

Bond Case Briefs

Municipal Finance Law Since 1971

Municipal Bankruptcy's New Rulemakers.

Neither Congress nor the Obama administration had a response — or even words of support — when two large U.S. cities lurched into bankruptcy two years ago. And there still isn't a response now as Puerto Rico, a U.S. territory, heads in that direction.

Well, that's not entirely true. As Congress completed its 2016 budget resolution in May, it included for the first time in U.S. history a provision of singular discrimination. It barred so-called "bailouts" to municipal corporations, cities and counties — none of which have ever been "bailed out" — while leaving unchanged support for federal bailouts of nongovernmental corporations, such as major Wall Street banks and automobile companies.

Local governments are facing heightened, long-term credit challenges at a time of profound changes in federalism. In the wake of the Great Recession, the oft-forgotten third branch of the federal government, the judiciary, has assumed the most critical role and responsibility for municipal and urban policy. It is increasingly displacing legislative and executive branches in addressing the long-term solvency of some of the nation's oldest cities — assessing, analyzing and examining the extent to which these cities and counties can achieve a sustainable future.

U.S. bankruptcy judges like Steven Rhodes in Detroit and Christopher Klein in Stockton, Calif., have devoted nearly three years to shepherding the two cities through extraordinary trials on their way to solvency. Moreover, unlike the federal bailouts to Detroit's major, iconic private corporations, these federal judges acted without access to solutions often provided private corporations, such as allowing them to shift the liabilities for pension obligations to the federal Pension Benefit Guaranty Corp.

When Congress adopted the municipal bankruptcy amendments in 1988, the country's experience had been that municipal bankruptcies affected small districts. Therefore, Congress acted to ensure that these small jurisdictions would continue to operate and provide essential public services. Indeed, from 1980 to 2013, the vast majority of Chapter 9 filings were by municipal utilities and special districts, as well as hospital and health-care facilities. In the last decade, however, we have experienced bankruptcies of large localities, from Jefferson County, Ala., to Vallejo, Calif., to Harrisburg, Pa., to name a few. These more recent, significant urban bankruptcies affect millions of Americans, disproportionately impacting low-income and minority Americans.

In an unprecedented session hosted by the New York Federal Reserve in April, bankruptcy judges involved in the largest municipal bankruptcies spoke of the lessons learned. Judge Thomas Bennett, who oversaw the Jefferson County bankruptcy, addressed the importance of "long-term municipal sustainability" as a key outcome to any successful municipal distress proceeding — in addition to an effective restructuring of a city or county's debt. Rhodes spoke of the uncertain future of this generation of cities and counties that emerge from municipal bankruptcy given the lack of a federal role in achieving "long-term sustainability," that is, a plan that entails a structuring of a pensions and debt service.

Rhodes said that he devoted much of Detroit's bankruptcy proceedings to ensuring any proposed

plan of debt adjustment be feasible, implementable by the city and enduring. "I did not want to become known as the judge on Detroit's first bankruptcy case," he said. As an example, he noted his decision to preserve the artwork housed at the Detroit Institute of Arts. "To sell the art," he said, "would be to forfeit Detroit's future."

The events of these past few years suggest a fundamental alteration in the federalism created half a century ago under former President Richard Nixon, a federalism that included congressional and administrative support for a general revenue sharing program. Even under Nixon's predecessor, Congress created the Advisory Commission on Intergovernmental Relations (ACIR), intending it as the nation's foremost repository of experience and information on intergovernmental structure, finance, process and practice. The ACIR also acted as a critical forum to identify emerging issues, trends and turning points, and as a way to promote stronger intergovernmental communication, cooperation and coordination. Today, that forum is no longer funded.

GOVERNING.COM

BY FRANK SHAFROTH | JULY 2015

fshafroth@gmu.edu

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com