. 901(a)).

<sup>71</sup> *In re Addison Cnty. Cmty. Hosp. Auth.*, 175 B.R. 646, 649 (Bankr. E.D. Mich. 1994).

<sup>72</sup> *Id.*

<sup>73</sup> *In re Richmond Unified Sch. Dist.*, 133 B.R. 221, 224 (Bankr. N.D. Cal. 1991) (citing 11 U.S.C. § 904 (2012)). Some scholars have argued that Chapter 9's focus on a fresh start, whereby municipalities retain control of assets but

For example, Chapter 9 does not permit involuntary petitions.<sup>74</sup> Instead, only a municipality may file under Chapter 9,<sup>75</sup> or propose or modify a plan of adjustment.<sup>76</sup> In addition, Chapter 9 does not permit the liquidation of municipal assets,<sup>77</sup> nor can a creditor divest a municipal debtor of control over municipal assets.<sup>78</sup> Instead, a debtor municipality may continue to operate under Chapter 9 and may use, sell, or lease its property, without the sort of approvals required of non-municipal debtors.<sup>79</sup>

In deference to Tenth Amendment concerns,<sup>80</sup> Chapter 9 also recognizes the states' right to control access to Chapter 9 relief.<sup>81</sup> Chapter 9 provides that a municipality may seek bankruptcy protection under Chapter 9 only if specifically authorized by state

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have the ability to avoid debts, does not encourage the efficient reorganization of municipalities, but instead encourages moral hazard. *See generally*, Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 281, 310-11 (2012); Richard C. Schragger, *Democracy and Debt*, 121 YALE L.J. 860, 877 (2012); Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 356-57 (2010); Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 427, 469-70, 494 (1993).

<sup>74</sup> *See infra* note 75 and accompanying text.

<sup>75</sup> Chapter 9 does not permit involuntary petitions because it incorporates only section 301 (voluntary petitions), not section 303 (involuntary petitions). 11 U.S.C. §§ 301, 303 (2012). "Involuntary cases are not permitted for municipalities, because to do so may constitute an invasion of State sovereignty contrary to the Tenth Amendment, and would constitute bad policy . . ." *In re Richmond Sch. Dist.*, 133 B.R. at 225 (citing H.R. REP. NO. 95-595 95th Cong., 1st Sess. 321 (1977); S. REP. NO. 95-989, 95th Cong., 2d Sess. 31 (1978)).

<sup>76</sup> 11 U.S.C. §§ 941-942.

<sup>77</sup> *Id.* § 943 (2012), noted in H.R. REP. NO. 95-595, *supra* note 75.

<sup>78</sup> *Id.*, noted in H.R. REP. NO. 95-989, *supra* note 75.

<sup>79</sup> This is in contrast to Chapter 11, which provides that debtors may not use, sell or lease property outside of the ordinary course of business only after notice and hearing, 11 U.S.C. § 363(b)(1), while Chapter 9 permits municipalities to engage in these activities without prior approval of the bankruptcy court.

<sup>80</sup> The Tenth Amendment to the U.S. Constitution provides that "[t]he 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." U.S. CONST. amend. X.

<sup>81</sup> 11 U.S.C. § 109(c)(2).



law (among other eligibility requirements).<sup>82</sup> State law is not uniform respecting authorization, as noted, and even states that permit Chapter 9 filings have different regimes.<sup>83</sup> So, whereas Michigan law provides that authority to file for Chapter 9 protection must be given in writing by the governor<sup>84</sup>—only upon recommendation of an emergency manager, and only if there is no reasonable alternative<sup>85</sup>—California (home to a number of high-profile municipal bankruptcies, including Stockton, Vallejo, and most recently San Bernadino)<sup>86</sup> permits any local public entity in the state to file a petition and exercise powers pursuant to applicable federal bankruptcy law, except as otherwise provided by statute.<sup>87</sup> Where state law prohibits a municipal debtor from filing under Chapter 9—as was the case for Harrisburg, Pennsylvania<sup>88</sup>—municipal bankruptcy is not an option for that debtor.<sup>89</sup> Thus, in 2011, a federal judge rejected Harrisburg, Pennsylvania's bankruptcy petition based on the lack of state authorization.<sup>90</sup>

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<sup>82</sup> As noted, to be eligible for Chapter 9, an entity must meet the five criteria listed in section 109(c), including the requirement that the municipality be "specifically authorized" by the state to be a bankruptcy debtor. *See id.* Courts have interpreted this requirement to mean express written authorization from the state. *See, e.g., In re County of Orange*, 183 B.R. 594, 604 (Bankr. C.D. Cal. 1995) (holding states must provide an "exact, plain, and direct" authorization with "well-defined limits").

<sup>83</sup> *See supra* notes 45-50 and accompanying text.

<sup>84</sup> MICH. COMP. LAWS. SERV. § 141.1523 (LexisNexis 2011).

<sup>85</sup> *Id.*

<sup>86</sup> *See* California cases cited *infra* note 87.

<sup>87</sup> CAL. GOV'T CODE § 53760 (Deering 2013); *see also In re City of San Bernardino* Cal., 499 B.R. 776, 778 (Bankr. C.D. Cal. 2013) (eligibility opinion); Voluntary Petition, *In re City of San Bernardino*, Cal., No. 6:12-bk-28006, 2014 WL 2511096 (MJ) at \*1 (Bankr. C.D. Cal. Aug. 1, 2012); *In re City of Stockton*, 493 B.R. 772, 777 (E.D. Cal. 2013); Memorandum of Fact and Law in Support of Statement of Qualifications Under Section 109(c) at 15, *In re City of Vallejo*, Cal., No. 2:08-BK-26813 (Bankr. E.D. Cal. May 23, 2008).

<sup>88</sup> *In re Harrisburg*, 465 B.R. 744, 765 (Bankr. M.D. Pa. 2011) (dismissing Harrisburg's Chapter 9 case on account of the then effective statutory ban against allowing financially distressed, third-class cities from filing bankruptcy). That ban, however, has since expired. Act of July 2, 2012, P.L. 823, No. 87 (codified at 72 P.S. § 1601-D.1).

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

Chapter 9 also limits the power of the bankruptcy court.<sup>91</sup> As the Code's legislative history reflects, "[t]he powers of the court are subject to a strict limitation [under Chapter 9]—that no order or decree may in any way interfere with the political or governmental powers of the petitioner, the property or revenue of the petitioner, or any income-producing property."<sup>92</sup> Section 903 affirms the court's limited role by providing that Chapter 9 does not in any way "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."<sup>93</sup> Section 904 likewise provides:

Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—(1) any of the political or government powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property.<sup>94</sup>

Under Chapter 9, the bankruptcy court is authorized *only* to approve the debtor's petition if properly filed, to facilitate a debt adjustment plan, and to confirm and implement the plan, provided it meets the code's requirements.<sup>95</sup> If a debt adjustment plan is unsuccessful, the bankruptcy court lacks both the power and jurisdictional "hook" to act, unless the municipality agrees.<sup>96</sup>

### III. CHAPTER 9 AND TAXPAYERS' RIGHT TO BE HEARD

So, if Chapter 9 reflects a particular balancing of debtor and creditor rights and judicial power, given constitutional concerns,

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<sup>91</sup> See *infra* note 92 and accompanying text.

<sup>92</sup> 121 CONG. REC. 30, 39409-10 (1975) (statement of Rep. Edwards).

<sup>93</sup> 11 U.S.C. § 903 (2012).

<sup>94</sup> *Id.* § 904.

<sup>95</sup> See 6 COLLIER ON BANKRUPTCY, ¶ 900.01[1] at 900-4 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014).

<sup>96</sup> See, e.g., *In re Richmond Unified Sch. Dist.*, 133 B.R. 221, 225 (Bankr. N.D. Cal. 1991).

how does this balancing "track" to the concerns of individual residents/taxpayers? As set forth below, prior to the plan confirmation stage, ordinary residents/taxpayers may not have a statutory right to be heard in Chapter 9 proceedings.<sup>97</sup> Instead, their interests and concerns are filtered through taxpayers whom otherwise have standing (for example, when they are creditors),<sup>98</sup> public officials (or duly-appointed intervenors like Detroit's Emergency Manager),<sup>99</sup> and potentially, through the discretion of the bankruptcy court judge and the doctrinal requirement of insolvency.<sup>100</sup> Once a municipal debtor files a proposed plan of confirmation, some case law suggests that landowning taxpayers may appear as parties-in-interest, though authority on this point is mixed.<sup>101</sup>

*A. Chapter 9 and the Taxpayer's Right to Be Heard:  
Pre-Confirmation*

With respect to taxpayers' right to be heard prior to the plan confirmation stage, Judge Rhodes' opinions in *In re Addison Community Hospital Authority*<sup>102</sup> and *In re Detroit, Michigan*<sup>103</sup> are instructive.<sup>104</sup> These opinions suggest that, while ordinary taxpayers may not qualify as parties-in-interest under 11 U.S.C. § 1109(b), the bankruptcy court may have discretionary authority—or, at least powers of moral suasion—through the Chapter 9 doctrinal requirement of insolvency to bring the concerns of ordinary taxpayers into the debt adjustment dialog from the start.<sup>105</sup>

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<sup>97</sup> See *infra* notes 122-123 and accompanying text (discussing *In re Addison Cmty. Hosp. Auth.*, 175 B.R. 646 (Bankr. E.D. Mich. 1994)).

<sup>98</sup> See *infra* note 127 and accompanying text (noting courts' treatment of ordinary taxpayers).

<sup>99</sup> See *infra* note 200 and accompanying text.

<sup>100</sup> See, e.g., *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 651.

<sup>101</sup> See, e.g., *In re Mount Carbon Metro. Dist.*, No. 97-20215(MSK), 1999 WL 34995477, at \*4 (Bankr. D. Colo. July 20, 1999).

<sup>102</sup> See, e.g., *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 651-52.

<sup>103</sup> See *Eligibility Opinion*, 504 B.R. 97, 139-40 (Bankr. E.D. Mich. 2013).

<sup>104</sup> See *supra* notes 102-03.

<sup>105</sup> *In re Addison Cmty. Hosp.*, 175 B.R. at 651; *Eligibility Opinion*, 504 B.R. at 138.

1. *Addison Community Hospital Authority*: Non-creditor Taxpayers Lack Standing, Not Entitled to Intervene

In *Addison Community Hospital Authority*, an unincorporated group of citizens ("Concerned Citizens") from the area served by the debtor, Addison County Community Hospital Authority ("Addison"), filed a motion to intervene in Addison's Chapter 9 proceedings, citing concerns over the debt adjustment process.<sup>106</sup> Concerned Citizens made several arguments in support of their petition.<sup>107</sup> First, they alleged that the Chapter 9 plan submitted by Addison did not comply with the intended purpose of the hospital as set forth under state law and Addison's Bylaws.<sup>108</sup> Second, Concerned Citizens claimed that its members had standing to intervene because they would be affected as taxpayers if additional taxes were required under a debt adjustment plan.<sup>109</sup> Third, Concerned Citizens argued that its members would be affected if the hospital was transferred out of the hospital authority to a private profit-making enterprise that was not bound by state law or the Bylaws.<sup>110</sup> Finally, Concerned Citizens claimed that its members were "special tax payers" under 11 U.S.C. § 943.<sup>111</sup> The case thus presented three questions relevant to taxpayer standing and taxpayers' right to be heard under Chapter 9: (a) "whether Concerned Citizens ha[d] a statutory right to be heard under 11 U.S.C. § 1109[;]" (b) "whether Concerned Citizens ha[d] a right to intervene under Fed. R. Bankr. P. 2018[;]" and (c) "whether the members of Concerned Citizens [were] 'special tax payers' [with] a right to intervene under 11 U.S.C. § 943."<sup>112</sup>

a. *11 U.S.C. § 1109(b): No Statutory Right to Be Heard*

Under 11 U.S.C. § 1109(b), "[a] party in interest . . . may appear and be heard on any issue in a [bankruptcy] case."<sup>113</sup> While

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<sup>106</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 647.

<sup>107</sup> *Id.* at 648.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 648.

<sup>113</sup> 11 U.S.C. § 1109(b) (2012).

the Code does not define party-in-interest (at least not through an exclusive listing of qualifying stakeholders),<sup>114</sup> 11 U.S.C. § 1109(b) states that a "party-in-interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."<sup>115</sup> While courts have interpreted party-in-interest expansively in the Chapter 11 context, citing Congressional intent to increase participation in the bankruptcy process,<sup>116</sup> courts appear to apply a narrower definition in Chapter 9 cases, at least at the eligibility stage, citing federalism concerns and the debtor's need to continue providing services despite insolvency.<sup>117</sup>

In *Addison County Community Hospital*, Concerned Citizens argued that it had the type of pecuniary interest typically required for party-in-interest status under 11 U.S.C. § 1109(b) because its members would be affected if their taxes went up as a result of a plan of adjustment.<sup>118</sup> Judge Rhodes rejected this argument as a basis for party-in-interests standing, holding that ordinary taxpayer interests would be adequately represented by creditor-taxpayer members of Concerned Citizens,<sup>119</sup> and that allowing ordinary taxpayers to intervene would interfere with the debt adjustment process.<sup>120</sup>

In reaching this result, Judge Rhodes distinguished between those members of Concerned Citizens who were creditors and those who were not.<sup>121</sup> With respect to creditor members, Judge Rhodes held that they had a statutory right to be heard on any issue

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<sup>114</sup> *Id.* § 1101.

<sup>115</sup> *Id.* § 1109(b).

<sup>116</sup> *See, e.g., In re Owen-Moore*, 435 B.R. 685, 690-91 (Bankr. S.D. Cal. 2010); *Hasso v. Mozsgai (In re La Sierra Fin. Servs.)*, 290 B.R. 718, 727-28 (B.A.P. 9th Cir. 2002); *In re Chandler Airpark Joint Venture I*, 163 B.R. 566, 569 (Bankr. D. Ariz. 1992).

<sup>117</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 650 (concluding that "courts do not have jurisdiction to interfere with the political and policy choices a municipality makes").

<sup>118</sup> *Id.* at 648.

<sup>119</sup> *Id.* at 650.

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

in the bankruptcy proceeding under 11 U.S.C. § 1109(b).<sup>122</sup> As to non-creditor members of Concerned Citizens, Judge Rhodes held that the possibility of tax increases was not enough to confer party-in-interests.<sup>123</sup> While acknowledging that § 1109(b) standing must be read broadly "to permit parties affected by the proceeding to appear and be heard," Judge Rhodes held that concepts of standing also must be harmonized with the goals and purposes of municipal bankruptcy.<sup>124</sup> Judge Rhodes observed that "[t]he purpose of Chapter 9 is to allow municipalities the opportunity to remain in existence through debt adjustment and obtain temporary relief."<sup>125</sup> He also recognized the limited role of the bankruptcy court in Chapter 9, holding "Congress intended municipalities to have more streamlined control in the debt adjustment period without interference from outside parties."<sup>126</sup> Citing these principles, Judge Rhodes held that ordinary taxpayer interests were sufficiently represented by those with standing, and that granting non-creditor taxpayers standing to be heard would "hamper, and unduly delay, the debt adjustment process."<sup>127</sup>

*b. No Permissive Intervention Under Rule 2018(a)*

Judge Rhodes also rejected Concerned Citizens' argument for intervention rights under Rule 2018(a).<sup>128</sup> Rule 2018(a) provides for intervention by entities that do not otherwise have a right to participate in a bankruptcy case. Granting intervention under this

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<sup>122</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 650.

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.* at 651.

<sup>127</sup> *Id.*; see also *In re Barnwell Cnty. Hosp.*, 459 B.R. 903, 907 (Bankr. D.S.C. 2011) (applying the *Addison* reasoning and holding that a group of 900-1,200 local residents—the Ad Hoc Committee tasked with saving the Hospital—lacked standing to object to the hospital authority's eligibility for Chapter 9 relief); *In re City of Bridgeport*, 128 B.R. 30, 32 (Bankr. D. Conn. 1991) (holding an unincorporated association of 115 Connecticut cities and towns was not a party in interest).

<sup>128</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 650-51.

rule is within the court's discretion,<sup>129</sup> and courts "balance the needs of a potential intervenor against any delay or prejudice which [will] result from such intervention."<sup>130</sup> As a general rule, courts permit litigants to intervene under Rule 2018(a) upon a showing of cause, which has been defined as "an economic interest in the case or one of its aspects or a concern with its precedential ramifications."<sup>131</sup> Courts do not permit litigants to intervene under this rule where "the potential intervenor's interests are already adequately represented or where intervention would cause unwarranted delay or prejudice to the original parties."<sup>132</sup>

Concerned Citizens argued that if its members were not present, there would be no controls over the development of Addison's adjustment plan, perhaps causing the purpose of the municipal hospital to be "evaded."<sup>133</sup> The court rejected this argument for two reasons.<sup>134</sup> First, it held that the court's authority to confirm—or not confirm—the plan offered sufficient controls over the development of a debt adjustment plan.<sup>135</sup> Here, the court noted:

[Under the Code, a bankruptcy court may confirm a plan of adjustment in a Chapter 9 case] *only if* it is satisfied that the plan is fair, equitable and feasible, and does not discriminate unfairly in favor of any creditor or class of creditors; that the provisions of Chapter 9 are complied with (including the observance of state law); that all compensation paid incident to the plan is reasonable; that the plan is offered and accepted in good faith; and that the

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<sup>129</sup> 11 U.S.C. § 2018 (2012); *see also In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 651 (citing *In re Benny*, 791 F.2d 712, 721-22 (9th Cir. 1986); *In re Charter Co.*, 50 B.R. 57, 63 (Bankr. W.D. Tex. 1985)).

<sup>130</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 651 (citing *In re City of Bridgeport*, 128 B.R. 686, 687 (Bankr. D. Conn. 1991)).

<sup>131</sup> *Id.* (citing *In re City of Bridgeport*, 128 B.R. at 687-88).

<sup>132</sup> *Id.* (citing *In re Pub. Serv. Co. of New Hampshire*, 88 B.R. 546, 551 (Bankr. D.N.H. 1988)).

<sup>133</sup> *Id.*

<sup>134</sup> *Id.* at 651

<sup>135</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 651.

petitioner is not prohibited by law from taking any action necessary under the plan."<sup>136</sup>

Second, the court reiterated that Concerned Citizens' interests could be adequately represented by members who also were creditors.<sup>137</sup> The court held that permitting non-creditor members of Concerned Citizens to intervene would run counter to municipalities' rights to have "streamlined control in the debt adjustment period without interference from outside parties," and would result in a "violation of the United States Constitution and its reservation of sovereignty to the states."<sup>138</sup>

*c. 11 U.S.C. § 943*

Finally, the court rejected, on procedural grounds, Concerned Citizens' claim that its members had standing to intervene under 11 U.S.C. § 943 as "special tax payer[s]."<sup>139</sup> The Code defines "special tax payer" as a "record [or equitable] owner [of] title to real property against which a special assessment or special tax has been levied the proceeds of which are the sole source of payment of an obligation issued by the debtor to defray the cost of an improvement relating to such real property."<sup>140</sup> In rejecting Concerned Citizens' arguments, Judge Rhodes held that § 943 allows special taxpayers to object only at the confirmation stage.<sup>141</sup> The court held that since Concerned Citizens' had sought to intervene prior to the plan confirmation stage, § 943 did not require or permit the court to allow Concerned Citizens into the case.<sup>142</sup>

2. *In re City of Detroit, Michigan*: "Service Delivery Insolvency"  
Opens the Door

While Judge Rhodes was unwilling to confer party-in-interest status on ordinary taxpayers (or to allow intervention under Rule

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<sup>136</sup> *Id.* at 651 (citing 121 CONG. REC. H39410 (daily ed. Dec. 9, 1975)).

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> 11 U.S.C. § 902(3) (2012).

<sup>141</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 651.

<sup>142</sup> *Id.*



2018(a) on the facts of *Addison Community Hospital*),<sup>143</sup> his Eligibility Opinion in *In re City of Detroit* suggests that taxpayer concerns may yet be heard, even at the eligibility stage, through the doctrinal requirement of insolvency.<sup>144</sup> Judge Rhodes' Eligibility Opinion principally was concerned with the complex constitutional issues associated with the city's proposal to impair accrued pension benefits.<sup>145</sup> Citing the Michigan Constitution and federalism principles, Detroit's pensioners had argued that Detroit was not eligible to be a Chapter 9 debtor because it had failed to ring-fence pensions, or otherwise protect them from possible impairment, prior to filing its Chapter 9 petition.<sup>146</sup> Judge Rhodes rejected the pensioners' arguments, holding Detroit is eligible to be a Chapter 9 debtor, despite the failure to ring-fence.<sup>147</sup> In a nutshell, Judge Rhodes found that pension rights are contract rights under the Michigan Constitution and thus subject to adjustment in Chapter 9 proceedings along with other contractual obligations.<sup>148</sup>

And yet, Judge Rhodes' concern for the plight of Detroit's beleaguered residents and taxpayers is evident from the first moments of the court's narrative:

The City of Detroit was once a hardworking, diverse, vital city, the home of the automobile industry, proud of its nickname – the "Motor City." It was rightfully known as the birthplace of the American automobile industry. In 1952, at the height of its prosperity and prestige, it had a population of approximately 1,850,000 residents. In 1950, Detroit was building half of the world's cars.

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<sup>143</sup> *Id.* at 650.

<sup>144</sup> *See Eligibility Opinion*, 504 B.R. 97, 129 (E.D. Mich. 2013) (citing the specific requirement that the city be "insolvent" under 11 U.S.C. § 109(c)(3)).

<sup>145</sup> *See id.* at 111-12, 129.

<sup>146</sup> *Id.* at 150-51.

<sup>147</sup> *Id.* at 190. I discuss the court's ruling in detail in Christine Sgarlata Chung, *Zombieland: Why Debts Associated with Pensions, Benefits, and Municipal Securities Never Die . . . How They Are Killing Cities Like Detroit*, 41 *FORDHAM URB. L.J.* 771, 823-24 (2014). In a nutshell, Judge Rhodes held that accrued pension benefits reflect contract rights, and like other contracts, may be impaired in a Chapter 9 proceeding. *Eligibility Opinion*, 504 B.R. at 150.

<sup>148</sup> *Eligibility Opinion*, 504 B.R. at 150, 152.

The evidence before the Court establishes that for decades, however, the City of Detroit has experienced dwindling population, employment, and revenues. This has led to decaying infrastructure, excessive borrowing, mounting crime rates, spreading blight, and a deteriorating quality of life.

The City no longer has the resources to provide its residents with the basic police, fire, and emergency medical services that its residents need for their basic health and safety.

Moreover, the City's governmental operations are wasteful and inefficient. Its equipment, especially its streetlights and its technology, and much of its fire and police equipment, is obsolete.

To reverse this decline in basic services, to attract new residents and businesses, and to revitalize and reinvigorate itself, the City needs help.<sup>149</sup>

In fact, Judge Rhodes' focus on the human costs of insolvency pervades the Eligibility Opinion, with its repeated and detailed references to Detroit's poverty, its horrific crime statistics, crumbling infrastructure, and pervasive blight.<sup>150</sup> By characterizing Detroit's residents—who suffer from high rates of poverty,

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<sup>149</sup> *Id.* at 112. Notably, during hearings on the Objections to Eligibility, Judge Rhodes said (with respect to the Pensions Clause of the Michigan Constitution), "[t]he question we all are struggling with is what is the meaning—the substantive meaning—of that provision in the context of a political subdivision that doesn't have the money to comply with it? What's the meaning of it? How do we give meaning to non-impairment . . . if the city doesn't have the money to pay?" Audio Recording of October 15, 2013, *In re* City of Detroit, Michigan, Debtor., Case No. 13-5384669, PDF 1199, at 41:19, available at <http://www.mieb.uscourts.gov/apps/detroit/DetroitAudio.cfm>. Judge Rhodes raised this theme repeatedly during arguments, questioning lawyer after lawyer about what the Pension Clause guarantee means if Detroit does not have the money to meet its pension-related obligations in full, or if meeting those obligations in full (were it even possible) would mean the City was unable to make the kind of investments in infrastructure, services and the living conditions necessary to put the City on a path towards recovery. See, e.g., Audio Recording of October 15, 2013, *supra*, at 2:45:47-2:48:00.

<sup>150</sup> See *Eligibility Opinion*, 504 B.R. at 119-21, 168-69.

unemployment, and taxation, but low rates of home ownership and falling property values<sup>151</sup>—as creditors of a sort, who were owed a debt of at least minimally acceptable public infrastructure and services, Judge Rhodes opened the door to consideration of taxpayer interests at the eligibility stage,<sup>152</sup> that is, even though taxpayers likely would not have standing as parties-in-interest or rights of intervention under Judge Rhodes' *Addison Community Hospital* tests.<sup>153</sup>

Doctrinally, Judge Rhodes brings the plight of ordinary taxpayer/resident into Detroit's Chapter 9 case through the doctrine of insolvency. To be eligible for Chapter 9 relief, a municipality must demonstrate that it is insolvent, among other requirements.<sup>154</sup> In the case of municipalities, 11 U.S.C. § 101(32)(C) defines insolvency as: "(i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due."<sup>155</sup> Judge Rhodes held that Detroit was insolvent under both tests.<sup>156</sup> As to the first test, the court found that Detroit had deferred pension contributions and failed to make payments due on complex financial instruments associated with pension liabilities.<sup>157</sup> The court also found that the city was "spending much more money than it was receiving, and only making up the difference through expensive and even catastrophic borrowings."<sup>158</sup> The court held "these facts establish[ed] that the City was [insolvent for] 'generally not paying its debts as they become due' as of the time of the filing."<sup>159</sup>

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<sup>151</sup> *Id.* at 188-89.

<sup>152</sup> *Id.*

<sup>153</sup> *In re Addison Cmty. Hosp. Auth.*, 175 B.R. 646, 651 (Bankr. E.D. Mich. 1994); *see, e.g.*, 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, 666-68, n.8-15 (2013-2014) (discussing poverty and economic headwinds in Detroit).

<sup>154</sup> *Eligibility Opinion*, 504 B.R. at 168.

<sup>155</sup> 11 U.S.C. § 101(32)(C)(i)-(ii) (2012).

<sup>156</sup> *Eligibility Opinion*, 504 B.R. at 168.

<sup>157</sup> *Id.* at 169.

<sup>158</sup> *Id.*

<sup>159</sup> *Id.* (quoting 11 U.S.C. § 101(32)(C)(i)).

As to the second test, the court cited the complete breakdown of Detroit's public infrastructure, holding that "there are many, many services in the City which do not function properly as a result of the City's financial state"<sup>160</sup> and concluding that "[t]he evidence was overwhelming that the City is unable to pay its debts as they become due."<sup>161</sup> In so holding, Judge Rhodes invoked the concept of "service delivery insolvency" as set forth in the seminal 2013 municipal bankruptcy case *In re City of Stockton, California*.<sup>162</sup> Service delivery insolvency "focuses on the municipality's ability to pay for all costs of providing services at the level and quality that are required for the health, safety, and welfare of the community."<sup>163</sup> Judge Rhodes held that "while the City's tumbling credit rating, its utter lack of liquidity, and the disastrous COPs [financial instruments associated with managing pension liabilities] and swaps deal might more neatly establish the City's 'insolvency' under 11 U.S.C. § 101(32)(C), it is the City's service delivery insolvency that the Court finds most strikingly disturbing in this case."<sup>164</sup>

In the *Stockton* bankruptcy case, opponents of the city's Chapter 9 filing argued that the city had manufactured a state of cash insolvency as a stratagem to qualify for Chapter 9 relief, where it could then adjust debts.<sup>165</sup> Citing evidence that the city was unable to provide even basic health and safety services, the court held that the city's cash insolvency was no "chimera," and that it was eligible for Chapter 9 relief.<sup>166</sup> The court cited evidence that Stockton's Police Department had been "decimated," and its crime rate had "soared" in the wake of the city's financial crisis.<sup>167</sup> The court observed that homicide rates were at record levels and that Stockton had one of the ten highest rates in the nation of

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<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *Eligibility Opinion*, 504 B.R. at 169-70 (citing *In re City of Stockton, Cal.*, 493 B.R. 772, 789 (Bankr. E.D. Cal. 2013)).

<sup>163</sup> *Id.* at 170 (citing *In re City of Stockton, Cal.*, 493 B.R. at 789).

<sup>164</sup> *Id.*

<sup>165</sup> *Id.* at 789.

<sup>166</sup> See *In re City of Stockton, Cal.*, 493 B.R. at 789-90.

<sup>167</sup> *Id.* at 790.

aggravated assaults with a firearm.<sup>168</sup> The court further noted that Stockton police "often respond only to crimes-in-progress."<sup>169</sup> The *Stockton* court held that these facts made the city a "paradigm example of service delivery insolvency" for purposes of Chapter 9 relief.<sup>170</sup>

In Detroit's case, Judge Rhodes cited overwhelming—and heartbreaking—evidence of the city's service delivery insolvency, including rampant crime, blight, poverty, and dysfunction, in support of his conclusion that the city was insolvent.<sup>171</sup> For example, Judge Rhodes noted that Detroit's violent crime rate was "five times the national average and the highest of any city with a population in excess of 200,000."<sup>172</sup> Judge Rhodes also noted that police response times in Detroit lag far behind those of comparable communities, even with respect to violent crime, and that the city's clearance rate for violent crimes also was substantially below that of comparable municipalities.<sup>173</sup>

Judge Rhodes further observed that Detroit's financial collapse, blight, and crumbling infrastructure has hobbled the city's efforts to meet public health and safety needs.<sup>174</sup> As Judge Rhodes noted, there are approximately 78,000 abandoned and blighted structures in the City, some 38,000 of which are considered dangerous.<sup>175</sup> The city's blighted buildings have become magnets for fires and crime: the city's evidence showed that in the past decade, the City had experienced 11,000 to 12,000 fires each year, with approximately 60 percent of those fires occurring in blighted or unoccupied buildings.<sup>176</sup> The court found that due to staffing constraints and the city's crumbling public safety infrastructure, police, fire, and EMS personnel were not able to address public safety hazards associated with blight, fires, and crime.<sup>177</sup> The

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<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

<sup>171</sup> *Eligibility Opinion*, 504 B.R. at 169.

<sup>172</sup> *Id.* at 120

<sup>173</sup> *Id.*

<sup>174</sup> *Id.* at 112.

<sup>175</sup> *Id.* at 120.

<sup>176</sup> *Id.*

<sup>177</sup> *Eligibility Opinion*, 504 B.R. at 112, 120.

court noted that in February 2013, for example, Detroit Fire Commissioner Donald Austin ordered firefighters not to use hydraulic ladders on ladder trucks except in cases involving an "immediate threat to life" because the ladders had not received safety inspections "for years."<sup>178</sup> And, the "most powerful[]" evidence of service delivery insolvency, according to the court, was the testimony of Detroit's police chief that "conditions in the local precincts were 'deplorable,' "<sup>179</sup> with everything "broken," too few officers on the streets, and facilities, equipment, and vehicles in various states of disrepair and obsolescence.<sup>180</sup> For Judge Rhodes, this evidence demonstrated that Detroit was insolvent for purposes of Chapter 9 eligibility and unable (without the help of the bankruptcy court debt adjustment process) to meet even basic municipal needs.<sup>181</sup>

Judge Rhodes' decision to highlight the cruel realities of life in Detroit in his Eligibility Opinion has a number of doctrinal and practical consequences.<sup>182</sup> First, Judge Rhodes' opinion signals to stakeholders—including the Emergency Manager, pensioners, bondholders, and other creditors—that the public health and safety needs of Detroit's residents must be addressed during the debt adjustment process.<sup>183</sup> This is consistent with Judge Rhodes' view of the purpose of municipalities and municipal bankruptcy as expressed in both *Addison Community Hospital Authority* and *In re Detroit, Michigan*.<sup>184</sup> If, as Judge Rhodes has held, municipalities have a fundamental obligation to provide essential services to

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<sup>178</sup> *Id.* at 120. The *Eligibility Opinion* reports other wounds to city life. Only forty percent of Detroit's street lights worked; and the city closed at least 219 parks, and announced that it planned to close or provide limited maintenance to many others. *See id.*

<sup>179</sup> *Id.* at 169.

<sup>180</sup> *Id.* (internal quotations and citations omitted).

<sup>181</sup> *Id.* at 168-71.

<sup>182</sup> Adam Santeusano, *In re Detroit: Consequences of Detroit's Bankruptcy for Pensioners*, 33 REV. BANKING & FIN. L. 430, 438-39 (2014).

<sup>183</sup> *See generally Eligibility Opinion*, 504 B.R. at 112. Asserting that the City of Detroit, during its period of financial hardship, lacked the resources to provide for the residents' basic health and safety, Judge Rhodes scorned the "wasteful and inefficient" operations of the City's government. *Id.*

<sup>184</sup> *See, e.g., In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 648; *Eligibility Opinion*, 504 B.R. at 112.

residents, and the goal of municipal bankruptcy is to get municipal debtors back on their feet so that they can provide these essential services,<sup>185</sup> then the taxpayers' interest in these essential services must be part of the debt adjustment conversation from the start.

To this end, Judge Rhodes has made it clear throughout these proceedings that he is anxious for the city's stakeholders to come together, if possible, to chart a course forward for the city, so that it can invest in a future which includes a functional public health and safety infrastructure.<sup>186</sup> Judge Rhodes repeatedly directed parties to mediation, stating "years of litigation, disputing issues in the courts," would be "horrendous" for the city and its residents.<sup>187</sup>

Judge Rhodes also rejected a settlement negotiated with the help of court-appointed mediators on the grounds that it was "just too much money" for the city.<sup>188</sup> By way of background, on December 24, 2013, banks involved in deals negotiated during Mayor Kilpatrick's tenure reportedly agreed to compromise certain claims relating to interest rate swap transactions following mediation overseen by United States District Court Chief Judge Gerald Rosen and United States Bankruptcy Court Judge Elizabeth

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<sup>185</sup> See *Eligibility Opinion*, 504 B.R. at 112; *In re Addison Cmty. Hosp. Auth.*, 175 B.R. at 648-49.

<sup>186</sup> See *Eligibility Opinion*, 504 B.R. at 191 (encouraging "the parties to begin to negotiate, or if they have already begun, to continue to negotiate, with a view toward a consensual plan").

<sup>187</sup> See, e.g., *Detroit Attempts to Reach Bankruptcy Settlement in Mediation With Creditors*, THEGUARDIAN, (Sept. 17, 2013), <http://www.theguardian.com/world/2013/sep/17/detroit-bankruptcy-settlement-creditors>. Since issuing his opinion regarding eligibility, Judge Rhodes has continued to direct litigants to mediation. See, e.g., Order to Certain Parties to Appear for Continued Mediation on DWSD Matters at 1-2, *In re City of Detroit*, No. 13-53846 (Bankr. E.D. Mich. Dec. 30, 2013), available at <http://www.mieb.uscourts.gov/sites/default/files/detroit/docket2346.pdf>; Order to Certain Parties to Appear for Continued Mediation on UTGO Matters at 1-2, *In re City of Detroit*, No. 13-53846 (Bankr. E.D. Mich. Dec. 30, 2103); Order to Certain Parties to Appear for Continued Mediation on LTGO Matters at 1-2, *In re City of Detroit*, No. 13-53846 (Bankr. E.D. Mich. Dec. 30, 2013), available at <http://www.mieb.uscourts.gov/sites/default/files/detroit/docket2344.pdf>.

<sup>188</sup> See, e.g., Mary Williams Walsh, *Judge Disallows Plan by Detroit to Pay Off Banks*, N.Y. TIMES DEALBOOK (Jan. 16, 2014), [http://dealbook.nytimes.com/2014/01/16/judge-rejects-detroits-deal-to-exit-swap-contracts/?\\_php=true&\\_type=blogs&\\_r=0](http://dealbook.nytimes.com/2014/01/16/judge-rejects-detroits-deal-to-exit-swap-contracts/?_php=true&_type=blogs&_r=0).

Perris.<sup>189</sup> The mediators argued against approving the agreement by contending:

[The agreement] allows the City to refinance its debt at more favorable terms, saving approximately \$65 million from the original terms of the Forbearance Agreement, approximately \$25 million at the time of the hearing on the assumption of the Agreement, and [thereby] permit[s] the City to reduce its interim loan (commonly referred to as the DIP loan) by up to an additional \$65 million."<sup>190</sup>

The mediators also argued that the proposed agreement would "provide much needed financial flexibility by freeing up casino revenues held in the collateral account providing funds needed to maintain operations and bolster city services."<sup>191</sup> With respect to the SWAP counterparties, the mediators stated that the proposed agreement would "enable them to avoid the risk of losing all that they invested and further avoid the lawsuit the City threatened to bring which, if successful, could have forced them to disgorge and pay back to the City all of the payments they received under the swaps."<sup>192</sup>

The proposed compromise between the city and SWAP counterparties was subject to court approval,<sup>193</sup> and on January 16, 2014, Judge Rhodes rejected it as too rich for the city's depleted coffers.<sup>194</sup> Just two weeks later, the city filed a declaratory judgment action against service corporations and funding trusts

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<sup>189</sup> See Mediators' Recommendation for Approval of Settlement Between the Debtor and SWAP Counter-Parties, *In re City of Detroit*, No. 13-53846 (Bankr. E.D. Mich. Dec. 30, 2103); see also Brent Snavely & Joe Guillen, *Detroit's Retirement Systems to Challenge Renegotiated Swaps Settlement With Banks*, DETROIT FREE PRESS (Dec. 26, 2013, 9:53 PM), <http://www.freep.com/article/20131226/NEWS01/312260107/Retirement-systems-bankruptcy-settlement>.

<sup>190</sup> Mediators' Recommendation for Approval of Settlement Between the Debtor and SWAP Counter-Parties at 2, *In re City of Detroit*, No. 13-53846 (Bankr. E.D. Mich. Dec. 30, 2103).

<sup>191</sup> *Id.*

<sup>192</sup> *Id.*

<sup>193</sup> FED. R. BANKR. P. 9019(a).

<sup>194</sup> See, e.g., Walsh, *supra* note 188.



involved in the transactions at issue.<sup>195</sup> The city's complaint alleged that the service corporations and funding trusts formed in connection with the COP transactions swaps were a sham and an unlawful attempt to evade debt restrictions.<sup>196</sup> This proceeding is pending as of the date of publication.<sup>197</sup> By rejecting the proposed compromise based on its impact on the city's finances going forward, Judge Rhodes once again made taxpayers' interest in a functional, fiscally responsible city a part of the Detroit bankruptcy proceeding.

Judge Rhodes also appointed an expert to determine whether Detroit's proposed plan of adjustment was "feasible as required by 11 U.S.C. § 943(b)(7); and [w]hether the assumptions that underlie the city's cash flow projections and forecasts regarding its revenues, expenses and plan payments are reasonable."<sup>198</sup> The expert's report was due in June 2014, but has not (yet) been released publicly on the court's pacer docket system.<sup>199</sup> Giving voice to taxpayer concerns may be particularly important in cases like Detroit, where those normally charged with speaking for residents/taxpayers (i.e., elected officials) were disabled by corruption, and those appointed to act in place of elected officials (i.e., the Emergency Manager) lack political legitimacy due to appointed (not elected) status.<sup>200</sup> By seeking expert advice respecting Detroit's proposed plan of adjustment separate and apart from the city's own experts, Judge Rhodes made it clear that the court will take its own, independent look at the debt adjustment process in Detroit bankruptcy, to ensure that any plan of adjustment offers the city a legitimate opportunity to return to fiscal stability while meeting residents' basic public health and safety needs.

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<sup>195</sup> Complaint for Declaratory and Injunctive Relief, City of Detroit, Michigan v. Detroit Gen. Ret. Sys. Serv. Corp., at ¶ 41, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Jan. 31, 2014).

<sup>196</sup> *Id.* ¶¶ 39-41.

<sup>197</sup> *Id.* (as of September 5, 2014, there has been no court ruling upon the Complaint for Declaratory and Injunctive Relief).

<sup>198</sup> Order Appointing Expert Witness, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Apr. 22, 2014).

<sup>199</sup> *Id.*

<sup>200</sup> *Eligibility Opinion*, 504 B.R. at 129.

Judge Rhodes' opinion carves out space for resident/taxpayer concerns in the ongoing dialog about the relationship between federal and state law in Chapter 9 cases. As Professor Moringiello has observed, scholars have questioned and studied the relationship between state and federal law in Chapter 9 cases for decades.<sup>201</sup> Judge Rhodes' eligibility engages deeply on this issue, of course, sorting through the numerous constitutional questions raised by pensioners' objections to Detroit's eligibility for Chapter 9 relief.<sup>202</sup> But by framing the opinion in terms of Detroit's collapse, and resulting service delivery insolvency, the Eligibility Opinion reminds us that federal and state distress and insolvency regimes share a single goal—namely, to help a battered municipality recover, so that it can provide for the health, safety, and educational needs of the residents/taxpayers, while still meeting obligations owed to creditors.<sup>203</sup> The Eligibility Opinion thus recognizes that debt adjustment plans are not just about dividing up the municipal pie to pay creditors—even undeniably worthy creditors like pensioners and general obligation bondholders. Instead, plans of adjustment must chart a feasible path towards recovery, so that debtor municipalities can attract new residents and businesses, and collect the tax revenues necessary to meet public health and safety along with legacy obligations. This is why state fiscal emergency laws and municipal bankruptcy exist, after all, and Judge Rhodes' opinion reminds us that recovery for all stakeholders—including current residents/taxpayers—is and ought to be an overriding goal under both federal and state regimes.<sup>204</sup>

Finally, Judge Rhodes' opinion raises important questions respecting the shape and scope of judicial discretion under Chapter

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<sup>201</sup> Moringiello, *supra* note 19, at 480 (noting that because there are so few Chapter 9 cases, there are few clear answers respecting the boundaries of state and federal regimes).

<sup>202</sup> *Eligibility Opinion*, 504 B.R. at 111-12.

<sup>203</sup> *Id.* at 170.

<sup>204</sup> As Professor Moringiello points out, "[w]hen Congress passed the predecessor to Chapter 9, it did so to bring together two sovereigns, the state and the federal government, to accomplish something that neither could accomplish alone—the imposition of a plan to adjust municipal financial liabilities that would be binding on all the municipality's creditors, wherever located." Moringiello, *supra* note 19, at 408.

9. For example, when should a court exercise discretion to bring taxpayer interests to the forefront in a Chapter 9 case? Only when elected officials have been disabled by corruption? Only when appointed intervenors (and not elected officials) are in charge? Or, only in cases of profound service delivery insolvency, as in Detroit? Also, what factors ought to guide the court in exercising its discretion? What happens if different courts take different approaches to these issues? Could we end up with different results in different jurisdictions in cases involving similarly-situated debtors?

As an alternative to judicial discretion, should we consider reforms to the Code that would expand, as a formal matter, the rights of residents/taxpayers to be heard under rules applicable to parties-in-interest or permissive standing? Would such reforms be permitted under the Tenth Amendment (I suspect not) and, even if permitted, would allowing ordinary taxpayers to participate more directly in Chapter 9 proceedings inject so many different, potentially conflicting voices in Chapter 9 proceedings as to undermine municipal debtors' interests in efficient debt adjustment? Certainly, delay and confusion are a risk in cases like Detroit, where the city has thousands of creditors and no ability to satisfy stakeholders' competing demands.<sup>205</sup>

*B. Chapter 9 and the Taxpayer's Right to Be Heard:  
Plan Confirmation Stage*

Moving to the plan confirmation stage of Chapter 9 proceedings, there are a few cases which have allowed landowning taxpayers to appear as parties-in-interest.<sup>206</sup> These cases suggest that taxpayers' arguments for party-in-interest status may be strong(er) after a debtor municipality has filed a proposed plan of

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<sup>205</sup> See Memorandum in Support of Statement of Qualifications, *supra* note 87, at 44; see also *Eligibility Opinion*, 504 B.R. at 113, 187.

<sup>206</sup> See, e.g., *In re Mount Carbon Metro. Dist.*, 1999 WL 34995477 (Bankr. D. Colo. July 20, 1999); see also Christine A. Schleppegrell, *Can Taxpayers Leverage the Ambiguity of "Party-in-Interest" to Enter the Chapter 9 Arena?*, 34 AM. BANKR. INST. J., no. 1, Jan. 2014 at 1, 2 (highlighting a "line of cases indicat[ing] that courts have allowed landowning taxpayers to appear as parties-in-interest in chapter 9 proceedings at the plan-confirmation stage").

adjustment.<sup>207</sup> In *In re Mount Carbon Metropolitan District*, for example, the court held that landowning taxpayers had the right to weigh in on the debtor's proposed plan of adjustment:

[T]he Plan . . . implicitly depends upon District property owners paying for all repair and installation of infrastructure. The Plan indirectly imposes the entire financial cost of repair and installation of sewers, street and other infrastructure upon landowners. If the Plan is confirmed and landowners refuse to pay for such improvements, landowners will be burdened by greater taxation without the ability to realize the value of their investment . . . . Because the landowners' vital interests are affected by the Plan, they have sufficient stake in the Chapter 9 proceeding to object to its confirmation.<sup>208</sup>

Likewise, in *In re Wolf Creek*,<sup>209</sup> the court held an owner of real property in the debtor district was a party-in-interest where the property owner was subject to a \$120,262 tax liability because the proposed plan exempted the owner from favorable tax treatment.<sup>210</sup> Note well, however, that these cases limit party-in-interest status to landowning taxpayers, and that current and future citizens of the debtor likely do not have standing under this line of cases to object to a debtor's proposed debt adjustment plan.<sup>211</sup> In addition, there are cases that have refused to confer party-in-interest status on taxpayers, even at the plan confirmation stage, on the grounds that the taxpayers' material interest was not affected, so authority is (and remains) mixed.<sup>212</sup>

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<sup>207</sup> *In re Mount Carbon Metro. Dist.*, 1999 WL 34995477 at \*4.

<sup>208</sup> *Id.*

<sup>209</sup> *In re Wolf Creek*, 138 B.R. 610 (D. Colo. 1992).

<sup>210</sup> *Id.* at 616.

<sup>211</sup> *Id.*

<sup>212</sup> See, e.g., *Green v. City of Stuart*, 135 F.2d 33, 35 (5th Cir. 1943) (holding taxpaying landowners did not have standing where plan called for adjustment of all debts, and landowners could not show that they had a material interest that would be affected by the plan).

#### IV. CONCLUSION

When municipalities fall on hard times, there are no easy answers. Stakeholders—taxpayers, public workers (past and present), bondholders, and other creditors—all may have compelling, but competing, claims for municipal resources. Chapter 9 is an important tool for eligible debtors struggling to sort out competing claims. And yet, as Detroit's example suggests, complex doctrinal and political questions remain. What is (or should be) the relationship between state distress regimes and Chapter 9? What room, if any, is there for the exercise of judicial discretion, given stakeholder concerns? How should we balance current taxpayers' needs for essential services against claims for municipal resources by bondholders, creditors, and others?

In this essay, I have focused on whether and under what circumstances ordinary taxpayers have a "seat at the table" in Chapter 9 proceedings. While it may make sense for courts to construe party-in-interest status and intervention rules narrowly under Chapter 9, given Tenth Amendment concerns, there are costs to this approach. Elected representatives may be compromised by corruption or special interest. Appointed officials may lack political legitimacy. And, different judges may proceed differently, leading to varying standards. Perhaps this is unavoidable. Tenth Amendment concerns may preclude reforms designed to further flesh out or codify taxpayer rights, and too-lenient rules regarding taxpayer standing would interfere with municipal debtors' interests in streamlined debt adjustment. And perhaps, we are better off leaving these matters to the discretion of the bankruptcy courts. Still, as Detroit's intractable, brutal service delivery insolvency suggests, it is worth considering how municipal bankruptcy affects the lives of ordinary taxpayers, and how municipal bankruptcy law might better take taxpayer interests into account.