Municipal Bankruptcy Law: A Solution Which Should Not Become a Problem

Eugenio VACCARI*

Introduction

Municipal bankruptcy has received little attention in legal literature outside the USA. International comparative studies have been commissioned to assess the benefits and limits of bankruptcy procedures involving municipalities. However, little has been done to change the state of affairs, the topic occupying “a rarely studied corner of bankruptcy law”.

Nevertheless, this subject is meaningful, especially in current times. It escaped the harmonization-frenzy affecting other sections of bankruptcy law, while political

---

* PhD Candidate City, University of London, LLM London School of Economics and Political Science, LL.B. (Hons) University of Modena. This paper is based on research conducted under the supervision of Professors Jason Chuah and Katherine Reece-Thomas, and supported by a Research Studentship from City, University of London. The author is grateful to Professor Katherine Reece-Thomas for her advice and comments throughout the writing of this article. Any mistakes or errors are entirely the author’s responsibility. The article covers literature, statistics and case law published before May 31, 2017.

1 The notion of ‘municipality’ or ‘local entity’ (synonyms in this article) is controversial. In the United States, while municipal law is a branch of public law, the discipline of their treatment in bankruptcy is entirely included in the Bankruptcy Code. Under Italian law, not only the notion of ‘municipality’, but also the treatment of their financial distress is a matter of public law.

2 Depending on the jurisdiction, there are different understandings of the meaning of ‘insolvency’ and ‘bankruptcy’ law. This paper adopts the American terminology. Therefore, the term ‘bankruptcy law’ is used to refer to cases involving not only corporations and individuals, but also municipalities.

3 Otaviano Canuto and Lili Liu, Until Debt Do Us Part (The World Bank, 2013).


6 As highlighted by Ryan Preston Dahl, “[a] debtor’s ability to rid itself of burdensome contractual obligations is one of the most fundamental virtues of bankruptcy” - ‘Collective Bargaining Agreements and Chapter 9 Bankruptcy’ (2007) 81(3) Am. Bankr. L.J. 295, 295. Shouldn’t this aphorism apply to municipalities?

7 The EU has adopted a regulation on cross-border issues in corporate bankruptcy proceedings [EC Regulation 1346/2000], recently amended [Regulation 848/2015/EU], and it is discussing the EC
and economic consequences in large cases can hardly be ignored. The failure of a municipality affects the wellbeing of a large number of current and retired public workers, of people with an indigent or low-income who rely on municipal social benefits, as well as the collectivity of taxpayers.

This study will prove of particular interest to Italy and the United States as illustrated by the following data.

In Italy, the Central Bank certified that at the end of 2015, local government consolidated debt (including regions and autonomous provinces) amounted to €92.3 billion, while an additional €139.9 billion was due as unconsolidated debt (4.3% and 6.52% of the national debt respectively).

In addition to that, the “Corte dei Conti” - a judicial institution with the role of safeguarding public finance and guaranteeing the respect of jurisdictional order - certified that until October 20, 2015, ninety-eight Italian local entities were involved in an “imbalance procedure”, while in the years from 2013 to 2015, one hundred-and-one entities filed for multi-year restructuring procedures. These numbers do not include out-of-court restructuring procedures, even if recently the same judicial 8

---

8 The focus of this article is on general-purpose entities in distress, as opposed to special-purpose authorities, that is those authorities established to provide a specific service (e.g. hospitals, airports, etc.).
9 For small towns the situation is equally cumbersome, and innovative solutions - such as voluntary dissolution into counties - have been proposed, both in the literature - see Michelle Wilde Anderson, ‘Who Needs Local Government Anyway?’ (2015) 24 Widener L. J. 149 - and in the legislation - see Municipality Financial Recovery Act, Act of Jul. 10, 1987, P.L. 246, No. 47 (Pa) <http://www.legis.state.pa.us/WU01/LI/LIUS HTM/1987/0/0047..HTM> [last viewed: 17 October 2016].
14 See further sections III(b) and III(c).
Vaccari: Municipal Bankruptcy Law

institutions have observed a downward trend in the number of imbalance and multi-year restructuring procedures.\textsuperscript{15}

In the United States, in 2015 state debt accounted for 6.4% of the US GDP, while local debt amounted to 10.5%.\textsuperscript{16} In addition, several municipalities filed for debt relief in recent years.\textsuperscript{17} Twenty-five entities sought protection from their creditors in the years 2013 to 2015 alone (among them, Detroit\textsuperscript{18}). A number which has decreased since the peak of 2011 (thirteen) and 2012 (twenty) after the Great Recession.

Scholars turn their attention to municipal bankruptcies whenever a high-profile filing arises. They investigate if municipal bankruptcy gives “much-needed relief to struggling municipalities that may have very few other options to get out from a self-reinforcing cycle of falling revenues and rising debt”.\textsuperscript{19} The procedural nature of bankruptcy law is rarely questioned.

This article challenges whether there should be a procedural bankruptcy law for municipalities. It sets out a list of alternatives ranging from structured\textsuperscript{20} to more discretionary, debtor- or creditor-oriented approaches. It questions whether the administration of these cases is more a matter of politics\textsuperscript{21} rather than of procedural, bankruptcy law. This question is embodied in a comparison of two legal systems (Italy and United States) and two similar, yet different cases (‘Rome’ and ‘Detroit’) and their implications.


\textsuperscript{16} <http://www.usgovernmentdebt.us> [last viewed: 14 October 2016].


\textsuperscript{18} Brent T. White et al., ‘Urban Decay, Austerity, and the Rule of Law’ (2014) Emory L. J. 1 (who argues that Detroit was a paradigmatic example of urban decay across the United States).

\textsuperscript{19} Jackson T. Carvey, ‘Municipal Bankruptcy and Public Pensions: Detroit’s Eligibility for Chapter 9 Relief and Legal Restraints on the City’s Actions as a Debtor’ (2013) 89 Notre Dame L. Rev. 2299, 2328.

\textsuperscript{20} Against, among others: Omer Kimhi, ‘Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem’ (2010) 27(2) Yale L.J. 351 (who makes a case for a proactive state-intervention solution); Richard C. Schragger, ‘Democracy and Debt’ (2012) 121(4) Yale L.J. 860 (who argues that the solution to state and local fiscal crises is largely a matter of politics, and not of institutional design); Samir D. Parikh, ‘A New Fulcrum Point for City Survival’ (2015) 57 Wm. & Mary L. Rev. 221 (who rejects central, federal and statutory solutions because “Chapter 9 is a resource-draining process” at 228).


\textsuperscript{21} See Hannah Heck, ‘Solving Insolvent Public Pensions: The Limitations of the Current Bankruptcy Option’ (2011) 28(1) Emory Bankr. Dev. J. 89 (who states that the main difference between bankruptcies of individual and municipalities lies in the political nature and relevance of the latter); and Schragger (n 20).
Each of the envisaged solutions are tested against two sets of criteria: the capability to ensure long-term reorganization, and regard for commonly-accepted principles of bankruptcy law. The focus is on general, as opposed to special-purpose authorities, facing long-term, endemic problems. Provided that a new definition of municipality is introduced for the purposes of bankruptcy law, the author finds that (and discusses how) a procedural, reorganization-oriented approach stands the best chances of reaching these goals.

Structure and Methodology

After having described the implications of the Italian approach to deal with municipal bankruptcies (in statutes and in practice), this article looks at the way in which the matter is treated in the United States; first, in the law, then in practice. It concludes that while municipal bankruptcies are largely ascribed to political failures, the US experience proves that general bankruptcy law can provide a comprehensive framework to handle these crises. The penultimate section submits a comprehensive proposal of reform of existing practices, followed by a conclusion.

The work on this study has been carried out according to a method of legal dogmatic of a relatively conventional type, adapted to the sources of the law. The comparative section adopts a functionalist approach, but results are evaluated against a tertium comparationis: the pre-defined criteria mentioned in the previous section.

Italy

Italian legal literature has paid little attention to the subject of the crises of local entities. Contributions on the topic are written mainly by scholars specialized in

---

22 There is no unanimous consensus among bankruptcy scholars on the guiding principles of this area of law; a most authoritative source is Royston Miles Goode, Principles of Corporate Insolvency Law (4th edn, Sweet & Maxwell 2011). Goode’s principles were conceived with reference to corporate entities. However, municipalities (even under the wide notion adopted in the United States) differ from corporations, in the sense that disappearance of one of them is not usually an option, and that they are not created to make profit but to provide public services. As a result:

- Principle 2 does not apply. Municipalities may be required to provide additional assets to the procedure than those available at the opening. On the other hand, certain assets held for public use - which existed at the time the municipality filed - may not be subject to debt foreclosure;
- Principle 8 does not apply. In general, there is no liquidation option for municipalities (there might be for their ‘instrumentalities’), therefore the municipality does not cease to be the beneficial owner of its assets unless otherwise agreed.

23 There have been exceptions, such as Orange County (Cal.) whose distress was mainly due to structural fiscal imbalance while the county was, in itself, viable and wealthy.

24 Reorganization-oriented does not mean neither pro-creditor nor pro-debtor. Under a reorganization-oriented approach, the long-term viability of the municipality, and its ability to perform essential public services are the main concerns, without this necessarily resulting in breaching fundamental principles of bankruptcy law.

25 Against, among others: Schragger (n 20); and Panikh (n 20).

26 Exceptions include: Luca Fazio, ‘Patologia degli equilibri di bilancio negli enti locali e obbligatorietà della dichiarazione di dissesto finanziario dopo il d.l. 10 ottobre 2012, n. 174’ (2013) 1 La Finanza Locale; N. Giudicepietro, ‘Note sul dissesto negli enti locali’ (2005) 1 Riv. trib. loc. 121; Paolo Tenuta, Dissesto e predissesto finanziario negli enti locali. Analisi e confronti in un’ottica economico-aziendale (FrancoAngeli Edizioni, 2015); papers written by Francesco Albo (sub n 37, 39 and 40) and Marcello Degni (sub n 37 and 45).
administrative law as the special nature of municipal entities has pushed the legislator to include the discipline of their failures within the greater sub-section of public law.

This choice, however, is prone to criticism. Despite the public nature of the debtor, its distress and the primary need to restructure its affairs affect the validity, enforceability and amendments to contracts and obligations subject to civil law rules. The private nature of the relationships impacted by the local entity’s distress suggests that their bankruptcy procedures should be subject to private, as opposed to public law rules.

The following subsections provide some information on the Italian bankruptcy framework, and its attitude towards reform. They describe the evolution and content of the Italian law applicable to municipalities in distress. Finally, they conclude by highlighting the most evident benefits and shortfalls of the current statutory system.

**Italian Bankruptcy Rules on ‘Municipalities’**

Italian bankruptcy rules can be found in a variety of statutory instruments, the main sources being the Civil Code (Royal Decree no. 262/1942) and the bankruptcy law (Royal Decree no. 267/1942).

Italian authorities have undertaken successive reforms in recent years. It should be noted that a lack of a “global view” has existed for some time. More recently, however, on February 10, 2016 the Cabinet adopted a draft statutory instrument (‘the bill’) to reform the Italian bankruptcy framework from the ground up. This bill has been licensed on February 1, 2017 by the House of Representatives, but it still has to be approved by the Senate. If no amendment will be introduced in the Higher House of the Parliament, the bill will be published in the Official Gazette (‘the act’). At that point, the Government will have the authority (and twelve months) to amend the current legislation by means of one or more law decrees (‘the decrees’), which have to conform to the requirements and directions set out in the act. It is the enactment of these decrees that will determine a change in the applicable law.

---

Jonathan Law, *Oxford Dictionary of Law* (8th edn, OUP 2015). Public law is described as “the part of the law that deals with the constitution and functions of the organs of central and local government, the relationship between individuals and the state, and relationships between individuals that are of direct concern to the state” (496). It follows that the treatment of local entities in distress should be considered part, and subject to the general rules of private law, i.e. “the part of the law that deals with such aspects of relationships between individuals that are of no direct concern to the state” (460).


The bill has already been interested by significant amendments. At the minute, there are two proposals: (i) (C-3671 bis <http://www.camera.it/_dati/leg17/lavori/stampati/pdf/17PDL0041360.pdf> [last viewed 26 July 2016]) which deals with the main body of the reform; (ii) (C-3671 ter <http://www.camera.it/_dati/leg17/lavori/stampati/pdf/17PDL0041370.pdf> [last viewed 26 July 2016]) which reforms the discipline of rescue procedure for large corporations only.

The bill has been licensed on February 1, 2017 by the House of Representatives, but it still has to be approved by the Senate. If no amendment will be introduced in the Higher House of the Parliament, the bill will be published in the Official Gazette (‘the act’). At that point, the Government will have the authority (and twelve months) to amend the current legislation by means of one or more law decrees (‘the decrees’), which have to conform to the requirements and directions set out in the act. It is the enactment of these decrees that will determine a change in the applicable law.
However, since the bill is currently languishing in the Justice Commission of the Senate, it is highly unlikely the reform will be approved before the next general elections.\textsuperscript{31}

A reform of the treatment of local entities in distress may well accord with this, but it may require recognition of the private, rather than public, nature of the phenomenon. The bill, however, does not propose to change the status quo.

Currently the administrative rules on the management of procedures involving municipalities in distress apply only to selected “enti pubblici locali e territoriali”.

“Enti pubblici” (public bodies/entities) are organizations created or recognized by the law (art. 4, law no. 70/1975) by means of which the public administration performs its activity and pursues a public interest.\textsuperscript{32} A ‘public interest’ is the interest of the community, in which the public entity operates. Public entities may be profitable, pursue economic goals, and be incorporated as private (e.g. limited liability) or even public companies.

“Enti locali” and “enti territoriali” are ‘enti pubblici’ that operate at a local, territorial level. They are characterized by statutory, legislative, organizational, tax and financial autonomy. According to art. 2 of the Uniform Code of Local Entities (Legislative Decree no. 267/2000 - hereinafter, ‘TUEL’), the notion of ‘enti locali’ includes “comuni” (i.e. councils), “province” (i.e. counties), “città metropolitane” (i.e. large cities, as defined by the law), “comunità montane” (i.e. groups of councils in mountainous areas), “comunità isolane” (i.e. groups of councils in islands), and “unioni di comuni” (i.e. groups of councils). According to art. 114 of the Constitution, the list of ‘enti territoriali’ includes “regioni” (i.e. regions), while groups of councils are not mentioned. Regions are equated to US federal states because, even if they do not have the same degree of autonomy as their American counterparts, they have legislative powers.

Local and territorial public entities subject to bankruptcy procedures are: ‘comuni’, ‘province’ and ‘città metropolitane’ (art. 244 TUEL).

\textbf{Italian Administrative Law on Municipalities in Distress}

Under Italian law, the main rules applicable to the above mentioned municipalities in distress are:

- Articles 242 to 269 of TUEL, amended recently in 2015. In this Code we find the definitions of “structural deficit” and “structural imbalance”, and the description of two reorganization procedures: “multi-year restructuring procedures”, and “imbalance procedures”;
- Article 6 of the Legislative Decree no. 149/2011, which provides the main rules on a procedure called “guided imbalance procedure”.

\textsuperscript{31} These elections are scheduled for spring 2018.
A municipality is in ‘structural deficit’ if its balance sheet does not meet at least five out of ten financial yardsticks set out by the government. When this occurs, it is placed under the supervision of a central administrative authority.

Under this supervision, elected officials remain in power, but employment of new personnel is strictly limited, and at least part of the costs for public services shall be compulsorily covered. Failure to meet these obligations may result in sanctions up to 1% of the municipality’s revenue.

If the structural deficit is not reduced, a situation of ‘structural imbalance’ may occur. Before that happens, the elected members of the municipality shall declare the ‘pre-imbalance status’, and commence a ‘multi-year restructuring procedure’.

This is a formal procedure run by the debtor. It triggers the same consequences as the ‘supervision’ process (control over personnel and expenses), with the addition that executory procedures against the municipality are suspended.

If the council increases local taxes to the maximum thresholds established by the law, and presents within ninety days a plan to reduce the structural imbalance and sell all non-core assets, it may apply for financial support. It may also borrow money on the market, but for investment purposes only. On the other hand, failure to meet these requirements, or to achieve judicial confirmation, results in lack of any forms of external support.

Back in 2011 the legislator introduced the “guided imbalance procedure”. This is triggered by judicial authority whenever it is satisfied - under ordinary auditing controls - that the municipality’s balance sheet evidences a situation of structural deficit that may lead to structural imbalance (i.e. same requirement for the commencement of a multi-year restructuring procedure).

First, the judicial authority invites the municipality to adopt, within a short timeframe, all the necessary measures to tackle the structural deficit (de facto, the
municipality is required to draft a multi-year adjustment plan. Failure to act leads to the dissolution of the elected organs, and to the appointment of a special commissioner with the duty to draft an adjustment plan.

If none of these mechanisms works, and the municipality faces a ‘structural imbalance’, the only alternative left is the ‘imbalance procedure’ (art. 244 TUEL).

This can be triggered either by the municipality or by a special commissioner. Management of the procedure is given to a third party (“organo straordinario di liquidazione”, hereinafter OSL) appointed by the Ministry of Interior.

Commencement of the procedure results in the suspension of executory procedures against the municipality, and in the freezing of interests for all consolidated debts. New debt can be borrowed only to repay existing debts from the ‘Cassa Depositi e Prestiti S.p.a.’, a public corporation fully owned by the state. All local taxes shall be raised to the highest possible rate for up to 5 years.

Under the law, OSLs have the power - not recognized in any other bankruptcy procedure for local entities - to re-negotiate existing debts with creditors. Additionally, they have to draft a plan to extinguish existing liabilities. However, should assets prove insufficient, the remaining balance will not be discharged. Finally, unlike what happened in the past, the state cannot contribute in any way.

Concluding Remarks

This summary demonstrates that the Italian procedural, creditor-oriented system has some remarkable merits. It grants a reasonable degree of confidence to investors, and it ensures equality of distribution among creditors. Further, shortfalls in municipal budgets are expected to be provided for by local residents, thus placing less pressure on central budgets especially during ‘austerity’ periods. Finally, mechanisms to control both the duration and the costs of this “liquidation without discharge” are compatible with procedural approaches to municipal distress (even if they are not currently provided for by the law).

40 Italian law recognizes two situations of structural imbalance: (1) when the municipality is not capable of ensuring adequate performance of essential, public services [functional imbalance]; and (2) when the municipality cannot pay its debt as they fall due with ordinary means of payment [financial imbalance] - see also Corte Conti Piemonte no. 67/2015 (2016) Redazione Giuffré. For more details: Francesco Albo, ‘La dichiarazione di dissesto finanziario negli enti locali’ (2011) 1 Azienditalia; Francesco Albo, ‘La dichiarazione di dissesto finanziario negli enti locali: prospettive di riforma’ (2011) 18(1) Azienditalia 5; and Elena Gori and Silvia Fassi, Il dissesto finanziario negli enti locali (FrancoAngeli Edizioni, 2012).

41 While the municipality experiencing a status of structural imbalance has an obligation to trigger the imbalance procedure [TAR Salerno no. 461/2002 (2002) Fon amm. TAR 2156], all residents have the right to challenge this decision in front of an administrative judge, since the admission to the procedure would determine further, negative consequences for them all (e.g. reduction in services, and increase in local taxes) - Consiglio Stato sez. V, no. 2837/2006 (2006) 2 Vita not. 716.

42 Until law no. 3/2001 (enforced on November 8, 2001), the state could cover the portion of the debt the OSL declared to be unable to repay. From that date to October 2007, structurally imbalanced municipalities could borrow new money on the market only for investment purposes. Nowadays, not even that form of additional funding is permitted.
However, due to the heavy burden on local taxpayers, elected officials have little or no incentive to commence bankruptcy proceedings. These procedures are designed to extinguish, not adjust or restructure, existing liabilities. As a result, local politicians end up in adopting temporary solutions, or in dissimulating the real situation of local finances, in the hope of future windfalls.

While general principles of bankruptcy law and pre-bankruptcy entitlements are usually respected, this procedural, creditor-oriented approach is incapable of tackling the cause of distress. When failure is determined by socio-economic, or otherwise external factors, it may simply be impossible for the municipality to draft an adjustment plan, despite what is prescribed for in the law. Should more discretionary, but still creditor-biased approaches address some of these shortcomings?

A Case Study: ‘Rome’

On April 28, 2008 Gianni Alemanno, the newly elected mayor of Rome, climbed the Capitoline Hill only to find the city coffers desparingly empty. What a cruel twist of fate: it took more than two decades for the conservative coalition to “conquer” Rome, only to rule over a city on the verge of bankruptcy.

But Gianni Alemanno did not despair. Instead of calling a council meeting to acknowledge the status of “structural imbalance” of the city’s finances, he waited for the general elections to take place (May 8, 2008). Once the results had been confirmed, he knocked at the door of Silvio Berlusconi, who was celebrating the victory in his Roman residence, Palazzo Grazioli.

Could the newly elected prime-minister-to-be - who campaigned under the manifesto “Rialzati, Italia!” (”Rise Again, Italy!”) - turn a blind eye on Rome, as well as on an influential member of his party? In little more than one month, despite the not-very-fierce opposition from “Lega Nord” (a member of the ruling coalition), ad hoc rules were conceived to save Rome from financial disaster.

---

43 Auditors and local officials are not held responsible for the imbalance of the municipality unless they acted with fraud, wilful misconduct or gross negligence (art. 248 TUEL). In case of “simple” prolonged concealment of the dire financial conditions of the municipality, no legal remedy or action against the perpetrator is allowed [Piemonte (n 40)].

44 Against: Consiglio di Stato sez. V., no. 6437/2005 (2005) 11 Foro Amm CD 53310 (the main goal of the procedure is to promote the rebalancing of the distressed municipality).

45 Vanessa Manzetti and Speranza Corbo, ‘Le procedure di risanamento degli Enti Locali: il quadro normativo’ in Marcello Degni et al. (eds), “Dissesto”, “pre-dissesto” e piani pluriennali di riequilibrio negli enti locali (Università di Pisa, 2014), 18. Frequently, all chickens come home to roost after local elections, where the former opposition party obtained the majority in the council - see what is happening in Turin: <http://www.lastampa.it/2016/10/20/cronaca/finanza-in-comune-per-i-conti-del-bilancio-che-non-tornano-oYM8i5fN9LuPb6FzEP/pagina.html> [last viewed: October 21, 2016]. Some authors suggest that he introduction of punitive criteria in the law to make elected officials accountable for their misadministration would mitigate this risk. This claim is controversial: it risks fostering “strategic filings” (n 54), creditors would be negatively affected, and interest rates would increase.

46 Lega Nord (“North League”) is a regionalist political party in Italy, which takes to heart the pleas of citizens living in the northern part of the country.
Nottingham Insolvency and Business Law e-Journal

Have Romans (and Italians) lived happily ever after?

*Rome*: Caput Mundi on its Knees

In certain cases, political valuations may “forcedly” recommend the adoption of tailored solutions. ‘Rome’ seems to fit properly in this group of cases.

As first act in the new legislature, the newly appointed government adopted some “urgent measures for the capital city of Rome” (art. 78, law decree no. 112/2008). As a result, all debts assumed before the appointment of the new mayor (April 28, 2008), and all revenues collected before December 31, 2007, were allocated to a “separate management”. The new mayor was appointed as special commissioner, to determine the outstanding balance of existing liabilities, and to conceive a restructuring plan.

Since then, time has passed, special commissioners have changed, but debt has increased. Despite the dubious legitimacy of a significant portion of it, and irrespective of generous, steady contributions to the separate budget, in a hearing in front of the V Commission of the House of Representatives (April 5, 2016) the then newly-appointed special commissioner highlighted that in 2020 the city will face a liquidity crisis, which is likely to last until 2035 if no additional funds are secured. In the same hearing, the commissioner hinted that a separate management of Rome’s finances may be required until 2048, when a €1.4 billion payment of a contestable bond will be due.

One would assume that, since 2008, current expenses (freed of the burden of previous debt) have been under control. Rome was granted a fresh start. Unfortunately, the city council has continued to spend more than its income, and the post-2008 balance sheet is in a situation of structural deficit.

To cope with this problem, in 2014 the new, centre-left government coalition granted special powers and privileges to deal with the crisis to the newly elected left-wing mayor (Ignazio Marino - June 12, 2013), and required him to draft a three-year plan of adjustment (article 16, law decree no. 16/2014). A plan that the recently elected

---

47 On May 5, 2010 a new, independent commissioner (Domenico Oriani) was appointed. He remained in charge until September 22 of the same year, when he was replaced by Massimo Varazzani. His appointment was first nullified by the judiciary (ruling no. 37085/2010, TAR Lazio), and then confirmed by political authorities. Finally, since September 2015 Silvia Scozzese is acting as special commissioner for Rome.


49 A series of bonds negotiated between 2003 and 2005 for a final amount of €1.4 billion, in breach of the indebtedness limits established by the national law.

50 From 2008 to 2010, the state granted €500 million/year in taxpayers’ money. Since 2011, part of this amount (€300 million) is still paid by Italian citizens, while the remaining portion (€200 million) is collected from Roman residents by means of higher local taxes (law decree no. 78/2010).

51 [http://documenti.camera.it/leg17/resoconti/commissioni/stonografici/html/05/audi2/audiizione/2016/04/05/indice_stenografico.0003.html](http://documenti.camera.it/leg17/resoconti/commissioni/stonografici/html/05/audi2/audiizione/2016/04/05/indice_stenografico.0003.html) last accessed 18 October 2016 (Italian-only version).
Vaccari: Municipal Bankruptcy Law

mayor (Virginia Raggi, M5S - June 22, 2016) is currently trying to renegotiate with the government.52

Concluding Remarks

In Italy, there is a prevailing administrative understanding of municipal crises. The statutory provisions that deal with these cases are restricted to few, non-holistic rules in the TUEL. Those have been frequently ignored whenever politically sensitive cases have come to light. This fatality exists despite the constraints imposed by Italy’s membership of the European Union.

Law and practice in Italy tend to favour the instances of the creditors, over the restructuring of the debtor. Compared to strictly procedural approaches, discretionary, politically-informed tactics (e.g. what is happening in Rome) may reduce the cost of credit for the debtor. Borrowers would only have to look to the solvency of the country,53 which would grant for any unpaid debts. Additionally, creditors are likely to be treated alike.

Intervention of a higher authority (either the region or the state) could help the ailing local entities to deal with problems that would otherwise fall beyond their reach. An increase in taxes and fares cannot offset a shrinking population and a declining economy; they are only likely to make things worse.

Nevertheless, the main concern stemming from discretionary solutions lies in their inability to address the other shortcomings evidenced in creditor-oriented, procedural approaches to bankruptcy: (i) no incentives to file timely; (ii) no incentives to tackle the causes of the crisis early on; (iii) no incentives to favour long-term, over short-term solutions. Additionally, (iv) costs (for the procedure and litigation), as well as duration, are likely to spike; and (v) competitions among municipalities would no longer be on a level playing field, thus paving the way for “strategic filings”.54

As none of the described creditor-oriented solutions is capable of promoting long-term reorganization of distressed municipalities, it seems appropriate to investigate alternative debtor-oriented mechanisms, which have been implemented for a long time (however with mixed success) by the United States.

---

54 A “strategic filing” may occur when an otherwise solvent debtor makes use of the bankruptcy law for some specific business purpose (e.g. to avoid repayment of liabilities arising from environmental claims, tort liabilities and health hazards). See Kevin J. Delaney, Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 to Their Advantage (University of California Press 1992).
United States

Several countries have mechanisms in their statutes to deal with municipalities in crisis. However, the US model in general, and the ‘Detroit’ case in particular, represent the most appropriate means of comparison. This is due to their antipodal statutory approach (debtor rather than creditor-oriented), and the comparable concerns that the ‘bankruptcy’ of Rome and Detroit brought up in public opinion and national and local politicians.

Whilst the United States Constitution (1787) authorized Congress to enact federal “uniform Laws on the subject of Bankruptcies”, and whilst the first federal laws on the subject were enacted in the early 19th century, it was not until 1934 - in the aftermath of the Great Depression - that the legislature drafted a legislation to deal with insolvent municipalities. This act was shortly after quashed by the Supreme Court in Ashton, since it was found in breach of the Tenth Amendment of the Constitution which upholds the sovereignty of the States.

A new law was enacted in 1937. This time, its enforceability was upheld by the Supreme Court in Bekins. Since then, fewer than 600 municipal bankruptcy petitions have been filed in the US Courts. In short, Chapter 9 - the section of the US Code, which deals with distressed municipalities - is one of the less used bankruptcy procedures in the US. And one of the most controversial.

Disputes arise even with reference to the notion of ‘municipality’. 11 U.S.C. §.101 describes municipality as a “political subdivision or public agency or instrumentality of a state”, thus including not only councils (cities, towns and villages), but also counties, taxing districts, municipal utilities, hospitals, and school districts within its scope. To narrow it down, courts consistently held that (1) ‘political subdivisions’ or ‘public agencies’ should be given government attributes (e.g. taxing authorities) or domain power, or they should engage in government functions to be considered municipalities, while (2) ‘instrumentalities’ should serve a public

---

55 For a comprehensive list, see Canuto (n 3).
56 Article 1, Section 8, Clause 4 of the US Constitution (1789).
57 Before 1898, there were several short-lived federal bankruptcy laws in the US. The first modern Bankruptcy Act - sometimes referred to as the “Nelson Act” - dates back to 1898, while the current Bankruptcy Code (11 U.S.C.) was enacted in 1978 (Bankruptcy Reform Act of 1978).
59 “[P]owers 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”.
61 Michael De Angelis and Xiaowei Tian, ‘Chapter 9 Municipal Bankruptcy - Utilization, Avoidance, and Impact’ in Canuto (n 3), 312.
62 Commentators observed that while “Chapter 9 is patterned on ordinary bankruptcy and assumes that the municipality decision makers will remain in place” (1081), the paucity of Chapter 9 cases up to recent times proves that the mechanism is in need of reform - David A. Skeel Jr., ‘Is Bankruptcy the Answer for Troubled Cities and States?’ (2013) 50(4) Houston L. Rev. 1063.
64 In re Pleasant View Utility Dist. of Cheatham County, Tenn. 24 B.R. 632 (Bkrtcy.M.D.Tenn.1982).
65 In re Greene County Hosp. 59 B.R. 388 (Bkrtcy.S.D.Miss. 1986).
66 In re City of Central Falls 468 B.R. 36 (Bkrtcy.D.Rhode Island 2012).
Vaccari: Municipal Bankruptcy Law

function, and the state or municipal control over the entity should result in direct management and not simply general oversight.  

This section describes the main features of Chapter 9. It also highlights the main hurdles that determine the paucity of municipal filings, and that pushed Michigan state authorities to tune the model to their needs when Detroit faced financial troubles. It concludes by discussing their relevance for the purpose of this research.

Chapter 9 in its Basics

Under federal law, Chapter 9 represents the only available mechanism to fix a financially struggling “municipality”. It has been described as “a modified chapter 11 for local entities that cannot pay their debts”. Unlike Chapter 11, it was conceived in a context where federal autonomy was limited on the one hand by the Tenth Amendment to the US Constitution and, on the other, by the Obligations of Contract Clause. The Bankruptcy Code, therefore, tries to strike a balance between two opposing interests: supremacy of federal bankruptcy law, and reservation of powers to the states.

It is not enough to be a municipality to have a right to file for bankruptcy. 11 U.S.C. §.109(c) sets out four additional eligibility requirements, the most controversial being the federal requirement for state authorization, imposed by the need to preserve the autonomy of the states. This judicial gatekeeping has no analogy to

68 On the importance of the role of the state in bankruptcy procedures, see Valbona Metaj: “[i]f it is not possible to achieve a mutual agreement [with the creditors], then the interference of the State is important to save its own creature from deeper regression of the financial situation” - in ‘Municipal Bankruptcy: 21st Century Challenges’ (2015) 4(7) The Macrotheme Review 89, at 98. Equally Keeok Park, who observes that “[g]overnment failure in the form of municipal bankruptcy can be reduced by strengthening the audit powers of the states” - in ‘To File or Not to File: The Causes of Municipal Bankruptcy in the United States’ (2004) 16(2) JPBAFM 228, at 228.
70 Article 1, Section 10 of the US Constitution (1789): “No state shall […] pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts”.
72 (1) The municipality shall be specifically authorized to be a debtor by a governmental officer or under State law; (2) The municipality is insolvent; (3) The municipality must desire to effect a plan to adjust its debts; (4) The municipality must either: (a) obtain the agreement of creditors; (b) negotiate in good faith with creditors and fail to obtain their agreement; (c) be unable to negotiate with creditors because such negotiation is impracticable; or (d) reasonably believe that a creditor may attempt to obtain a preference [11 U.S.C. §.109(c)].
74 The Tenth Amendment to the US Constitution reserves for states and the people any powers not expressly delegated to the federal government. When properly understood, it prevents the bankruptcy court from replacing the executive and legislative discretion of municipal and state entities.
voluntary Chapter 11 cases, and it is amplified by 11 U.S.C. § 921(c) which grants the bankruptcy court the power to reject the petition for lack of good faith or inability to meet the requirements of Chapter 11.

Chapter 9 is structured to give the insolvent debtor time to negotiate with its creditors, who are consequently prevented from seizing the municipality’s assets. The debtor is asked to negotiate a plan to adjust its debts in a manner that enables the municipality to continue to provide essential services.

Municipalities must voluntarily seek protection under this chapter of the Code. The case is then assigned to a judge appointed by the chief judge of the Court of Appeal for the circuit embracing the district, in which the case is commenced.

Technical and procedural aspects aside, the most striking element of Chapter 9 is that it is a judicial procedure, where courts play a very limited role. Courts can neither interfere with the political or governmental powers of the debtor, nor with the debtor’s choices on the allocation of property and revenues. They cannot even order a stay, or issue an order or a decree which interferes with the debtor’s administration of the estate unless the debtor consents or the plan so provides.

It follows that the leading role in Chapter 9 cases is taken by the debtor. “Chapter 9 is patterned on ordinary bankruptcy and assumes that the municipality decision makers will remain in place”. As such, the municipality not only has broad powers to dispose of its assets, taxes and personnel, but it also enjoys the debtor-in-possession prerogatives, and the power to reject executory contracts and unexpired leases. Finally, Chapter 9 debtors can reject collective bargaining agreements and

---

76 Filing determines the application of the “automatic stay” (§ 901(a), which applies 11 U.S.C. § 362 to Chapter 9 cases), which prevents the commencement and continuation of collection efforts against the debtor.
79 Barta J in In re City of Wellston (Bkrtcy.E.D.Mo. 1984) 42 B.R. 282, “[t]he Federal law clearly intends to limit intrusion by its Courts into the political and governmental operations of a municipality, notwithstanding the voluntary filing of a Chapter 9 Bankruptcy petition” (283). Similarly: “Congress has barred the bankruptcy court from interfering with any of the political or governmental powers of a Chapter 9 debtor-municipality” [In re City of Stockton, Cal. (Bkrtcy.E.D.Cal. 2013) 499 B.R. 802]. Against: Melissa B. Jacoby, ‘Federalism Form and Function in the Detroit Bankruptcy’ (2016) 33(1) Yale J. on Reg. 55.
81 11 U.S.C. § 904. Despite the statutory limitations, Detroit’s case has proven that these constraints are not as robust as thought.
82 Skeel (n 62) 1081 and Jacoby (n 79) 57.
83 The possibility to modify or reject a collective bargaining agreement signed with a public-sector union is highly controversial. Courts have addressed the issue on a case-by-case approach, and the paucity of Chapter 9 cases does not ensure that similar solutions will be followed in the future. For an analysis of the topic, see Trotter (n 10), who concludes that the current understanding and interpretation of the law makes unilateral modification possible, thus lowering “the bar for outright municipal rejection of collective bargaining agreements” (87).
pension benefit plans without going through the usual cumbersome procedures required in Chapter 11 cases (and despite the limits set by the Obligation of Contracts Clause).

Creditors’ secured rights are usually preserved, but the law gives the municipality the right to divert revenues which, according to the contracts signed with the creditors, should have been used to repay the bond/financial instrument. Similar to courts, the role of creditors is equally limited, since the only party who can submit a plan of adjustment - within the time deemed appropriate by the court - is the municipality itself. If approved by all (or the majority of) creditors and the court, the plan becomes binding on all parties, including dissenting creditors.

The municipality is not - however - free to do as it pleases. To obtain the discharge from part of its burdensome liabilities, the plan needs to be “confirmed” according to the standards set out in 11 U.S.C. §.943(b), and by those portions of 11 U.S.C. §.1129 (the Chapter 11 confirmation standards) made applicable by the renvoi operated by 11 U.S.C. §.901(a).

Concluding Remarks

Compared to the creditor-oriented approach under Italian administrative law, Chapter 9 is a rather structured procedure, built on the assumption that

“[c]ities cannot be liquidated, nor can they be split up and sold for parts. So Congress wrote Chapter 9 bankruptcy law to protect cities from being forced to sell assets to satisfy creditors.”

In addition, the possibility to renegotiate the main elements that burden the state’s budgets (pensions and wages) is extremely attractive.

Compared to more discretionary approaches, procedural ones should keep costs “on a leash”, especially if coupled with limits to the duration of the procedure (which, however, is not the case for Chapter 9). Finally, the debtor-in-possession paradigm makes the bankruptcy alternative enticing for the elected members of the municipality: timely filing may be achieved.

So why are so few applications observed?

The comparably low number of Chapter 9 cases has to be ascribed to a range of causes. On the one hand, eligibility criteria are among the primary suspected

85 This is a pivotal characteristic of Chapter 9 cases. In Ashton and Bekins, the Supreme Court ruled out that others than the municipality could draft a plan.
86 The main confirmation standards are: (1) The plan is legal, and complies with statutory provisions; (2) The plan serves the best interests of the debtor’s creditors; (3) The plan does not discriminate unfairly among creditors; (4) The plan is feasible to implement; (5) The plan has been accepted at least by one impaired class of creditors.
87 Nathan Bomey, Detroit Resurrected - To Bankruptcy and Back (Norton 2016) 95.
While it is comprehensible that barriers to a relaxed, nonchalant use of the procedure are put into place, the ‘insolvency’ criterion, the lack of additional funding and the need to draft a plan capable of obtaining the approval of a large portion of the creditors push applicants to file at the eleventh hour.

On the other hand, councils may lack the expertise to write these plans, and they usually do not have the money to hire professional consultants to assist them in the process. Furthermore, they may be unable to write feasible restructuring plans where the situation of distress is primarily ascribed to socio-economic causes. As a result, the stringent eligibility criteria and the procedural hurdles may increase the risk of multiple filings in short succession.

Weaknesses have been identified in regards to the uncertain duration of this procedure, while other authors have criticized elements that may equally be listed as strengths: debtor-in-possession paradigm, and costs. Finally, a pro-debtor approach to bankruptcy may result in higher interest rates for loans, and in a more equal treatment for some creditors, especially if the plan can be imposed upon dissenting creditors and courts are unwilling to question the content of the restructuring plan.

However, the most critical aspect of the current procedure lies in its purpose. Chapter 9 was never intended to serve as a comprehensive scheme to solve municipal financial problems; it was designed to complement state efforts to solve these problems.

It is a “municipal debt adjustment” procedure, governance reform does not figure among its intended goals. It follows that debtor-oriented procedures may fall short...

---

88 Warren et al. (n 69) 835. It is argued that, since there is no liquidation alternative to failure to confirm a plan, creditors, who prefer to grab assets (that otherwise would remain in the municipality’s control upon approval of the plan), fight strenuously against the eligibility of the entity to file for Chapter 9.

89 This occurred to the city of Mack’s Creek, Mo. which filed for Chapter 9 in 1998 and 2000, and contemplated filing in 2004; to Prichard, Al. which filed for Chapter 9 in 1999 and in 2009 (2 years after the conclusion of the previous procedure). In both cases, the reasons for the crisis were multiple, and structural - thus questioning Chapter 9’s ability to properly address these issues. Other cases include Westminster, TX. (2001 and 2004); Moffett, Okla. (2006 and 2009); and Washington Park, IL. (2004 and 2009).

90 For instance, the City of San Bernardino filed for bankruptcy on August 1, 2012, and only on February 7, 2017, US Bankruptcy Court Judge Meredith Jury filed a Confirmation Order (<http://sbcity.org/civicax/filebank/blobdload.aspx?BlobID=23856 > last accessed 3 June 2017) allowing the City to finalize the implementation of the approved Third Amended Plan of Adjustment of Debts. At the time of writing, the formal effective date has yet to be determined.

91 Skeel (n 62). See also McConnell (n 4), who makes a case against a debtor-in-possession Chapter 9.

92 The final bill for Detroit’s bankruptcy was $170 million, roughly one sixth of the municipality’s annual budget, and it lasted for little more than one year.

93 Moringiello (n 5) 485.

94 This is the official title of 11 U.S.C. Chapter 9 section.

95 Adam Levitin, ‘Bankrupt Politics and the Politics of Bankruptcy’ (2012) 97 Cornell L. Rev. 1399, 1450. However, the “feasibility test” grants courts sufficient discretion to assess if the real causes of failure - including dysfunctional governance - have been adequately tackled.
of achieving both purposes laid down at the beginning of this work: the capability of ensuring long-term reorganization, and respect for commonly-accepted principles of bankruptcy law.

These concerns were carefully considered in 2012, when it became increasingly clear that the city of Detroit would have never been able to restructure its debt outside a bankruptcy procedure.

A Case Study: ‘Detroit’

This section describes the elements that set the case of ‘Detroit’ aside when compared to other bankruptcy procedures, and the most significant variations applied to the Chapter 9 model during this process. It concludes by proving that Detroit’s success story could not have occurred in the absence of a functioning statutory framework for municipalities in distress.

Detroit’s Case

Despite recent downturns in its economy, Detroit is the largest city of Michigan with a population of nearly 700,000 people. However, at the beginning of 2012, the city’s precarious financial conditions worsened to the point that it was no longer able to stand on its own. Decades of industrial decline, economic downturn, social and racial strife, financial mismanagement, municipal disarray, and political corruption brought the city on the verge of a liquidity crisis.

In its heydays in the 50s, Detroit was the hometown of more than 1.8 million people. Source: <http://historydetroit.com/statistics/> last accessed 15 October, 2016.

Michigan and Detroit industries have always heavily relied on the auto sector. However, the oil crisis of the 70s, and the emergence of Japanese and Korean automakers in the US car market found the “Big Threes” (GM, Ford and Chrysler) ill-prepared to meet these new challenges. Automation of the industry meant that less workers were needed in factories, while the neglected municipal teaching system is incapable of educating skilled workers.

Michigan backtracked a revenue-sharing agreement negotiated with the city in 1998. Furthermore, the 2008 financial crisis also affected the money that state and federal lawmakers could devote to city budgets. While many commentators blame mayor Coleman Young for the city’s economic collapse, a great deal of responsibility is to be charged also on mayor Kwame Kilpatrick, and not simply for the corruption scandals that resulted in his twenty-eight year conviction in a federal prison. Back in 2005, his administration engineered a US$1.44 billion borrowing from the investment banks UBS and Merrill Lynch to cover the shortfalls in the pension funds. While this borrowing was in excess of federal limits, it was nevertheless approved by the council - and not challenged by the federal government - because the money was not borrowed directly by the city, but by two “service corporations” linked to the municipality. FGIC and Syncora agreed on securing the payment, should an event of default occur. A system strikingly similar to the €1.4 billion bonds subscribed by the city of Rome between 2003 and 2005 - see supra n 49.

In 2012, city’s violent crime rate was five times higher than national average, police took on average thirty minutes to arrive on the scene of a high-priority call, and only 39 out of 344 murders were solved in 2011. In addition, 40% of the city streetlights were not working, and a study conducted in 2014 estimated that in Detroit area there were at least 84,000 blighted or vacant structures. Source: Bomey (n 87).

Before taking the books in court, the city and the state looked for consensual solutions with creditors, first by means of a state fiscal oversight over the city expenses (April 2012), and then by the appointment of Jones Day restructuring attorney Kevyn Orr as the city’s emergency manager (hereinafter, EM) on March 14, 2013. While in charge of re-writing Detroit’s contracts (including collective bargaining agreements), effecting redundancies, and liquidating assets, Orr first sought an arrangement with the creditors. The unsuccessful outcome of this attempted “haircut” on Detroit’s debt has resulted in the most controversial municipal bankruptcy of recent times.

Detroit filed for Chapter 9 in the US Bankruptcy Court of the Eastern District of Michigan on July 18, 2013 at 4:06 p.m. However, the city was declared “eligible” for bankruptcy only on December 3, 2013. It was this second ruling, which paved the way for real negotiations between the creditors and the city. With the support of a mediator (Chief Judge Gerald Rosen), EM’s staff negotiated with major creditors over a reduction of the outstanding liabilities.

Detroit had debt in excess of US$18 billion. While a portion was secured, the majority was not. Among unsecured creditors, the most problematic positions - for different reasons - were those of pension and healthcare liabilities, and those of bondholders (primarily, UBS and Merrill Lynch) and their insurers (primarily, Syncora and FGIC). While ranking at the same level, bankruptcy officials tried (and managed) to secure a significantly better treatment for the retirement funds in the battle between citizens and bondholders, the former fared remarkably better.
In parallel with the bankruptcy procedure, the EM and his team had the duty to ‘run’ the city. From the commencement of the case, they made it clear that one of their priorities was to restructure the city, not simply its finances. This has resulted in the reorganization of key departments (e.g. transports, and water and sewage), and in a plan to replace broken streetlights and demolish unoccupied and derelict buildings.

The final plan of adjustment - subject to state’s oversight -, included a significant financial support from the “Great Bargain”, as well as minor contributions from the state budget. This was approved by all classes of creditors, and confirmed by Rhodes J. on November 7, 2014. However, the plan’s goals were achieved at the expense of some of the most fundamental axioms of bankruptcy law: maximization of creditors’ interests, and rateable distribution among similarly placed creditors. In other words, the politically-informed nature of the governance prevailed over the procedural constraints of the Code.

The Importance of Being… Detroit

The team that was in charge of Detroit’s bankruptcy case explored some variations to the standard, federal framework. This should not lead to conclude that Detroit was a “one-off” incident. In particular, some of the innovations introduced by this procedure should and could make their appearance in future municipal bankruptcies.

The coup de théâtre in Detroit’s procedure was the appointment (imposed by the state’s governor) of an EM. Compared to the elected officials, an independent third party is often less subjected to political pressures, and more likely to impartially assess the causes of the municipality’s distress, and come up with solutions in the interests of all stakeholders.

In regards to municipalities, the case for a debtor-in-possession approach is seen as weaker. Elected officials do not usually have the same knowledge of the debtor as the managers and chief financial officers of a distressed corporation. While they may equally be part of the problem, they are less likely to contribute to its solutions than their private counterparts. As Gillette puts it, “the root causes of severe local fiscal distress are likely to lie in political structures that cannot readily be reformed through normal politics.”

Goode (n 22), equality of creditors is one of the pivotal principles of bankruptcy law, and this article is looking for solutions which are compatible with these principles.

109 The “Great Bargain” is the colloquial term used to designate the contributions to pension funds made available by a series of foundations as part of a comprehensive settlement to preserve city-owned art at the Detroit Institute of Art for the benefit of the local residents and the region.

110 Large cases such as Lehman, GM and Chrysler present peculiarities that make them hardly replicable. Nevertheless, it is hard to claim that their outcome did not influence the evolution of the law or, more generally, Chapter 11 practices. It does not appear inappropriate to argue that a similar influence can be recognised to Detroit’s case. As Melissa Jacoby puts it, “even if the Detroit Blueprint is never replicated in full, we have neither seen nor heard the last of it” - (n 79) 108.

111 Jacoby (n 79) 104. As Hannah Heck observed, “[t]he relationship of the debtor as elected official and the “creditor” as a voter creates a powerful disincentive for elected officials to reorganize” in bankruptcy - (n 21) 132.

The second and frequently neglected innovation was the appointment and use of a mediator. Authoritative mediators may achieve at least three fundamental purposes. When properly conducted, “[f]orcing parties to negotiate while the litigation conveyor belt is humming along pressures everyone to make a deal instead of taking their chances in a courtroom”\(^\text{113}\). Mediators prove that consensual deals may be achieved in bankruptcy, but only if parties negotiate on equal footings. Additionally, the activity of mediators prevents courts from interfering in the political mélange,\(^\text{114}\) and to remain focused on the legal conundrums of the case. Finally, under current legislation, mediators may exercise more power than bankruptcy judges.\(^\text{115}\)

However, while mediations, settlements, and out-of-court agreements are part of all bankruptcies, in Detroit’s case the activity of Judge Gerald Rosen went well beyond that of a facilitator. Since statutory bankruptcy law attempt to provide a level playing field for all participants, emphasis should be placed on defining the powers and limits of conciliatory actions.

Another worthy element of the ‘Detroit’ case was the step-by-step approach, which brought some commentators to assert that the case “generated procedural precedent”.\(^\text{116}\) The federal bankruptcy procedure has been perceived and treated as a last-resort mechanism. It was seen as a failure to reach a consensual agreement outside bankruptcy, as well as the lack of efficient state-law instruments to deal with municipal crises, which rendered the filing no longer avoidable.

The forth element worth being replicated is the appointment of a financial oversight board upon completion of the procedure. This independent authority, comprising experts appointed by the city, the state, and creditors, retains the power to veto budgets, reject new debt, and approve major contracts (including union deals) for a period of up to 10 years following the resolution of the case.

This is a powerful instrument to ensure that elected officials do not come back to old habits as soon as the city balance sheet has been cleared of burgeoning debt. To the board’s effect in its supervisory activity, its members could be given the opportunity to reject the employment of new personnel, both within the council and within the corporations controlled by the municipality.\(^\text{117}\)

A more contingent and praiseworthy element of the procedure was the refusal of federal political authorities to attach “political” conditions to the confirmation of

\(^\text{113}\) Bomey (n 87) 228.
\(^\text{114}\) Moringiello (n 5) 409.
\(^\text{115}\) Jacoby (n 79) 82 and Steven Church, ‘Detroit Judge’s Tough Tack Said to Speed Bankruptcy’ (Bloomberg News, 6 November 2014) <http://www.cranesdetroit.com/article/20141106/NEWS01/141109919/judge-rosens-tough-tack-on-creditors-helped-speed-detroit> last accessed 1 June 2017.
\(^\text{116}\) Jacoby (n 79) 59, who argues that “Detroit’s impact on other municipalities in distress […] cannot be dismissed as sui generis” (60).
\(^\text{117}\) The supervision should extend to practices and policies adopted in all corporations whose debt, in case of failure, would consolidate with the municipal one.
the plan, as well as the duration of the procedure. Further, the exit plan set aside US$1.7 billion over a decade to remove blighted buildings, to buy fire trucks and ambulances, and to upgrade the city’s antiquated computer systems, while the federal state partially contributed to cover some existing liabilities (even though in breach of the pari passu rule).

Concluding Remarks

Detroit’s experience proves that a higher degree of discretion within a debtor-oriented framework may promote the restructuring of the debtor’s administration and balance sheet. However, the merits of this case should not be overstated. Politically-informed approaches to municipal bankruptcy are likely to infringe one of the basic principles of bankruptcy law: equal treatment of similarly-placed creditors (pari passu principle of distribution). Further, a lack of authoritative guidance may result in higher costs, bitter litigation, and overall longer duration of the procedure.

The biggest hurdle of Detroit’s approach, however, lies in its non-replicability. Municipalities depend on financial institutions to finance their debts. If the latter starts to doubt the enforceability of contractual clauses, municipalities may find it more difficult and expensive to raise money on the market.

Comparative Thoughts

As stated in the introduction, this article assumes that any municipal bankruptcy procedures should aim at a timely reorganization of the debtor, without moving away from commonly-accepted principles of corporate bankruptcy law (including the preservation of pre-bankruptcy entitlements whenever possible). For different reasons, none of the approaches analysed so far have proven satisfactory.

---

118 Orr’s team was likely under additional pressure from federal official to close the case before the state’s general election, which took place in November 2014, and which marked the confirmation of governor Rick Snyder (Rep.) for a second term.

119 As opposed to the Italian administrative procedures for municipalities in structural deficit or structural imbalance, which are designed to extinguish liabilities by increasing taxes and revenues.

120 This assumption is shared by other commentators. See, among others: Clayton P. Gillette and David A. Skeel Jr., ‘Governance Reform and the Judicial Role in Municipal Bankruptcy’ (2016) 125 Yale L.J. 1150 (who argue that Chapter 9 proceedings should achieve two objectives: debt adjustment and governance reform).

121 For a more detailed analysis, see Heck (n 21).
Nottingham Insolvency and Business Law e-Journal

<table>
<thead>
<tr>
<th></th>
<th>Reorganization-oriented</th>
<th>Compliance with General Principles of Bankruptcy Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Procedural, Creditor-oriented Solutions (e.g. Italian law)</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Discretionary, Creditor-oriented Solutions (e.g. Rome)</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Procedural, Debtor-oriented Solutions (e.g. Chapter 9)</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Discretionary, Debtor-oriented Solutions (e.g. Detroit)</td>
<td>✓</td>
<td>✗</td>
</tr>
</tbody>
</table>

Thanks to its comparative method, this research proposes a procedural, reorganization-oriented approach, which combines the strengths of the above mentioned laws and cases, while addressing some of their shortcomings. Unlike other papers, the purpose of this comparison does not go beyond the topic of municipal bankruptcies.

Previous sections have shown that excessive political discretion may infringe upon the goals and principles of bankruptcy, as well as foster uncertainty in financial markets. A procedural attitude may limit abuses, and reassure markets. However, it may prove ill-positioned and too rigid to apply to a wide range of situations and participants. To strike a balance between these opposing factors, this article proposes the adoption of a Chapter 9-based procedure with the amendments described in the following paragraphs.

Chapter 9 Shortfalls

(1) Especially controversial for non-US scholars and practitioners is the mechanism of the appointment of the judge to a case. Municipalities do not have the possibility

---

122 Which differentiates this work from other articles with similar goals, such as Laura Napoli Coordes, ‘Restructuring Municipal Bankruptcy’ (2016) 2 Utah L. Rev. 307.
124 Existing literature has recognized some of the limits of the procedure. See Coordes (n 122); Sgarlata Chung (n 11); Katherine Newby Kishfy, ‘Preserving Local Autonomy in the Face of Municipal Financial Crisis’ (2011) 16 Roger Williams U. L. Rev. 348; Clayton P. Gillette, ‘Fiscal Federalism Political Will, and Strategic Use of Municipal Bankruptcy’ (2012) U. Chi. L. Rev. 281. Many of the criticisms address Chapter 9’s inability to deal with the causes that lead general-purpose entities to file for bankruptcy relief.
to forum-shop, since Chapter 9 empowers the chief of the circuit court of appeals (in this case, Chief Judge Alice Batchelder) to select the judge. This mechanism seems entrenched in U.S. bankruptcy legal culture, but it may give rise to criticisms if the selection and appointment procedure is not fully transparent. There is an existent risk that the selection is perceived as being influenced by political or lobbyist pressures. Alternative mechanisms could be explored to ensure that the need for specialised judges does not trump over or reduce transparency or impartiality.

Additionally, the role and powers of the judges should be reconsidered. While the Code significantly restricts their powers and discretion in municipal procedures, the Detroit case has proven that an active, direct and indirect role of the judiciary can positively contribute to the outcome of the proceedings. In the Detroit bankruptcy, the court was willing to use inquisitorial techniques (such as calling witnesses or appointing experts) to keep the case moving ahead.

Such an affirmative questioning role of the judiciary has been favourably received by the public opinion. Additionally, the recognition of wider powers and more latitude and discretion to judges seems to mirror a general evolutionary trend for bankruptcy law, even though some commentators argued that courts have moved (and should move) from dispute resolution to problem solving in handling municipal bankruptcies.

The selection procedure for the mediator and the EM are equally contentious. Prospective reformers may consider assigning their appointment to independent authorities, while affording key political, central or regional politicians a limited veto power.

---

127 Against Jacoby (n 79) 73, who praises that “non-random appointment also offers an opportunity for the bankruptcy, district, and circuit courts to discuss a philosophy for, and collaborate on, management of the case”.
128 Jacoby (n 79) 77.
129 Church (n 115); David Ashenfelter, ‘Meet Gerald Rosen, The Judge Trying to Save Detroit’ (Deadline Detroit Politics, 6 December 2013) <http://www.deadlinedetroit.com/articles/7464/meet_gerald_rosen_the_federal_judge_who_is_trying_to_save_detroit#.WS_YgOvyu70> last accessed 1 June 2017; Nathan Bomey et al., ‘How Detroit Was Reborn: The Inside Story of the Detroit Bankruptcy Case’ Detroit Free Press (Detroit, 9 November 2014).
130 Prior to the enactment of the 1978 Code, municipalities were expected to file for bankruptcy only after they obtained the creditors’ approval over a restructuring plan, thus significantly limiting the overseeing powers of the courts. For a comparison between current and old bankruptcy procedures, see Hon. Thomas B. Bennett, ‘Consent: Its Scope, Blips, Blemishes and a Bekins Extrapolation Too Far’ (2015) 37 Campbell L. Rev. 3.
131 Among others: Judith Resnik, ‘Managerial Judges’ (1982) 96 Harvard L. Rev. 374; Jacoby (n 79) 67. Such an approach may well work in an Anglo/American common law context, but it is of more problematic implementation in civil law countries, where the judge is still primarily seen (both by the law and the practitioners) as the impartial umpire of a legal dispute. See Philip R. Wood, Principles of International Insolvency (2nd edn, Sweet & Maxwell 2007).
(2) Another issue of all US bankruptcy procedures is represented by cost. Nobody questions that professionalism does not come cheap. Nevertheless, skyrocketing costs brought some commentators to question the alleged benefits of the procedure. They observed that

“Chapter 9 is a resource-draining process that perpetuates cost shifting, fails to produce needed structural change, yields poorly formed results, and raises borrowing costs that further burden future generations”. 132

Protections may be put into place to limit the expenses of the procedure.

(3) While some claim that bankruptcy procedures tend to convey excessive deference to local control,133 other scholars disagree.134 Detroit’s bankruptcy has proven that correctives should be implemented to minimize this risk.

“Sovereign and quasi-sovereign entities can often muddle through their financial distress, not least because it is usually quite difficult for their creditors to insist on repayment”. 135

Ill-conceived bankruptcy statutes could aggravate these risks. Since “[t]he case for formal restructuring rules is especially strong”,136 informed legislators should act proactively to produce mandatory, yet also flexible mechanisms capable of preventing the municipality from falling into a crisis in the first place or - should the crisis not be avoided - of restructuring its debt.

(4 - Purpose) One of the most conventional criticisms of municipal bankruptcy lies in its “disutility and moral hazard”.137 It is believed that current statutory mechanisms do too little and react too late to incentivise overhauls and maximise creditors’ returns.

This is due to the fact that Chapter 9 is designed to reduce the debt burden of a distressed municipality, not to reshape its governance. This poses significant limits to the usefulness of the mechanism. As a result, many commentators argued for the unlash of Chapter 9’s “untapped potential in urging states to address local government organization”.138

(5) It is not clear which debts can be renegotiated in bankruptcy. For instance, some states have constitutional provisions which prevent municipalities from modifying

---

132 Parikh (n 20) 228.
133 Kimhi (n 20). The author argued that state intervention has to be preferred to Chapter 9 (federal) approach because only states can cure the ills of the underlying political structure (386).
134 Among others, Moringiello (n 5).
135 Skeel (n 62) 1092.
136 Ibid 1093.
137 Jacoby (n 79) 66.
Vaccari: Municipal Bankruptcy Law

or impairing accrued pension benefits. Special revenue bonds and leases are not eligible for adjustment either. These issues call for a redefinition of the balance between state sovereignty and federal bankruptcy law.

One of the most contentious aspects (at least in the United States) is the possibility to renegotiate pension obligations, and (should that be possible) to give pension claimants who rank as general unsecured creditors a better return than other unsecured creditors, thus breaching the absolute priority principle.

A detailed analysis of this matter falls outside the scope of this article. As it happened in the case for Stockton, in Detroit Rhodes J gave an affirmative answer to both queries mentioned above. Such a conclusion has been supported by some commentators but is still highly controversial. For instance, in an article published before Rhodes’ decision, Jackson T. Garvey argued that the “courts will need to give real weight to state law in the bankruptcy context”, with the result that the “pension clause of the Michigan Constitution would prevent Detroit from reducing vested pension obligations”. Jackson T. Garvey does not stand alone with this position.

The debate is therefore far from settled. Garvey’s approach may be followed in other US cases, since exceptions to the principle of rateable distribution among equally ranking creditors have been recognised only after a fact-specific analysis. Additionally, a cut to these claims may prove even more debatable in municipal reorganizations that occur in countries such as Italy, where vested pension rights are protected by the Constitution.

Detroit and Judicial Shortcomings

(1) Where possible, standardized procedures for the appointment of takeover boards should be preferred to the use (or abuse) of emergency legislation. As observed by other commentators,

139 However, in Detroit’s case pensions were cut, under the principle that federal law prevails over state law.
140 See In re Heffernan Memorial Hosp. Dist. (Bkrtcy.S.D.Cal. 1996) 202 B.R. 147, where the court held, however, that secured bondholders would not have recourse to other sources of funds (e.g. general revenues and taxes) for the payment of their claims.
141 For an analysis of the reasons behind the ruling, read Sgarlata Chung (n 11) 817-826.
142 Among others, see B. Summer Chandler, ‘Is It “Fair” to Discriminate in Favour of Pensioners in a Chapter 9 Plan?’ (2014) 33(12) Am. Bankr. L.J. 22; Dawson (n 11) (who however argues that, instead of the novel interpretation of unfair discrimination adopted by Rhodes J, the court should have adopted a more flexible interpretation of the Markell test commonly used in Chapter 11 cases).
143 Garvey (n 19) 2328.
144 See, among others: C. Scott Pryor, ‘Municipal Bankruptcy: When Doing Less is Doing Best’ (2014) 88(1) Am. Bankr. L.J. 85 (who argues that the policy chosen by Congress in drafting Chapter 9 was to respect pre-bankruptcy entitlements, with the results that plans which fail to meet the fairness and best interest of creditors tests should be dismissed); Richard M. Hynes and Steven D. Walt, ‘Fair and Unfair Discrimination in Municipal Bankruptcy’ (2015) 37 Campbell L. Rev. 25 (who argue that the claims of retirees and active workers do not fall in any of the categories in which discrimination between coequal classes is permitted, thus resulting in unfair discrimination if allowed by the courts).
“takeover boards with near-dictatorial powers, including those to coerce or displace the authority of elected local officials, may be the most effective means of addressing the shortfalls and consequences of normal politics”. 145

Furthermore,

“the increased democratic deficit created by such authority certainly presents certain risks, but the temporal limitations on takeover boards and the possibility of city-charter amendment means that any restructuring must ultimately receive at least implicit approval of local residents”. 146

The appointment of financial managers has been criticised by other authors. 147 However, the more regulated their powers, duties and responsibilities, the more likely they would work in harmony with elected officials and municipal employees.

(2) Detroit’s case also teaches us the importance of adequately stringent confirmation standards. A fresh start cannot come at the expense of the cornerstone principles of bankruptcy law such as the absolute priority rule.

In testing Detroit’s plan, Judge Rhodes found that the law granted him enough discretion to assess if the restructuring efforts offered a feasible route to restore basic services to residents, and would prevent Detroit from relapsing. 148 Equality of creditors was overseen if not ignored. This is not to suggest that judges should mingle with the content of the plan. However, priorities are established by contract or by statutes, not by takeover boards.

145 Gillette (n 108) 1462.
146 Ibid.
147 For instance, Watkins (n 20). The author argues that financial managers represent a sub-optimal solution because: (1) they entail less disclosure and transparency than a traditional bankruptcy procedure; (2) they are more vulnerable to political influence; and (3) bankruptcy stigma may represents a last-minute factor, which pushes then reluctant administrators to adopt the needed reforms before it is too late. In light of that, some commentators advocate for a more prominent role for the state - see Moringiello (n 5) -. Others place more confidence in the supervisory powers of judges - see McConnell (n 4); and Gillette (n 108).
148 In justifying his position, Rhodes J declared that “determining fairness, for purposes of Bankruptcy Code provisions forbidding classifications that discriminate unfairly against creditors of debtor, is a matter of relying upon the judgment of conscience” [In re City of Detroit (Bkrtcy.E.D.Mich. 2014) 524 B.R. 147, 3563.1] However, the author argues that subjective valuations should have no place in the judicial supervision of the bankruptcy procedure. Against, Christine Sgarlata Chang writes that, in devising and valuating a plan, court’s discretion should be employed to evaluate how “municipal bankruptcy affects the lives of ordinary taxpayers” - ‘Municipal Bankruptcy, Essential Municipal Services, and Taxpayer’s Voice’ (2015) 24 Widener L. J. 43, 79. See also Scott C. Pryor, who argues that “taxpayers […] should be afforded a rebuttable presumption of standing with respect of feasibility [unless for] plans that do not propose tax increases” from ‘Who Pays the Price? The Necessity of Taxpayer Participation in Chapter 9’ (2015) Widener L. J. 81, 118.
Other authors blamed the confirmation standards for Chapter 9 for being vague and relaxed\textsuperscript{149}. In reality, the criteria is fairly strict. The problem is represented by the lack of sufficient case law, and by the courts’ tendency to freely and subjectively interpret otherwise precise legal concepts. Courts have an independent obligation to determine that a proposed plan meets Chapter 9 plan confirmation requirements, notwithstanding creditors’ approval.\textsuperscript{150} In other words, the problem lays not with the standards, but with their interpretation.\textsuperscript{151}

**General Improvements**

(1) The **preamble** of the bankruptcy law for municipalities should clearly state the goal of the procedure (reorganization of the distressed local entity), to be achieved primarily by using local funds. The same section should also clarify that, unless otherwise specified, the general principles which apply to corporate failures shall remain applicable to municipalities.\textsuperscript{152}

(2) The analysed statutes and cases prove the absence of efficient, **pre-emptive mechanisms** to address the crisis before bankruptcy stands as the only remaining option. However, debate on their content and characteristics falls outside the scope of this contribution.

(3) With reference to the **eligibility criteria**, this article has already highlighted the different understandings in the notion of ‘municipality’ between the US and Italy. Both notions are formal rather than substantive: they try to define “what the municipality is” (for the purposes of bankruptcy law) rather than “what the municipality does”.

While apparently clear, the notion of ‘municipality’ has proven as one of the most controversial aspects of this study. In Italy, judges had to clarify that the debt of private corporations, which pursue public interests could be consolidated with the debt of the municipality, which filed for bankruptcy.\textsuperscript{153} In the United States, litigation on the subject has been extensive.\textsuperscript{154}


\textsuperscript{150} *In re* Valley Health System (Bkrtcy.C.D.Cal. 2010) 429 B.R. 692.

\textsuperscript{151} It is certainly true that “the interpretation of the language (Chapter 11 protections) must be tailored to the type of debtor” [Moringiello (n 150), 84]. There is a risk, however, in adopting Chung’s point of view (n 149), 79.

\textsuperscript{152} Subject to the exceptions listed in note 22.


\textsuperscript{154} Detroit filed for bankruptcy on July 18, 2013 but it was only on December 3, 2013 that the city was declared to be eligible (after 5 months), and it took only another 11 months for the final adjustment plan to be approved and confirmed.
Because some discretion and control from the judiciary are required, this article recommends adopting a notion of municipality which, while being anchored on formal criteria, compliments them with purpose-based yardsticks. This would allow entities (such as 'comunità montane' in Italy) which are similar in powers, responsibilities and duties to existing local councils to be included in the list of beneficiaries. At the same time, it may also restrict the number of eligible applicants to only those entities which are - by nature - substantially dissimilar from profit-oriented corporations.

It might therefore be appropriate to adopt a notion of municipality which includes all local entities that:

- Operate at a local or territorial level, and which are characterized by statutory, legislative, organizational, tax and financial autonomy (but not by legislative powers) [formal criterion];
- Despite their public or private nature, pursue a fundamental public interest (e.g. a constitutional interest), which could not be provided by a competitive market in comparable terms [purpose-based criterion].

Given that premise, to access the procedure, the applicant/debtor should additionally prove to the satisfaction of the court that adequate, structural measures to reduce indebtedness have been taken (e.g. cuts in the personnel, reasonable increases in taxes, etc.), but that the size of the debt still makes it non-sustainable on a long-term basis.

Furthermore, if the mechanism of preliminary approval is retained, this should be granted from an independent, supervisory body, rather than an elected authority, to avoid that political considerations prevail over objective analysis.

---

155 In In re City of Bridgeport (Bkrtcy.D.Conn. 1991) 129 B.R. 332, the court rejected an application for a Chapter 9 case because the city was deemed not insolvent since it had access to a US$27 million bond fund. More importantly, in In re Town of Westlake, Tex. (Bkrtcy.N.D.Tex. 1997) 211 B.R. 860, the court rejected the filing because it appeared that the municipality did not want to adjust its debts, but to pay its creditors in full.

156 Regions and US states would therefore be excluded by the list. This appears a sensible conclusion, given the lack of agreement among commentators on the opportunity of statutory procedures to restructure sovereign debt - see, among others Martin Guzman et al., Too Little, Too Late - The Quest to Resolve Foreign Debt Crises (Columbia University Press, 2016).

157 In other words, the applicant should be experiencing, or be likely to experience in the near future a "liquidity crisis", to escape Kimhi's criticism that "[b]ankruptcy allows insolvent localities to avoid full repayment of debts by refusing to maximize their tax-raising capacity" - Omer Kimhi, 'Reviving Cities: Legal Remedies to Municipal Financial Crises' (2008) 88 B. U. L. Rev. 633, 653.

158 A requirement, which may be excessive if more stringent criteria are introduced in the law.

159 Against, see Frederick Tung, 'After Orange County: Reforming California Municipal Bankruptcy Law' (2002) 53 Hastings L. J. 885. He argues that the governor should hold "discretionary power to approve, disapprove, or condition a municipality's access to bankruptcy" (888). In doing so, however, the political aspect of bankruptcy would prevail over its procedural dimension. A solution, which has been rejected by this note: early, fruitful interaction between state and local authorities should not be conditioned by the state being the only authority entitled to pull the trigger of the procedure.
Vaccari: Municipal Bankruptcy Law

Chapter 9 works when it is properly understood as a last resort mechanism, for insolvent municipalities, as solvent but distressed entities can make use of alternative, less disruptive remedies. If flexible, yet sufficiently precise and narrow eligibility criteria are established, litigation (costs and time) should reduce.

(4) With reference to procedural aspects, this note recommends introducing a deadline for the approval of the plan. Alternatively, deadlines may be imposed by the court, subject to criteria set out in the law. Failing to reach an agreement in time would empower the takeover manager/board (the only person entitled to write a plan of adjustment) to unilaterally submit a proposal to the court, which will have the power to confirm the plan if it is in the best interest of creditors, it does not discriminate unfairly among them and it appears to be feasible.

While Detroit’s case presents similar political challenges to the Rome affaire, the existence of a functioning restructuring system for municipalities, and the proactive role of state authorities, allowed the Motor City to recover from bankruptcy in little more than one year.

Local institutions are far from perfect. Nevertheless “fiscal responsibility has been more the norm than the exception”. As a result, a procedural, reorganization-oriented restructuring system for insolvent municipalities should be sought, since those who seek bankruptcy protection are not usually looking for a fast-track exit to years of mismanagement.

Final Remarks

Some authors have criticized certain recommendations hereof. They have challenged the mechanics of the Chapter 9 procedure (but the same consideration is valid for the procedures described in the Italian TUEL) as an example of “usurpation of local democracy”. They described them as a blatant example of a “draconian intervention on the affairs of a tottering municipality”.

These criticisms have some foundation, but they should not be overstated. When taken into isolation, they are persuasive. When viewed as part of a system with appropriate check and balances, they lose much of their eloquence.

This comparative article has proven that, to achieve the restructuring goal, municipal distress should be handled by means of a reorganization-oriented bankruptcy procedure. This “viable option” should be conceived as a last-resort mechanism,

---

161 As a means of comparison, Rome has been under state supervision since July 4, 2008.
162 Schragger (n 20), 886.
163 As Skeel observed, “municipal bankruptcy is problematic but defensible” - Skeel (n 20) 2252.
164 Skeel (n 62) 1081.
165 Ibid 1082.
166 David L. Dubrow, ‘Chapter 9 of the Bankruptcy Code: A Viable Option for Municipalities in Fiscal Crisis?’ (1192) 24(3) Urb. Law. 539.
and should be applicable to a restricted pool of applicants that are not simply formally, but also substantially dissimilar from profit-oriented corporations.

This court-based procedure should be governed by an independently-appointed turnaround manager/board, who should replace the debtor’s elected officials whenever it becomes apparent that the latter are unfit to deal with the magnitude of the crisis. Judges should also be assisted by mediators, and the goal of agreeing on a consensual restructuring plan should not be dismissed simply for the reason of the bankruptcy filing.

The proposed solution is not without drawbacks. For instance, the appointment of an external manager (where possible under general law) can appear as a punitive practice, if the financial crisis of the municipality arises only or primarily due to socioeconomic, external factors. These are factors that fall outside the control of the municipality, as opposed to internal, political causes.

Experience proves however, that failures due to mainly external causes are rare, and restricted to small councils/entities that are unable to deal with unexpected judicial sanctions or the consequences of environmental disasters. It follows that while there is a case for not making the appointment of turnaround managers mandatory, the opposite should be the default choice.

Additional measures may be needed to properly implement the suggested recommendations in national systems. Additionally, limits on the scope of the study (two jurisdictions, and two cases) and lack of empirical testing of the proposed conclusions should not be overlooked.

Despite that, this article has demonstrated that the proposed approach represents an improvement from current practice. Municipal insolvencies should be regulated within bankruptcy law, but better statutes are needed desperately.

---

167 For an analysis of the possible causes of municipal distress, and their categorization, see Park (n 68).
168 As Watkins (n 20) observes, “the perfect storm for municipal default includes both internal (political) and external (socioeconomic) factors - some controllable and some not” (97).