2015

Who Pays the Price: The Necessity of Taxpayer Participation in Chapter 9

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WHO PAYS THE PRICE? THE NECESSITY OF TAXPAYER PARTICIPATION IN CHAPTER 9

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The recent narrative of Chapter 9 municipal bankruptcies has focused on the battle between two sets of powerful creditor interests: municipal retirees and bondholders. Two questions have dominated this narrative: To what extent can the vested pension and health care benefits of retirees be modified in bankruptcy?[1] How much of a discount can bondholders be forced to take?[2] Both of these constituencies have a claim to be satisfied from a municipality's future revenues.[3] The relative treatment of these groups of claimants must be evaluated by the requirements that a plan of adjustment is fair and equitable with respect to dissenting creditor classes and that the plan is in the best interest of each creditor.[4] Layered on these standards is the requirement that a plan be feasible.[5] The cumulative uncertainty of application of these tests under Chapter 9 contributes to an environment that encourages negotiated settlements.[6] A plan, in other words, for which the competing creditor constituencies will vote.

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[1] *See* Daniel Fisher, *Municipal Bankruptcies Set Up War Between Pensioners and Bondholders*, FORBES (Apr. 3, 2013, 9:49AM), http://www.forbes.com/sites/danielfisher/2013/04/03/muni-bankruptcies-set-up-war-between-pensioners-and-bondholders/ (highlighting the classic tug-of-war between municipal retirees and bondholders in municipal bankruptcy cases).

[2] *Id.*

[3] *Id.*

[4] 11 U.S.C. § 943(a)-(b) (2012).

[5] *Id.* § 943(b)(7).

[6] *See* Mark N. Berman, *New Outlooks on Bankruptcy and Restructuring Issues*, BANKRUPTCY & FINANCIAL RESTRUCTURING LAW 2013, March 2013, at

There remains, however, a large constituency whose members are not creditors, but a substantial set of stakeholders who do not have an opportunity to vote on the plan negotiated among the claimants. Taxpayers are not creditors; thus, taxpayers do not have a formal role or representative in a Chapter 9 case. In addition, as interested parties, but ones without claims, taxpayers cannot vote on a plan.[7] Municipal taxpayers will shoulder the costs of implementing the plan. Increased taxes and decreased municipal services are standard fare in recent Chapter 9 cases, but those who must pay more and receive less have at best only an indirect voice in the process.[8]

Recognizing this problem of unrepresented and non-voting stakeholders, some bankruptcy courts have recognized that taxpayers have standing as parties in interest.[9] Statutory authority for taxpayer standing in Chapter 9 is less clear than might be expected.[10] Even if they are parties in interest, taxpayers cannot vote on confirmation of a plan, which weakens whatever bargaining power they have.[11] These procedural and structural impediments can be addressed by the bankruptcy courts. The balance of this paper explains how.

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*6, *available at* 2013 WL 574483 (noting that the current state of the law encourages negotiated settlements).

[7] 11 U.S.C. § 943(a) (allowing only a "special tax payer" to oppose confirmation of a plan). A "special" tax payer is the owner of property, against which a special assessment was levied in relation to an improvement benefitting the property. *Id.* § 902(3). Throughout this article, the term "taxpayers" refers to general taxpayers as opposed to such special taxpayers.

[8] *See, e.g.*, Carl DeMaio, *Fixing California: DeMaio Sees a Money Pit*, SAN DIEGO UNION-TRIBUNE (Jul. 13, 2013, 6AM), http://www.utsandiego.com/news/2013/jul/13/fixing-california-more-bucks-less-bang/ (reporting that California taxpayers are paying higher taxes but receiving less in services).

[9] *See infra* text accompanying notes 142-144.

[10] *See infra* text accompanying notes 128-132.

[11] *See supra* note 7.

I. FREEDOM FROM (BANKRUPTCY) TAXATION

A. The Limits of Chapter 9

The Tenth Amendment[12] occasions concerns about the limits of the federal bankruptcy power[13] with respect to subordinate state entities like municipalities.[14] Thus, section 904 of the Bankruptcy Code bars a bankruptcy judge from interfering with the "political or governmental powers" of a municipality.[15] Included among the forbidden acts would be an order by a bankruptcy court to a municipality to increase its tax revenues even if that would enhance distributions to creditors.[16] Although the Bankruptcy Court cannot order taxes to be increased, the court can refuse to confirm a plan that does not increase them.[17] Chapter 9 thus permits a plan of adjustment to do what the judge may not—increase taxes.

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[12] U.S. CONST. amend. X.

[13] *Compare* U.S. CONST., art. I, §10, cl. 1 (representing one end of the spectrum by limiting state power to issue bills of credit or coin money without congressional approval), *with* Juliet M. Moringiello, *Goals and Governance in Municipal Bankruptcy*, 71 WASH & LEE L. REV. 403, 410 (2014) (representing the limits of federal power "[t]he Tenth Amendment limits the control that a federal court can exercise over a municipality").

[14] The definition of municipality in the Bankruptcy Code is broader than cities alone. *See* 11 U.S.C. § 101(40) ("The term 'municipality' means political subdivision or public agency or instrumentality of a State."). For purposes of this article the terms city and municipality may be used interchangeably.

[15] *Id.* § 904(1).

[16] *See, e.g.*, *In re* Corcoran Hosp. Dist., 233 B.R. 449, 459 (Bankr. E.D. Cal. 1999) (holding that nothing in Chapter 9 requires a court to raise taxes); *see also* Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 476 (1993) (arguing that bankruptcy court imposed tax increases would rightly be held unconstitutional).

[17] McConnell & Picker, *supra* note 16, at 474-76. *But see* Kevin A. Kordana, *Tax Increases in Municipal Bankruptcies*, 83 VA. L. REV. 1035, 1058-60, 1065-66 (1997) (highlighting some of the arguments on the other side that find the judicial authority to increase municipal taxes in the legislative history of Chapter 9 and the inconsistency of courts to take a plain meaning approach to interpreting Chapter 9).

B. The Power of a Confirmed Plan

The power of a plan to increase taxes is not plenary. Section 943(b)(4) of the Bankruptcy Code requires voter approval if generally applicable state law so mandates.[18] Conversely, a confirmed plan alone can increase taxes if state law does not give taxpayers a voting stake.[19] In other words, office holders in municipal government and its creditors can agree to a plan that increases taxes, and the taxpayers have no vote.[20] The public officials who agree to a tax increase face the risk of losing at the next election, but subsequent changes in the makeup in municipal government cannot undo a confirmed plan.[21] The negative effect on municipal credit (and credibility) of a subsequent rollback of a plan's tax increases would be substantial.[22]

Only a plan that is ultimately confirmed can increase taxes, and the Bankruptcy Code imposes multiple requirements on confirmation of a plan of adjustment. Among the three most significant are that the plan be in the best interests of creditors,[23] that it provide for fair and equitable treatment of classes of creditors,[24] and that it not discriminate unfairly among creditors.[25]

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[18] 11 U.S.C. § 943(b) ("The court shall confirm the plan if – (4) the debtor is not prohibited by law from taking any action necessary to carry out the plan."); *see also* Diana Marcum, *Stockton Voters Approve New Tax Measure for Bankruptcy City*, L.A. TIMES, Nov. 6, 2013, *available at* http://articles.latimes.com/2013/nov/06/local/ la-me-ln-stockton-tax-measure-election-20131106 (illustrating one example where states place some restrictions on raising taxes).

[19] *See* Richard Briffault, *Forward: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 909 (2003) ("A considerable number [of state constitutions] also limit state and local taxation."). Briffault goes on to observe, however, that "[s]tate legislatures and local governments have repeatedly sought to expand the scope of 'public purpose' and to slip the restraints of the tax and debt limits." *Id.*

[20] *See* Kordana, *supra* note 17, at 1042 (showing the ability of creditors and the municipality to increase taxes without taxpayer approval).

[21] 11 U.S.C. § 944(a)-(c).

[22] *See generally* Kordana, *supra* note 17, at 1058 (fully analyzing the argument of creditors that raising taxes is often the only viable solution for municipalities).

[23] § 943(b)(7).

[24] *Id.* § 1129(b)(1) (incorporated by § 901(a) of the Bankruptcy Code).

[25] *Id.*

Whether individually or as classes, the element common to these standards of confirmation is *creditors*. What is missing are the interests of taxpayers. The standards of confirmation directly address only the interests of creditors, yet taxpayers are certainly stakeholders in any adjustment of municipal debt. Even though the Bankruptcy Code does not address them directly, hidden in plain view is warrant for consideration of taxpayer interests: plans must also be feasible to be confirmed.[26] And feasibility is the key that unlocks the door to take into account the interests of non-creditor stakeholders like taxpayers.

II. UNPROTECTED RESIDUAL STAKEHOLDERS

A. Municipal Government Outside Chapter 9

Taxpayers are stakeholders in a municipality along with office holders, creditors, employees, retirees, and residents.[27] All stakeholders have some means of participating in municipal governance whether by contracting with it, working for—or quitting—it, choosing to own property within its jurisdiction, monitoring the affairs of its government, or petitioning its office holders. The role of taxpayers, or at least those who are natural persons and have the right to vote, is limited to voting for office holders, monitoring, and petitioning. Taxpayers have on occasion organized to enhance these powers, but monitoring and petitioning remain their legally sanctioned powers unless state law provides further recourse.[28]

Municipal government exists as an application of the inherent authority of state power.[29] Municipal governance is generally

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[26] *Id.* § 943(b)(7).

[27] *See* Christine Sgarlata Chung, *Municipal Securities: The Crisis of State and Local Government Indebtedness, Systemic Cost of Low Default Rates, and Opportunities for Reform*, 34 CARDOZO L. REV. 1455, 1462 (2013) ("[M]unicipal securities issuers must keep investors' risk of loss low even if risks and costs for taxpayers and other stakeholders ultimately responsible for repaying municipal bond debt spiral upward.").

[28] *See id.* at 1483-84 (showing the inherently limited powers of taxpayers).

[29] Hunter v. City of Pittsburgh, 207 U.S. 161, 178 (1907) ("Municipal corporations are political subdivisions of the state, created as convenient

understood to fulfill three ends or purposes.[30] First, it is the downstream locus of authority that serves the interests of the larger state, which is content to delegate local power to local decision-makers.[31] The sorts of state interests delegated to local government include those encompassed within the traditional "police powers"—health, safety, and welfare—as well as the power to tax and to exercise eminent domain.[32] Second, municipal governance is the upstream mechanism available to local voters to control local government decision making.[33] Spending choices reflect most clearly the upstream concerns of voters.[34] Both the downstream and upstream purposes presuppose that different problems are better resolved at different levels of government.[35] And third,

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agencies for exercising such of the governmental powers of the state as may be entrusted to them.").

[30] The goals or ends to which the powers of municipal governance are put have expanded over the years from public works to public safety to public welfare. *See* JON C. TEAFORD, THE MUNICIPAL REVOLUTION IN AMERICA: ORIGINS OF MODERN URBAN GOVERNMENT 1650-1825, at 113-14 (1975).

[31] OSBORNE M. REYNOLDS, JR., LOCAL GOVERNMENT LAW 20 (3d ed. 2009) ("Control over local government [following the American War for Independence] thus largely passed to the legislative branch, and legislative control over local government was considered to be unlimited except by specific constitutional provisions."). The delegated powers, in turn, revolve around three purposes: public services, maintenance of land for public use, and regulation of public safety. *See* TEAFORD, *supra* note 30, at 114.

[32] *See* REYNOLDS, *supra* note 31, at 198-99.

[33] *See id.* at 1-2 ("[I]t has always been recognized that many functions can best be provided at the community level, where the government is not a distant, dimly perceived entity, but is close to—and is responsive to—its constituents.").

[34] *See* Zoltan L. Hajnal & Jessica Trounstine, *Who or What Governs?: The Effects of Economics, Politics, Institutions, and Needs on Local Spending*, 20 AM. POL. RES. 1130, 1137-38 (2010) ("According to this traditional accounting, local governments can choose to devote their resources to redistributive spending, developmental spending, or allocational spending.").

[35] *See* Yishai Blank, *Federalism, Subsidiarity, and the Role of Local Governments in an Age of Global Multilevel Governance*, 37 FORDHAM URB. L.J. 509, 510 (2010) ("[A] growing number of contemporary problems and challenges require decision-making and implementation at different territorial spheres and by different governmental (and political) levels."); *see also* Nestor M. Davidson, *Cooperative Localism: Federal-Local Collaboration in an Era of State Sovereignty*, 93 VA. L. REV. 960, 1007-08 (2007) (concluding that local government serves "as a means of enhancing democratic engagement and civic participation").

municipal government meets the baseline requirement for political legitimacy in the context of American political liberalism—its office holders are elected.[36]

Creditors do not figure directly in any of the purposes that municipalities serve. State-level grants of authority do not require municipal indebtedness although they authorize it. Citizens rarely consider municipal debt when voting for office holders.[37] Creditors, at least voluntary ones such as employees, retirees, and purchasers of municipal bonds, are necessary for a municipality to carry out its downstream and upstream purposes, but are merely means to the ends of municipal government.[38] Although ubiquitous, creditors exist outside or below the consciousness of most municipal stakeholders.[39] Given the limits on the bankruptcy power imposed by the Tenth Amendment,[40] however, bankruptcy courts must be careful to ensure balance between the interests of creditors and other stakeholders.

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[36] *See* REYNOLDS, *supra* note 31, at 2 ("[T]he demand of individuals that their voices be heard always exerts, at least in any democratic system, a counter-pressure for smaller units, in which each person's opinion and vote can have greater impact."); *see also* Moringiello, *supra* note 13, at 438 ("Because municipalities are political instrumentalities, elected officials manage their functions . . . ."). For problems associated with municipal elections see *infra* text accompanying notes 87-93. For systemic concerns about the dangers of local autonomy, *see* Davidson, *supra* note 35, at 1023-26 (describing the "perils of local parochialism").

[37] *See* Richard C. Schragger, *Citizens Versus Bondholders*, 39 FORDHAM URB. L.J. 787, 787 (2012) ("In both these roles—as a bondholder and as a citizen—my incentive and capacity to monitor local government is limited. It is not nonexistent, but it is quite crude.").

[38] For a thorough analysis of the "ends" of municipal governance, see Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118, 1198-99 (2014).

[39] *See generally* Kordana, *supra* note 17, at 1046-47 (showing that municipalities borrow money with the intent to pay it back over time, often leaving debt to bleed over onto future generations of taxpayers).

[40] For example, see "Limitation on jurisdiction and powers of court." 11 U.S.C. § 904 (2004); *see generally*, David E. Solan, *State Bankruptcy: Surviving A Tenth Amendment Challenge*, 42 GOLDEN GATE U.L. REV. 217, 235-37 (2012) (discussing the evolving tension between state sovereignty under the Tenth Amendment and federal bankruptcy laws).

Taxpayers, by contrast, are intimately related to the three ends of municipal governance.[41] Without taxpayers, many of whom will also be residents,[42] municipal government need not exist. Taxpayers are also stakeholders in the functions of municipal governance.[43] As sources of revenue, they permit municipal government to carry out its downstream and upstream functions[44] and, given their overlap with residents, taxpayers are vitally interested in resolution of political issues including municipal managerial slack.[45] Yet, like creditors, taxpayers as such are not the objects of municipal governance.[46] Although necessary, taxpayers only function as political stakeholders in a represented capacity.[47]

Taxpayers enjoy mixed protections under state law. Some state constitutions do not address local taxation.[48] Even in states that subject new or increased taxation to special scrutiny, the rise of "non-tax taxes" permits local governments to circumvent constitutional limitations.[49] Local governments have added fees, user charges, and special assessments to real estate taxes to supplement their revenue.[50] Faced with such efforts, state courts

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[41] *See generally* Anderson, *supra* note 38, at 1139 (explaining the importance of taxpayers to the function of municipal government).

[42] *See id.* at 1123 (noting widespread agreement that municipalities should provide for the health and safety of residents).

[43] *See id.* at 1139 (taxpayers both fund and receive governmental services).

[44] *See* Michelle Wilde Anderson, *Dissolving Cities*, 121 YALE L.J. 1364, 1437 (April 2012) ("Even if cityhood still exists legally, it is little more than a geographic label if the government has no money or power.").

[45] *See infra* text accompanying notes 79-89.

[46] *See* Anderson, *supra* note 38, at 1198 (explaining the broader role and responsibility of municipal government to consider the health and safety of all inhabitants).

[47] *See, e.g.,* Anderson, *supra* note 44, at 1395-96 (detailing the effect that taxpayers' grassroots campaigns can have on local political debates over how to deal with fiscally distressed localities).

[48] *See* Briffault, *supra* note 19, at 909 (citing U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, SIGNIFICANT FEATURES OF FISCAL FEDERALISM 18 (1992)) (noting, in 2003, the constitutions of Connecticut, Georgia, Maine, South Carolina, Vermont, and Wisconsin contained no limits on local taxation).

[49] Briffault, *supra* note 19, at 932-34.

[50] *Id.* at 932.

have acquiesced notwithstanding state constitutional limitations.[51] Thus even outside Chapter 9, taxpayers' interests in local governance are better advanced by the ordinary political means—voting, monitoring, and petitioning—than by judicial enforcement.[52]

B. Municipal Government Under Chapter 9

Chapter 9 alters much of what justifies municipal government in the political space outside of bankruptcy. Service as a downstream functionary of the state remains in place, but control and even a measure of legitimacy is ceded to creditors. The addition of creditors as voting stakeholders in Chapter 9 is warranted by a municipality's insolvency.[53] Nonetheless, local control and political legitimacy remain—or at least they should remain—part of the municipal landscape even in Chapter 9.[54] The position of taxpayers as stakeholders also continues near the ends of municipal governance. The provisions of Chapter 9, however, elide recognition of taxpayers, which thus attenuates the upstream function of municipal government and reduces its political legitimacy.[55]

The structure of Chapter 9 generally follows the pattern of reorganization under Chapter 11 with exceptions imposed out of concern for the Tenth Amendment.[56] It is Tenth Amendment

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[51] *Id.* at 935 & n.153 (citing numerous examples of state courts that have upheld more expansive and creative forms of local revenue collection).

[52] *See supra* text and accompanying note 28.

[53] *See* 11 U.S.C. § 109(c)(1)-(5) (2006) (requiring proof of insolvency); *In re* City of Stockton, 493 B.R. 772, 789-90 (Bankr. E.D. Cal. 2013) (discussing evidence of city's insolvency).

[54] *See* Moringiello, *supra* note 13, at 414 ("[O]missions from Chapter 9 reflect the congressional decision to leave the management of an insolvent municipality to the municipality itself and its state.").

[55] *See* Anderson, *supra* note 38, at 1197-99 (comparing a creditor-centric view of providing only those municipal services necessary to making tax revenues sufficient to pay creditors with a "social justice" view of providing municipal services adequate to maintain human dignity and flourishing).

[56] *See* Moringiello, *supra* note 13, at 411 ("Chapter 9 incorporates many elements of other types of bankruptcy, Chapter 11 in particular."). *But see id.* at 413 ("The partial incorporation of Chapter 11 concepts reflects the fact that the

apprehensions that preserve unimpaired the downstream purposes of municipal government in Chapter 9.[57] Section 903 expressly provides that Chapter 9 "does not limit or impair the power of a State to control... the political or governmental powers of [its municipalities]."[58] Bankruptcy courts have construed the states' reserved powers broadly.[59] From the other direction, nothing in Chapter 9 formally preempts the upstream powers of monitoring and petitioning.[60] Practically, however, responsiveness to those powers is limited by the recognition of creditors as stakeholders.[61] Access to and influence on municipal governance is limited, and thus formal recognition of creditor interests reduces the influence of taxpayers.[62] Only a finite pool of political power exists, and that of taxpayers is reduced as the power of creditors is increased.[63]

Even accounting for the rights reserved to the states, there is an asymmetrical relationship between the structures of Chapter 9 and Chapter 11. The most significant difference is the scope of creditor rights protected in the event of cramdown.[64] Cramdown is the colloquial term applied to the power of the court to confirm a plan over the dissent of a class of voting parties.[65] Section 901(a) of the Bankruptcy Code incorporates two of the three subsections of section 1129(b)(2) regarding cramdown, those protecting the

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bankruptcy court... must refrain from interfering with the governance of a municipality.").

[57] *Id.* at 424-25.

[58] 11 U.S.C. § 903.

[59] *See generally* 6 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 903.02[1] (16th ed. 2014) (highlighting that Chapter 9 unambiguously states the reserved powers shall remain with the states).

[60] That is because "Chapter 9 is better viewed as a component of a state plan to resolve the financial distress of its municipalities than an independent alternative to state intervention." Moringiello, *supra* note 13, at 416.

[61] *See id.* at 411-12 (delineating a municipality's options under Chapter 9 and the statutory controls that creditors have over the process).

[62] *Id.*

[63] *See id.* (indicating that municipalities do not have "unfettered control" over reorganization plans, but are largely constrained to considering the interest of creditors).

[64] *Id.*

[65] *Id.* ("Like Chapter 11, Chapter 9 contains a cramdown provision, which provides that the plan can be imposed on nonconsenting creditors if at least one class of creditors accepts the plan . . . .").

rights of secured and unsecured creditors.[66] To confirm a plan of adjustment over the dissent of a non-consenting class of creditors, the plan must satisfy two cramdown-specific criteria: it must not "discriminate unfairly" and it must be "fair and equitable."[67] Section 1129(b)(2)(A) specifies further cramdown protection for secured creditors and section 1129(b)(2)(B) for unsecured creditors.[68]

Chapter 11's protections for holders of equity interests (shareholders of the corporate world) in the event of cramdown are not incorporated by Chapter 9.[69] Such an omission makes sense in one respect; after all, neither residents nor taxpayers "own" the residual value of a city because there can be no residual value—a city cannot be liquidated, only dissolved.[70] The assets of a dissolved city are transferred to the succeeding unit of local government.[71] Thus, in the event of its dissolution, municipal assets do not devolve to its residents.[72] In another respect, municipal taxpayers are disadvantaged in comparison to corporate shareholders.[73] A shareholder's loss is capped at the amount paid for the equity interest.[74] A taxpayer, by contrast, is exposed to a future of compulsory contributions to the ongoing municipal enterprise.[75]

Notwithstanding taxpayers' lack of a legal interest in the municipal entity as such, the nature of their relationship is more

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[66] 11 U.S.C. § 901(a); *see also id.* § 1129(b)(2)(A)-(B).

[67] *Id.* § 1129(b)(1) (incorporated by 11 U.S.C. § 901(a)). For a through analysis of Stockton's eligibility for Chapter 9 relief, see generally C. Scott Pryor, *Municipal Bankruptcy: When Doing Less Is Doing Best*, 88 AM. BANKR. L.J. 85, 96-97 (2014).

[68] *See* 11 U.S.C § 1129(b)(2)(A)-(B).

[69] *Id.* § 1129(b)(2)(C); *id.* § 901(a) (showing that section 1129(b)(2)(C) is not incorporated by Chapter 9).

[70] *See infra* note 84 and accompanying text.

[71] Anderson, *supra* note 44, at 1368.

[72] *See* Moringiello, *supra* note 13, at 441-42.

[73] *Id.* at 438 ("[A municipality] does not have shareholders, who bear the risk of its failure.").

[74] *Id.*

[75] *See* Anderson, *supra* note 44, at 1384 (explaining the goal of municipalities to remain in the same form before and after bankruptcy even though taxes may be high and public services diminished).

closely intertwined with the financial health of a city than that of most shareholders in a corporation. Corporate creditors do not have the power to compel shareholders to contribute to a reorganized enterprise, but municipal creditors effectively have such power through a plan of adjustment.[76] Liquidation by plan or through Chapter 7 ends the economic life of an insolvent corporation.[77] Insolvent cities, on the other hand, continue zombie-like to limp along.[78] The citizens must continue to pay taxes, yet remain exposed to ongoing "service insolvency" from their municipal government.[79]

When elected municipal officials negotiate with creditors, one could hope such officials would protect the interests of their constituents, those whose votes put them in office or might remove them at the next election. Yet, the lack of interest in municipal elections makes them a poor means by which to protect the interests of taxpayers.[80] Outside Chapter 9, the opacity of the

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[76] *See supra* note 75 and accompanying text.

[77] Moringiello, *supra* note 13, at 433.

[78] *See* Christine Sgarlata Chung, *Zombieland / The Detroit Bankruptcy: Why Debts Associated With Pensions, Benefits, and Municipal Securities Never Die . . . And How They Are Killing Cities Like Detroit*, 41 FORDHAM URB. L.J. 771, 781-82 (2014) (detailing the horrific degradation of Detroit's infrastructure, public services, population and public coffers as the city faces rising crime, poverty, and blight).

[79] Cases utilizing the concept of "service insolvency" or "service delivery insolvency" when considering a municipality's eligibility for Chapter 9 relief include, *In re* City of Stockton, 493 B.R. 772, 788-90 (Bankr. E.D. Cal. 2013), and *In re* City of Detroit, 504 B.R. 97, 169-70 (Bankr. E.D. Mich. 2013). As Michelle Wilde Anderson explains, however, there is no straightforward standard by which to measure the extent of municipal services residents are entitled to expect. *See* Anderson, *supra* note 38, at 1194 ("I find it surprising to report that neither Chapter 9 case law nor state law regulations or guidelines define legally adequate service levels . . . .").

[80] *See* ZOLTAN L. HAJNAL, AMERICA'S UNEVEN DEMOCRACY: RACE, TURNOUT, AND REPRESENTATION IN CITY POLITICS 24-25 (1968):

> This low turnout means that the skew in turnout at the subnational level can be dramatic. Tingsten's (1937) "law of dispersion" tells us that the possible extent of a skew grows as turnout declines. If . . . only a small fraction of the population participates, the skew can be severe. For this reason, we might be especially concerned about the representativeness of democracy at the local level.

workings of municipal government and the ability of special interests to lobby local office holders attenuates the power of taxpayers.[81] Once in Chapter 9, the organized presence of creditors and after-the-fact involvement of voting taxpayers reduces their influence in municipal government generally and, hence, in the process of negotiating a Chapter 9 plan.[82]

C. Implications of Non-Liquidation

The ongoing nature of municipal existence provides the conceptual reason for excluding taxpayers from the formal negotiating table and voting on a plan. Congressional thinking along these lines concluded that the interests of taxpayers are not "impaired" so long as the municipality provides baseline services.[83] Unlike shareholder interests that cease with the liquidation of an insolvent corporation, taxpayers retain their status as stakeholders even after confirmation of the Chapter 9 plan.[84] They retain the power to vote out of office those who agreed to enter Chapter 9, but the confirmed plan controls.[85] Lack of explicit attention to municipal taxpayers in bankruptcy law was also due to Tenth Amendment concerns.[86] If state law does not directly afford taxpayers the power to vote on tax increases, how can Congress do so indirectly by giving taxpayers a vote on plan confirmation?

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[81] *See* Briffault, *supra* note 19, at 945 ("Special interest groups have the incentive to lobby and the means to reward legislators who provide them with benefits. But the general public is unlikely to be sharply affected by any one interest group giveaway and lacks both the incentive and the means to closely police spending programs.").

[82] *See* Moringiello, *supra* note 13, at 411 (explaining that a municipality's creditors initially vote on a plan).

[83] *See* Anderson, *supra* note 38, at 1196-1204 (describing a multi-faceted list of factors that should be used to analyze the baseline of services provided by a municipality).

[84] *See generally* McConnell & Picker, *supra* note 17, at 465 (explaining that unlike corporations, "municipalities are not liquidated in bankruptcy").

[85] *See, e.g.*, Chapter 9 Plan of Adjustment for Jefferson County at 63, *In re* Jefferson Cnty., Ala. (Bankr. N.D. Ala. Nov. 6, 2013), ECF No. 2182, *available at* www.alnb.uscourts.gov/jca?page=74 (limiting power of Chapter 9 debtor to raise sewer rates after confirmation); *see also* Moringiello, *supra* note 13, at 408 (discussing how and why Congress passed the predecessor to Chapter 9).

[86] *See* Moringiello, *supra* note 13, at 445-46.

Congress additionally may have believed that other aspects of the political process—voting, monitoring, and petitioning—provided taxpayers with adequate protection of their interests.

III. WHEN THE RIGHT TO VOTE ISN'T ENOUGH

A. Attenuated Municipal Politics

Municipal elections enjoy less legitimacy than elections at other levels of state and federal governments. Low voter turnout[87] and the opacity of the issues of municipal governance, especially municipal finance,[88] cause most municipal elections to turn on the ability of relatively small groups to organize a high-percentage turnout of like-minded voters.[89] Thus the personal interests of municipal office holders may not coincide with larger groups within the municipality, such as taxpayers.[90] "Capture" by a segment of an electorate is a well-recognized problem.[91] Capture need not rise to the level of corruption to raise concerns because simple divergence of interests between elected officials and taxpayers may result in a failure to identify important issues and respond to them.[92] Corporate law scholars have labeled such divergence "managerial slack" and have spent considerable effort

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[87] HAJNAL, *supra* note 80, at 24.

[88] *See* Schragger, *supra* note 37, at 794.

[89] *See* Pryor, *supra* note 67, at 100 ("[T]he weakness of electoral discipline for municipal government offices exacerbates the costs of political agency . . . ."); Hajnal & Trounstine, *supra* note 34, at 1125 ("Although presidential and Congressional elections get much of our attention, urban politics represents a key component of American democracy. Policy decisions at the local level affect citizens in profound and immediate ways.").

[90] *See* Pryor, *supra* note 67, at 107 (pointing out that taxpayers and unsecured creditors such as municipal retirees face uniquely heightened risks concerning municipal insolvency).

[91] *See* Robin Paul Malloy, *The Political Economy of Co-Financing America's Urban Renaissance*, 40 VAND. L. REV. 67, 102 (1987) (discussing financing in so-called public private partnerships that redirects wealth between and within cities).

[92] *See* George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CALIF. L. REV. 1073, 1074 (1995) (arguing that failure to react to exogenous shocks is a more important cause of business failure than the shocks themselves).

to address its reduction.[93] Public choice theory explains this problem at the local level in terms of two insights.[94] First, elected officials are tempted to make decisions "that advance their own personal welfare, even when doing so comes at the expense of the community's general welfare."[95] Second, as observed above, the scale of municipal politics makes them particularly susceptible to minorities with strong organizational or financial resources.[96]

Municipal managerial slack ranges from run-of-the-mill incompetence through lack of effort from political entrenchment all the way to outright corruption.[97] All municipal stakeholders are concerned about slack because it impedes a municipality's efforts to carry out its downstream and upstream duties and impairs its political legitimacy.[98] Scholars focusing on corporate governance have identified internal and external mechanisms to deter and correct managerial slack.[99] For a corporation, the internal control mechanisms include shareholder voting, shareholder proposals, and legally enforceable fiduciary duties.[100] Voting out sitting directors, passing shareholder resolutions, and successfully suing directors for breach of duty are potent responses to managerial

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[93] *Id.* at 1074-81.

[94] Clayton P. Gillette, *In Partial Praise of Dillon's Rule, Or, Can Public Choice Theory Justify Local Government Law?*, CHI.-KENT. L. REV. 959, 961 (1991).

[95] *Id.*

[96] *See supra* text accompanying notes 87-89; *see also* Gillette, *supra* note 94, at 961-62 ("[L]ocalities are particularly susceptible to the political alliances that form as a result of economic interests, as local governance heightens both opportunities for the formation of some groups and opportunities for free riding among those not easily organized.").

[97] *See* Anderson, *supra* note 38, at 1149 ("Beyond poor planning and unrealistic performance models for pension liabilities, the research cities have faced other management problems. These include failure to plan for downturns, staffing challenges, and, in a few cases, self-dealing and corruption."); *see also* Triantis & Daniels, *supra* note 92, at 1074 (describing managerial slack in terms of "lapses in managerial competence or effort, managerial entrenchment or empire building, and excessive managerial compensation or perquisite consumption.").

[98] *See supra* note 55 and accompanying text (discussing how Chapter 9 reduces the upstream function of municipal government).

[99] Triantis & Daniels, *supra* note 92, at 1076.

[100] *Id.* at 1075.

slack that exist for owners of a corporate firm.[101] Forces external to a firm that address slack in corporate governance include its lenders and the market.[102] Lenders who will no longer lend and buyers who no longer buy indicate that something about the governance of a firm is not in order.[103] Lender and market actions are thus signals to shareholders, whose residual interests are at risk, to take action.[104]

The relative significance of internal and external means to rectify managerial slack in municipal government is nearly reversed. Municipal lenders are often diffuse groups of bondholders whose individual claims are insufficient to warrant monitoring municipal government.[105] In addition, when managerial slack comes to the attention of individual bondholders, exercising their exit rights is easy; bondholders can simply sell. Unfortunately, the opacity of the market for municipal financial debt reduces the signaling function of sales of bonds in the secondary market.[106] In other words, municipal managerial slack is only weakly affected by individual creditor action.[107]

Even indenture trustees who underwrite issuance of municipal bond debt have not taken an active role in monitoring for slack. The long-standing pattern of paying bonds in full has lulled trustees into a low level of diligence.[108] Moreover, requiring

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[101] *Id.*

[102] *Id.* at 1075-76.

[103] *Id.* at 1091.

[104] *See id.* at 1092 (indicating that investors can rely on bank monitoring to inform their decisions).

[105] *See* Schragger, *supra* note 37, at 787 ("[Even] as a bondholder . . . [one's] incentive and capacity to monitor local government is limited. It is not nonexistent, but it is quite crude.").

[106] *See* U.S. SEC. AND EXCH. COMM'N, STAFF REPORT ON THE MUNICIPAL SECURITIES MARKET at 105, (July 31, 2012), *available at* http://www.sec.gov/news/studies/2012/munireport073112.pdf ("[M]arket participants have stated that access to current financial information about issuers or obligated persons may be limited, difficult to find, or unavailable.").

[107] *But cf.* Triantis & Daniels, *supra* note 92, at 1079 ("[T]hrough their *observable* reactions, [corporate] stakeholders convey signals and information regarding the corporation to each other.") (emphasis added).

[108] *See* Pryor, *supra* note 67, at 98 ("The near-perfect record of payment of municipal securities has provided the historical cocoon that encouraged

municipal issuers to purchase bond insurance exacerbates trustee indifference.[109] The active secondary market in municipal securities also reduces concerns of indenture trustees.[110] There is no market for municipal services comparable to that for business entities.[111] Thus the effectiveness of the external means—lenders and the market—to identify managerial slack is negligible in the case of a municipality.

There is little space for taxpayer protection or even input in states that do not provide for special elections for approval of additional debt or taxes.[112] Indeed, even in states whose constitutions limit local taxation and indebtedness, judicial responses have worked to weaken those limits.[113] In the event of municipal insolvency, it is taxpayers among all stakeholders who are better positioned to identify managerial slack in municipal government. What before a financial crisis may have been of little concern[114] becomes much more salient upon filing of a Chapter 9 bankruptcy. When awakened to the risks of municipal mismanagement, taxpayers will have a strong incentive to examine municipal management because, unlike creditors, they cannot reallocate their risk by selling their debt in an opaque secondary market. Nor can taxpayers do much to address risk before it materializes. Unlike creditors, who can reduce risk by improving

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investors to be lackadaisical about the fiscal and financial fundamentals of municipal debt issuers.").

[109] Bond insurance shifts the risk of default onto insurers, and thus, has the tendency to enhance a municipality's creditworthiness. *Id.* at 91.

[110] *See id.* at 98 ("[T]he secondary market in municipal securities is active, [but] matching small transactions is not straightforward and current pricing information is often lacking.").

[111] There are no buyouts or takeovers of failing municipalities, nor competitive product markets for municipal services; either a municipality provides a service or it does not. *But cf.* Triantis & Daniels, *supra* note 92, at 1075-76 (naming competitive product markets, leveraged buyouts, and corporate takeovers as some of the external controls over corporate governance).

[112] California has the most well-known requirement for taxpayer approval of tax increases, Proposition 13. CAL. CONST. art. XIIIA, §§ 1(a), 2(b). For description of widely used techniques to avoid state constitutional limits on increasing taxes see *supra* text accompanying notes 48-51.

[113] *See* Briffault, *supra* note 19, at 957 ("[F]iscal limits [often receive] disfavored treatment by many state courts . . . .").

[114] *See supra* note 105.

the quality, liquidity, and diversification of their assets, taxpayers are tied to the municipality where their property is located.[115]

B. Right to Vote in Bankruptcy

Equity security holders[116] have the right to vote on a corporate plan of reorganization unless they are totally impaired.[117] It follows that a class of equity interests is conclusively presumed to have rejected the plan if it proposes to cancel those interests. In that event, the plan must be crammed down to be confirmed.[118] Cancellation of equity interests, however, requires proof of insolvency, which in turn justifies shareholder standing on that issue.[119] Due process requires that shareholders have an opportunity to be heard before their equity interests are eliminated.[120] Shareholders are thus parties in interest through the point at which the court determines they are "out of the money."[121]

Taxpayers are not equity security holders.[122] It is thus no surprise that the sections of Chapter 11 addressing equity security holders are not incorporated in Chapter 9.[123] Similarly, Chapter 11's provisions for cramdown of equity interests are excluded from

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[115] *See* Pryor, *supra* note 67, at 105 ("Modern portfolio theory explains that risk can be reduced by improving the quality, liquidity, and diversification of assets.").

[116] 11 U.S.C. §§ 101(16), (17) (2006).

[117] *Id.* § 1126(g).

[118] *Id.* § 1129(b)(2)(C). Cramdown of equity interests in Chapter 11 is rarely difficult in light of the insolvency of most corporate debtors together with application of the absolute priority rule. *Id.* § 1129(b)(2)(B)(ii).

[119] *See generally* Lawrence Ponoroff, *Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings*, 23 CAP. U. L. REV. 441, 475 (1994) (discussing the reasoning for requiring proof of insolvency).

[120] *See* 7 COLLIER ON BANKRUPTCY ¶ 1129.05[3] (16th ed. 2014) ("If a plan eliminates any class, that class is deemed conclusively to have rejected the plan. Members of that class are then entitled to a showing that the plan is fair and equitable as to them . . . .").

[121] *Id.* ("[I]f equity is to be eliminated, as will be the initial consideration with most insolvent debtors, then equity holders can force a valuation of the reorganized debtor . . . .").

[122] 11 U.S.C. §§ 101(16), (17) (2006).

[123] 11 U.S.C. § 901(a) (2012).

Chapter 9.[124] Taxpayers cannot vote on their municipality's plan because their political interests in municipal governance are not cancelled.[125] Moreover, unlike holders of equity interests,[126] the Bankruptcy Code does not explicitly afford taxpayers standing as parties in interest before plan confirmation.[127] Taxpayers, without the right to vote or standing to object, are thus marginalized in Chapter 9.

IV. A CODE-BASED SOLUTION

A. Taxpayer Standing

Even if they are not among a municipality's creditors, some courts have considered taxpayers as parties in interest.[128] Other courts have concluded that taxpayers have not been threatened with a concrete injury sufficient to qualify as parties in interest.[129] The description in Chapter 11 of parties in interest, which is incorporated into Chapter 9,[130] does not expressly include taxpayers.[131] That omission alone is not conclusive because the rules of construction in section 102 of the Bankruptcy Code provide that a list which "includes" a series is not limited to the items listed.[132]

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[124] *Id.*

[125] *Id.* §§ 903-04 (preserving state and local governmental political power and control over property and local fiscal matters).

[126] *See, e.g., id.* § 903 (binding only creditors who consent to the plan); *id.* § 943 (requiring the plan to be in the best interest of creditors).

[127] *Id.* § 901(a) (mentioning nothing of taxpayer standing); *see also id.* § 901 *et seq.* (lacking any mention of taxpayer standing); *id* § 943 (describing confirmation without mention of taxpayer input).

[128] *In re* Mount Carbon Metro. Dist., No. 97-20215MSK, 1999 WL 34995477, at *4 (Bankr. D. Colo. July 20, 1999).

[129] *In re* Barnwell Cnty. Hosp., 459 B.R. 903, 908 (Bankr. D.S.C. 2011).

[130] *See* 11 U.S.C. §§ 901(a), 1102(a)(3), (4) (2012) (showing inclusion of parties of interest in Chapter 9).

[131] *Id.* § 1109(b) ("A party in interest, includ[es] the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee . . . .").

[132] *Id.* § 102 ("In this title . . . 'includes' and 'including' are not limiting[.]"); *see also* Vermejo Park Corp. v. Kaiser Coal Corp. (*In re* Kaiser Steel Corp.), 998 F.2d 783, 788 (10th Cir. 1993) ("Under the Bankruptcy Code, 11 U.S.C.

What have the courts said to the issue of taxpayers as parties in interest? Seven decades ago the Fifth Circuit denied a petition of taxpayers to intervene in a Chapter IX composition.[133] The City of Stuart proposed a plan to refinance some of its bond debt, and several taxpayers wanted a declaration that their property, which had not been subject to taxation for the original bonds, should remain free from taxes to pay the new bonds.[134] The court held that the Bankruptcy Act did not permit courts to consider matters such as local taxes that were controlled by state law.[135] The opinion was not explicitly based on Tenth Amendment concerns but only on the court's conclusion that "[C]ongress has not undertaken to confer jurisdiction to determine them."[136] The Fifth Circuit's holding was particularly straightforward, since the bonds to be issued under the city's plan would reduce current municipal payment obligations and the plan said nothing about taxes.[137] The normal means of access to municipal governance—voting, monitoring, and petitioning—could protect the taxpayers' interests.[138]

Whatever was the scope of standing to be heard under Chapter IX, it has been expanded by the Bankruptcy Code.[139] Section 206 of the Bankruptcy Act limited standing to the debtor, indenture trustees, creditors, and stockholders,[140] but section 1109(b) of the Bankruptcy Code has added trustees and committees to the list.[141]

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§ 102(3), the word 'including' is not a limiting term, and therefore, 'party in interest' is not confined to the list of examples provided in section 1109(b).").

[133] Green v. City of Stuart, 135 F.2d 33, 35 (5th Cir. 1943).

[134] *Id.*

[135] *Id.* ("Nothing in the act purports to confer jurisdiction upon the court of bankruptcy to determine . . . particular persons and properties subject to its taxing powers.").

[136] *Id.*

[137] *Id.*

[138] *See supra* note 52 and accompanying text.

[139] *See* 7 COLLIER ON BANKRUPTCY ¶ 1109.LH (16th ed. 2014) ("The history of section 1109 consists of two interrelated developments. The second involves the expansion of the right of the myriad 'parties in interest' affected by any particular business failure to participate in the process of the business' reorganization.").

[140] Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, § 206 (1898) (amended 1976).

[141] 11 U.S.C. § 1109(b) (2012).

Thus, a bankruptcy court in Colorado recognized the standing of taxpayers to "raise . . . appear and be heard" in a Chapter 9 case, at least when it came to confirmation issues.[142] The court went on to conclude that where the plan "implicitly depends upon [debtor] property owners paying for all" substantial improvements, the taxpayers "have sufficient stake in the Chapter 9 proceeding to object to confirmation."[143] Similarly, in another Colorado case, a property owner who did not currently pay taxes had standing to object to a plan that would revoke his tax exemption.[144]

Other courts have been less inclined to recognize taxpayers as parties in interest. Two decades ago, Bankruptcy Judge Steven Rhodes denied a request of taxpayers to intervene in a Chapter 9 proceeding of a multi-county municipal hospital authority.[145] The taxpayers had sought to object to the hospital's Chapter 9 plan because they believed it was inconsistent with state law, but not because the plan was not feasible.[146] Judge Rhodes held that the taxpayers were not parties in interest.[147]

A bankruptcy court in South Carolina reached the same result when faced with a motion to intervene by a self-described group of interested citizens who were concerned that a hospital that served two counties might be relocated.[148] The citizens' committee objected to the hospital's eligibility for Chapter 9 relief, not the

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[142] *In re* Mount Carbon Metro. Dist., No. 97–20215 MSK, 1999 WL 34995477, at *3 (Bankr. D. Colo. July 20, 1999).

[143] *Id.* at *4.

[144] *In re* Wolf Creek Valley Metro. Dist., 138 B.R. 610, 613, 616, 620 (Bankr. D. Colo. 1992).

[145] *In re* Addison Cmty. Hosp. Auth., 175 B.R. 646, 647 (Bankr. E.D. Mich. 1994).

[146] *Id.* at 648 ("Concerned Citizens alleges that the chapter 9 plan submitted by Addison does not comply with the intended purpose of the hospital as provided in both the [Joint Hospital Authority] Act and the by-laws.").

[147] *Id.* at 650 (quoting *In re* City of Bridgeport, 128 B.R. 30, 31 (Bankr. D. Conn 1991)) ("Where a party is merely interested in the outcome of the matter and does not have a direct legal interest in the chapter 9 proceeding, that party is not a 'party in interest.' "). The court went on to express concern that permitting taxpayers without a particularized concern to participate "would hamper, and unduly delay, the debt adjustment process." *Id.*

[148] *In re* Barnwell Cnty. Hosp., 459 B.R. 903, 905, 909, 911 (Bankr. D.S.C. 2011).

feasibility of its plan.[149] The court pointed to section 904 of the Bankruptcy Code, which prohibits the court from interfering with "any of the political or governmental powers of the debtor,"[150] and concluded that the citizens were not parties in interest because the harm they described was "hypothetical, contingent, and speculative."[151] The normal political process was the forum for questions of governance.[152] The limitations of standing under Article III of the Constitution,[153] as well as the boundary established by the Tenth Amendment, formed the basis for the court's conclusion.[154]

"Determining whether a given party is a 'party in interest' is a recurring problem," observed a bankruptcy court in Illinois.[155] Given the vagueness of the expression, it is no surprise that courts have concluded that the range of parties in interest must be determined "on a case by case basis."[156] The Third Circuit's standard for standing in bankruptcy is "whether the prospective party in interest has a sufficient stake in the proceeding so as to require representation."[157] Such a standard merely restates the issue. The Supreme Court's decisions on Article III standing—beginning with *Lujan v. Defenders of Wildlife*[158]—add only slightly more substance when applied in a Chapter 9 context.[159]

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[149] *Id.* at 906.

[150] *Id.* at 910 (quoting 11 U.S.C. § 904(1) (2006)). Taxation is a core power of government. *See* Missouri v. Jenkins, 495 U.S. 33, 67 (1995) (Kennedy, J., concurring) ("A judicial taxation order is but an attempt to exercise a power that always has been thought legislative in nature.").

[151] *In re Barnwell,* 459 B.R. at 909. The court also expressed concern about efficiency: "Allowing all citizens to be heard in Debtor's eligibility proceeding would not be productive for anyone involved, but would merely cause confusion and delay." *Id.*

[152] *Id.* at 911.

[153] *See* U.S. CONST. art. III, § 2, cl. 1 ("The judicial Power shall extend to all Cases, in Law and Equity . . . .").

[154] *In re Barnwell,* 459 B.R. at 906, 910.

[155] Peachtree Lane Assocs. Ltd. v. Granader (*In re* Peachtree Lane Assocs., Ltd.), 188 B.R. 815, 824 (N.D. Ill. 1995).

[156] *In re* Amatex Corp., 755 F.2d 1034, 1042 (3d Cir. 1985).

[157] *Id.*

[158] Lujan v. Defenders of Wildlife, 504 U.S. 555 (1992).

[159] The Court in *Lujan* addressed the standing of environmental groups attacking the failure of the Secretary of the Interior to apply the Endangered

The focus of the Supreme Court's jurisprudence of standing has revolved around individual or organizational challenges to regulatory (in)action rather than participation in a collective proceeding like bankruptcy.[160] If confirmation of a Chapter 9 plan

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Species Act to actions of federal agencies in other nations. *Lujan*, 504 U.S. at 558-59. In an opinion written by Justice Scalia, the majority concluded the organizations did not have standing and described three criteria by which to evaluate standing:

> First, the plaintiff must have suffered an "injury in fact"—an invasion of a legally protected interest which is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained of . . . . Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.

Id. at 560-61 (internal quotation marks omitted). Fourteen years later the Court relaxed the requirements for standing where Congress has afforded an individual a distinct "procedural right" to protect a "concrete interest." Massachusetts v. Envtl. Prot. Agency, 549 U.S. 497, 517 (2007) (citation omitted) ("When a litigant is vested with a procedural right, that litigant has standing if there is some possibility that the requested relief will prompt the injury-causing party to reconsider the decision that allegedly harmed the litigant."). Only three years elapsed before the Court, through Justice Scalia, trimmed the scope of standing in such procedural rights cases by re-emphasizing the need for a concrete injury. See *Summers v. Earth Island Institute*, in which Justice Scalia declared:

> But deprivation of a procedural right without some concrete interest that is affected by the deprivation—a procedural right *in vacuo*—is insufficient to create Article III standing. Only a "person who has been accorded a procedural right to protect *his concrete interests* can assert that right without meeting all the normal standards for redressability and immediacy."

Summers v. Earth Island Inst., 555 U.S. 488, 496 (2009) (citation omitted).

[160] *See, e.g.*, *In re* Barnwell Cnty. Hosp., 459 B.R. 903, 908-09, 911 (Bankr. D.S.C. 2011) (finding that the Committee failed to present evidence "showing that any of the members of the Committee [had] a pecuniary interest in [the] bankruptcy proceeding"); *In re* Addison Cmty. Hosp. Auth., 175 B.R. 646, 650 (Bankr. E.D. Mich. 1994) (citation omitted) (explaining that "[w]here a party is merely interested in the outcome of the matter and does not have a direct legal interest in the chapter 9 proceeding, that party is not a 'party in interest.' "); Green v. City of Stuart, 135 F.2d 33, 34-35 (5th Cir. 1943) (discussing what constitutes a proper party in a proceeding for composition of indebtedness).

is not a public right,[161] a person must meet the constitutional standard for standing in order to be heard in a bankruptcy proceeding .[162] Where a Chapter 9 plan proposes to increase taxes, taxpayers clearly have the requisite imminent concrete injury that can be redressed by the bankruptcy court.[163] Even in cases where the plan does not propose a tax increase, the collective nature of the proceeding combined with the forward-looking standard of feasibility points to recognition of taxpayers as parties in interest.[164]

Feasibility has been described as the ceiling on a plan of adjustment.[165] In other words, feasibility is the most that can be

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[161] *But see* C. Scott Pryor, *Who Bears the Burden: The Place for Participation of Municipal Residents in Chapter 9*, 37 CAMPBELL L. REV. __ (forthcoming 2014) (arguing that the standing requirements of Article III do not apply to confirmation of chapter 9 plan because it is a public right).

[162] *See* S. Todd Brown, *Non-Pecuniary Interests and the Injudicious Limits of Appellate Standing in Bankruptcy*, 59 BAYLOR L. REV. 569, 578-79 (2007) (discussing Article III standing, statutory standing, and prudential standing in bankruptcy).

[163] *See id.* at 585 (implying that anyone whom would suffer an increased pecuniary burden from a bankruptcy court order should have standing); *see also In re* Hutchinson, 5 F.3d 750, 756 (4th Cir.1993) (explaining that "[a]lthough the Code does not define the term 'party in interest,' the term 'is generally understood to include all persons whose pecuniary interests are directly affected by the bankruptcy proceedings").

[164] Brown, *supra* note 162, at 578-79 (footnotes omitted):

> An order concerning a discrete proceeding may have a substantive impact on the bankruptcy case and, directly or as a result of the order's impact on the case as a whole, the interests of several distinct parties. Any resulting injury, financial or not, may constitute an "injury in fact" for Article III purposes regardless of whether it stems from the outcome of the proceeding in isolation or due to its impact on the entire bankruptcy case. Furthermore, these injuries may be redressed in many instances with affirmative relief authorized under the Code or by blocking the entry of (or, on appeal, reversal of an order granting) relief requested by another party. In short, a large number of parties may satisfy Article III standing requirements in a single bankruptcy dispute.

[165] *See* 6 COLLIER ON BANKRUPTCY ¶ 943.03[7] (16th ed. 2014) ("[The remaining section 943(b) statutory requirement] for confirmation of a plan in a chapter 9 case is that the plan 'is in the best interests of creditors and is feasible' ") (quoting 11 U.S.C. § 943(b)(7) (2012)).

extracted from non-creditor stakeholders.[166] Given the constitutional standing requirements of Article III of the Constitution and the limits on federal power under the Tenth Amendment, a workable definition of "party in interest" in bankruptcy for purposes of feasibility should comprise two elements. The first distinguishes between parties who are stakeholders—whose pecuniary interests are at risk—and those who are simply interested in a municipality's governing actions. Fears that hospitals might be closed or a generalized concern that taxes might be increased are within the scope of governmental powers reserved to the states and their subdivisions by the Tenth Amendment,[167] and specifically protected by sections 903 and 904 of the Bankruptcy Code.[168] Standing to contest such matters should thus be limited to higher state authorities and creditors. Ordinary political means—voting, monitoring, and petitioning—and not participating in the bankruptcy process are the principal tools of disgruntled taxpayers and citizens.[169]

On the other hand, the interests of an owner of property whose tax exempt status would be eliminated by a plan is an example of a taxpayer whose "pecuniary interests are directly affected" and who is thus a party in interest.[170] Similarly, extraction of additional taxes through the plan directly implicates a concrete interest of a taxpayer.[171] A plan of adjustment that provides for tax increases

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[166] *See* 11 U.S.C. § 943(b)(7) (2012) (while not expressly granting general taxpayers a vote on the plan, still requiring that the plan be "feasible," even after a court determines that "the plan is in the best interest of creditors").

[167] *See* Moringiello, *supra* note 13, at 438 (explaining that the Tenth Amendment cloaks state municipal mangers with a certain autonomy to decide matters concerning local government services).

[168] 11 U.S.C. §§ 903-04 (generally restraining federal judicial intervention into local matters).

[169] *See generally* Moringiello, *supra* note 13 at 411-12 (describing the process of how a plan of adjustment is passed, which lacks any input from taxpayers, and noting that Chapter 9 leaves much of the municipal oversight to the political process.

[170] *In re* Hutchinson, 5 F.3d 750, 756 (quoting *In re* Leavell, 141 B.R. 393, 399 (Bankr. S.D. Ill. 1992)).

[171] *See generally* McConnell & Picker, *supra* note 17, at 465-66 (describing municipalities' broad power to tax and explaining that increased taxes have become the "prime source of payment" to creditors in bankruptcy proceedings).

implicates the issue of feasibility and gives taxpayers a sufficient stake to object on that ground. The bankruptcy court should be aware of the possibility of widespread tax resistance or an exodus of taxpayers when considering plan confirmation.[172] Limiting taxpayer standing in most cases to the issue of feasibility would reduce the risk of turning the Chapter 9 case into a political free-for-all. Yet this element will not always be sufficiently straightforward; most plans of adjustment do not propose to increase taxes apart from voter approval.[173] There is a continuum between governance in general and particularized pecuniary interests[174] and an additional element will be necessary to confer standing on taxpayers in cases where a tax increase is not part of the plan.

The second element looks to the salience of the stakeholders' input to the issue at hand. The requirement that a plan be feasible[175] augurs for a broad construction of party in interest. The myriad of considerations that go into evaluating a plan's feasibility suggests that Congress intended an equally expansive understanding of what counts as a concrete injury for purposes of standing to be heard.[176] Of all stakeholders, taxpayers should be

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[172] *See* Taylor v. Provident Irrigation Dist., 123 F.2d 965, 967 (9th Cir. 1941) ("The burden a district is able to carry is in practice limited by the amount of the revenues it can raise through the exertion of its taxing power; and this limit is pretty definitely fixed by the ability of landowners to pay assessments.").

[173] FRANCISCO VAZQUEZ, EXAMINING CHAPTER 9 MUNICIPAL BANKRUPTCY CASES 13 (Thomson Reuters/Aspatore 2011).

[174] The line between governance and particularized pecuniary interest is especially blurry in bankruptcy cases, and thus, "standing considerations are often more complex in bankruptcy cases." Brown, *supra* note 162; *see also id.* ("In short, a large number of parties may satisfy Article III standing requirements in a single bankruptcy dispute.").

[175] *See infra* Part IV.C for a discussion of feasibility.

[176] *See* Lujan v. Defenders of Wildlife, 504 U.S. 555, 580 (1992) (Kennedy, J., concurring):

> As Government programs and policies become more complex and far reaching, we must be sensitive to the articulation of new rights of action that do not have clear analogs in our common-law tradition. Congress has the power to define injuries and articulate chains of causation that will give rise to a case or controversy where none existed before . . . .

most concerned that one Chapter 9 filing not be followed by a subsequent filing by their municipality.[177]

Taxpayers—along with recipients of municipal services—bear a disproportionate share of the risk of municipal default.[178] Unlike institutional creditors such as bondholders, the cost of exercising the exit rights of taxpayers are high.[179] Even non-institutional creditors such as contract parties and employees bear less of a risk than taxpayers.[180] Only fixed-income retirees may bear more.[181] Given the place of real estate taxes in municipal finance and the relative size of real estate in the portfolio of investments of most taxpayers, it is more difficult for them to diversify against the risk of tax increases.[182] Since a greater share of the burden of municipal insolvency falls on taxpayers more than almost all creditors,[183] the interests of taxpayers in the feasibility of any plan will usually be sufficiently concrete to confer standing on the issue of feasibility.[184]

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[177] *See* Chung, *supra* note 27, at 1472 & n.62 (citation omitted) (implying that negative credit ratings of municipalities caused by their defaulting on obligations impacts every municipality in the state).

[178] *See* Chung, *supra* note 78, at 807-09 (comparing the limited exposure of corporate investors to ongoing economic risks suffered in perpetuity by municipal taxpayers); *see also* Pryor, *supra* note 67, at 103 ("When compared with corporate borrowers and their shareholders, the borrowing decisions and sources of repayment of municipalities are less flexible and the exit rights of their taxpaying residents are much more expensive.").

[179] Pryor, *supra* note 67, at 104 ("[Taxpayers] must sell their real property, an expensive proposition whether it is a home or business location.").

[180] *Id.* at 105 ("Taxpayers . . . can address the negative effects of risk [only] by moving from a municipality . . . .").

[181] *See id.* ("[I]t is more difficult for retirees, taxpayers, or employees to reduce risk . . . than it is for bondholders given the need of the former to live in a particular place and the costs of getting or changing jobs. Such individuals find it difficult to diversify.").

[182] *Id.* at 104.

[183] *See* McConnell & Picker, *supra* note 17, at 466 (noting that tax increases are often used to satisfy creditors).

[184] *See generally* Brown, *supra* note 162, at 578-79 (discussing bankruptcy standing, including Article III standing, statutory standing, and prudential standing).

Taxpayers in Chapter 9 are analogous to equity security holders in Chapter 11.[185] Taxpayers do not, of course, have a residual interest in municipal assets.[186] On the other hand, taxpayers' long-term losses are not limited to the amount of their investment; their property is liable in perpetuity for the financial misfortunes of their municipality.[187] A plan that increases taxes is like a capital call on corporate shareholders, something that is not required under state or federal bankruptcy law.[188] To the extent that continued property ownership justifies increased taxes, taxpayers have a stake comparable to holders of equity interests.[189] Thus, taxpayers, like holders of equity interests, should be counted as parties in interest for the issue of a plan's feasibility.[190]

Although the primary purpose of Chapter 9 "is to permit local taxing agencies . . . and their consenting creditors to compose their indebtedness,"[191] stakeholders whose pecuniary interests will be affected by the plan should have the opportunity to weigh in on a plan's feasibility. Just as a court cannot deny confirmation simply

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[185] *See* Kordana, *supra* note 17, at 1056 (noting that municipal residents are the functional equivalent of a corporation's shareholders).

[186] *See* Anderson, *supra* note 44, at 1368 ("Instead of municipal government and county government . . . the area reverts to unincorporated county rule alone.").

[187] *See supra* note 178.

[188] Kordana, *supra* note 17, at 1057 ("[A] mandatory tax increase, imposed on a municipality in bankruptcy, resembles a combination price increase on customers and capital call on shareholders.").

[189] *Id.* at 1057-58 (footnotes omitted):

> Thus private law parallels, in which limited liability shifts losses in bankruptcy from control parties onto parties with contractual relationships with the bankrupt entity, suggest that a mandatory tax increase imposed on municipal residents in favor of bondholders and other investors is neither an inevitable nor obviously correct default rule. We should not be surprised if in a Chapter 9 bankruptcy proceeding, losses are placed on those parties, including bondholders, who have a contractual relationship with the municipality.

[190] The court in the bankruptcy of the City of Detroit appointed its own expert witness on matters related to feasibility. *See* Order Appointing Expert Witness, *In re* City of Detroit, No. 13-53846 (Bankr. S.D. Mich. Apr. 22, 2014), ECF No. 4603.

[191] Green v. City of Stuart, 135 F.2d 33, 35 (5th Cir. 1943).

because a plan does not raise taxes,[192] a court should consider whether an increased tax burden proposed in a plan will render the plan unfeasible. Without entertaining objections from taxpayers, a court may be deprived of a significant source of revenue-related information that could be crucial to a finding of feasibility.[193]

B. Taxpayer Committees

Recognition of committees of taxpayers would give effect to Chapter 9's incorporation[194] of section 1102 of the Bankruptcy Code.[195] The two cases where a taxpayer has successfully objected to confirmation of a plan demonstrate that it will be an exceptional situation where a single taxpayer can expect a return commensurate with the cost of the battle.[196] In no sizeable Chapter 9 case will a single taxpayer do the work necessary to demonstrate that a plan is not feasible.[197] A committee of taxpayers, however,

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[192] *See In re* Corcoran Hosp. Dist., 233 B.R. 449, 459 (Bankr. E.D. Cal. 1999) (holding that hospital district was not obliged even to attempt to raise taxes to pay its unsecured creditors in full because evidence indicated it would be a "futile exercise").

[193] *See e.g.*, Taylor v. Provident Irrigation Dist., 123 F.2d 965, 967 (9th Cir. 1941) (ruling that the properties within the district could not sustain a much higher tax burden, based on "informed . . . witnesses who took into consideration all relevant factors–the past experience of the district over a long period of years, *its assessment history* the *nature of the crops* which the lands are capable of producing, *soil conditions*, *prices* and *production costs* [for taxpaying farmers]") (emphasis added).

[194] 11 U.S.C. § 901(a) (2012).

[195] Section 1102(a)(1) mandates appointment of a creditors' committee. *Id.* § 1102(a)(1). Appointment of a committee of equity security holders is within the discretion of the United States trustee. *Id.* Even if the United States trustee declines to appoint one, the court may order the appointment of a committee of equity securities holders on the request of a party in interest. *Id.* § 1102(a)(2).

[196] *See In re* Mount Carbon Metro. Dist., No. 97–20215 MSK, 1999 WL 34995477, at *3 (Bankr. D. Colo. July 20, 1999); *In re* Wolf Creek Valley Metro. Dist., 138 B.R. 610, 613, 616, 620 (Bankr. D. Colo. 1992).

[197] *See In re* Addison Cmty. Hosp. Auth., 175 B.R. 646, 648 (Bankr. E.D. Mich. 1994) (showing that taxpayers sought to object to the hospital's Chapter 9 plan because they believed it was inconsistent with state law, not because the plan was not feasible). Even a self-described group of interested citizens objected to the relocation of a hospital on the ground that it was ineligible for Chapter 9 relief, but did not contest the feasibility of the plan. *In re* Barnwell Cnty. Hosp., 459 B.R. 903, 906 (Bankr. D.S.C. 2011).

whose fees and expenses will be borne by the estate, will be able to rebut a one-sided feasibility analysis presented by a municipality and supporting creditors. Yet, the list of committees to which section 1102 refers does not explicitly include taxpayers.[198] Does silence preclude appointment of such a committee?

Neither Chapter X, XI, nor XII authorized the court to appoint an official committee of equity security holders.[199] The Bankruptcy Code of 1978 included—for the first time—a provision for the appointment by the court of such a committee.[200] Congress had concluded that equity committees were appropriate to "counteract the natural tendency of a debtor in distress to pacify large creditors, with whom the debtor would expect to do business, at the expense of small and scattered public investors."[201] The risks to the interests of taxpayers in a municipal bankruptcy are greater than those of shareholders in a business corporation. The inability of creditors in a Chapter 9 case to convert it to one under Chapter 7 makes it all the more likely that they might be pacified at the expense of unrepresented taxpayers. Most taxpayers, like most investors in public corporations, are small and isolated and thus in danger from the machinations of large and sophisticated institutional stakeholders.

Appointment of an equity committee in a Chapter 11 case is not mandatory.[202] There is no reason to incur the expenses of a committee when a corporation is hopelessly insolvent and neither liquidation nor reorganization will lead to any recovery for equity interests.[203] Nonetheless, insolvency is not the sole criterion for the

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[198] 11 U.S.C. §§ 1102(a)(1)-(2).

[199] *See generally* 2A COLLIER ON BANKRUPTCY ¶ 44.21[1]–[5] (14th ed. 1987) (discussing the appointment of committees by creditors).

[200] 11 U.S.C. § 1102(a)(2).

[201] S. Rep. No. 95-989, at 10 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5796.

[202] 11 U.S.C. § 1102(a)(1).

[203] *See In re* Wang Labs., 149 B.R. 1, 3-4 (Bankr. D. Mass. 1992) (citation omitted) (finding that "[w]hen a debtor appears to be hopelessly insolvent [an equity committee is not generally warranted] because neither the debtor nor the creditors should have to bear the expense of negotiating over the terms of what is in essence a gift").

appointment of an equity committee.[204] Indeed, recent bankruptcy cases have downplayed insolvency in favor of an inquiry into a variety of factors including whether "there is a substantial likelihood that [equity] will receive a meaningful distribution ."[205] In any event, taxpayers remain stakeholders in a city regardless of the extent of its insolvency.[206] Though not receiving a distribution in the typical form of property, taxpayers will continue to receive a variety of municipal services.[207] Other factors that courts consider when deciding whether to appoint an equity committee, such as numerosity, lack of effective representation by other parties in interest, and need for representation in the case, also suggest that a taxpayers committee will be appropriate in large municipal bankruptcies.[208]

The absence of "taxpayer" from section 1102(a) of the Bankruptcy Code should not limit the power of the court to appoint a taxpayers committee.[209] The incorporation of the entirety of section 1102 into Chapter 9,[210] recognition of taxpayers as parties in interest,[211] and the general powers of the court under section 105[212] cumulatively warrant such action.[213]

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[204] *In re* Williams Commc'n Gr., Inc., 281 B.R. 216, 220 (Bankr. S.D.N.Y. 2002) ("[T]he court retains the discretion to appoint an equity committee based on the facts of each case.").

[205] *Id.* at 223.

[206] *See supra* text accompanying notes 71-75.

[207] *See* Anderson, *supra* note 38, at 1196 ("Indeed, the ongoing provision of basic services is an absolute necessity in retaining residents and businesses who generate any kind of tax and fee revenue.").

[208] The appointment of an expert witness on the issue of feasibility in the bankruptcy of Detroit is consistent with the need for a taxpayers committee. *See* Order Appointing Expert Witness, *supra* note 190.

[209] *See* 11 U.S.C. § 1102(a)(1)-(2) (2012) (omitting taxpayers from the list of committees); s*ee generally* Matthew Bruckner, *The Virtue in Bankruptcy*, 45 LOY. U. CHI. L. J. 233, 236 (2013) (stating that the Bankruptcy Code not only "empowers bankruptcy judges to confirm a plan of reorganization, provided that the plan is feasible[,]" but it also "empowers the bankruptcy courts to use their discretion to determine the relevant considerations in a particular case and then to apply those factors to the facts of that case").

[210] 11 U.S.C. § 901.

[211] *In re* Mount Carbon Metro. Dist., No. 97–20215 MSK, 1999 WL 34995477, at *3 (Bankr. D. Colo. July 20, 1999); *In re* Addison Cmty. Hosp.

C. Strict Feasibility

Notwithstanding the affirmative vote of each class, section 1129(a)(11) of the Bankruptcy Code requires that the bankruptcy court find that the plan is "not likely to be followed by liquidation, or the need for further financial reorganization;" in short, the plan must be feasible.[214] Even if no party objects to confirmation, the court must find that the plan is feasible before confirming it.[215] In other words, the bankruptcy court is entitled to substitute its judgment for that of the debtor and its creditors.[216] Yet nowhere does Chapter 11 define feasibility nor does the Bankruptcy Code list the elements a court should consider when evaluating a plan's feasibility.[217] Bankruptcy courts have gone on to consider a range of factors in connection with feasibility,[218] but there is no

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Auth., 175 B.R. 646, 647 (Bankr. E.D. Mich. 1994); *In re* Wolf Creek Valley Metro. Dist., 138 B.R. 610, 613, 616, 620 (Bankr. D. Colo. 1992).

[212] 11 U.S.C. § 105(a) ("The court may issue any order . . . that is necessary or appropriate to carry out the provisions of this title.").

[213] Unlike a surcharge on exempt property for which the Supreme Court found no warrant under section 105(a) of the Bankruptcy Code, Law v. Siegel, No. 12-5196, 571 U.S. ___ (Mar. 4, 2014), appointment of a taxpayers committee is within the scope of the equitable powers of the bankruptcy court and does not conflict with any provision of the Bankruptcy Code.

[214] 11 U.S.C. § 1129(a)(11).

[215] *See, e.g.*, *In re* M&S Assocs., 138 B.R. 845, 848 (Bankr. W.D. Tex. 1992) ("The bankruptcy court has an affirmative obligation to scrutinize a reorganization plan to determine whether it is feasible. In order to confirm a plan, the court must make a specific finding that the plan, as proposed, is feasible.").

[216] *See id.* ("The bankruptcy court must be satisfied that a reorganization plan satisfies all of the requirements of section 1129(a) . . . in order to confirm the plan.").

[217] *See* Bruckner, *supra* note 209, at 236 ("[T]he Bankruptcy Code empowers bankruptcy judges to confirm a plan of reorganization, provided that the plan is feasible. However, the Code does not define feasibility, nor does it provide any substantive guidance as to how feasibility should be determined.").

[218] See 7 COLLIER ON BANKRUPTCY ¶ 1129.02[11] (16th ed. 2014) listing six factors:

(1) the adequacy of the debtor's capital structure;
(2) the earning power of its business;
(3) economic conditions;
(4) the ability of the debtor's management;

comprehensive list, and even less is there a consensus of how the factors should be weighed.[219]

What is merely unclear in Chapter 11 is an impenetrable fog in Chapter 9. Section 1129(a)(11) of the Bankruptcy Code is not incorporated into Chapter 9.[220] Instead, section 943(b)(7) simply makes an undefined "feasibility" a requirement of confirmation of a plan of adjustment.[221] On its face, "this standard includes, and then goes beyond, the Chapter 11 expectation that the debtor will not need another bankruptcy reorganization in the near future."[222] Like cases under Chapter 11,[223] however, most bankruptcy courts have paid little more than lip service to the requirement of feasibility in an uncontested Chapter 9 filing.[224] The relatively few

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> (5) the probability of the continuation of the same management; and
> (6) any other related matters which determine the prospects of a sufficiently successful operation to enable performance of the provisions of the plan.

[219] *See* Stephen H. Case, *Some Confirmed Chapter 11 Plans Fail. So What?*, 47 B.C. L. REV. 59, 60 (2005) (footnotes omitted):

> A frequently cited legal standard for feasibility is whether the factual showing at the plan confirmation hearing establishes a "reasonable assurance of success," though "[s]ucess need not be guaranteed." In the context of section 1129(a)(11), relatively few reported cases articulate much more than this basic standard, except to state that Chapter 11 issues are fact-intensive and that trial court decisions will be upheld unless "clearly erroneous."

[220] 11 U.S.C. § 901(a) (2012).

[221] *Id.* § 943(b)(7) ("The court shall confirm the plan if . . . the plan is in the best interests of creditors and is feasible.").

[222] Anderson, *supra* note 38, at 1193.

[223] *See* Case, *supra* note 219, at 67:

> In the author's experience, uncontested Chapter 11 plan confirmation hearings have often been the result of successful consensus-gathering efforts. These efforts frequently result in hearings where the court has no reason to question plan-proponent representations with respect to feasibility. This can result in court acceptance of expectations as to future revenue levels, interest rates, and business activity that might not have been able to withstand an attack from well-prepared creditors opposing the plan.

[224] *See, e.g.*, *In re* Corcoran Hosp. Dist., 233 B.R. 449, 453 (Bankr. E.D. Cal. 1999); *In re* City of Colo. Springs Spring Creek Gen. Impr. Dist., 187 B.R.

contested Chapter 9 cases make it difficult to identify any uniquely municipal definition of plan feasibility or even to list factors a court should consider.[225]

Regardless of the lack of statutory guidance, bankruptcy courts should apply a significant level of scrutiny to the feasibility of a municipality's plan, especially where taxpayers object to its confirmation. Without the right to vote, an attack on a plan's feasibility is the only recourse taxpayers have.[226] The pre-Bankruptcy Code history of Chapter 9 suggests that Congress understood that feasibility was particularly important in municipal bankruptcy because the alternative of liquidation is not available.[227]

In order to confirm a plan under former Chapter IX the bankruptcy court was required to find that the plan was "for the best interests of creditors" and that it was "fair and equitable."[228] The Supreme Court of the United States in *Kelley v. Everglades Drainage District*[229] read a subsidiary finding of feasibility into the requirement that a plan be fair and equitable.[230] In *Kelley*, a

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683, 686 (Bankr. D. Colo. 1995) (concluding that feasibility was met, but without further explanation).

[225] *See, e.g., In re* Mount Carbon Metro. Dist., 242 B.R. 18, 35 (Bankr. D. Colo. 1999) ("A plan should offer a reasonable prospect of success and be workable. In Chapter 9, this requires a practical analysis of whether the debtor can accomplish what the plan proposes and provide governmental services.").

[226] *See supra* text and accompanying notes 7, 26.

[227] *See, e.g., The Bankruptcy Reform Act Revision of the Salary Fixing Procedure for Bankruptcy Judges Adjustment of Debts of Political Subdivisions and Public Agencies and Instrumentalities: Hearings Before the S. Subcomm. on Improvements in Judicial Machinery of the Comm. on the Judiciary*, 94th Cong. 213 (1975) [hereinafter *1975 Subcommittee Hearings*] (statement of Antonin Scalia, Assistant Att'y Gen., Office of Legal Counsel, DOJ) (explaining to the Senate Subcommittee that the idea of "feasibility" is necessary "to make it very clear to the judge that he has a serious obligation under the statute to look closely into the future financial plans of the city").

[228] *See* 5 COLLIER ON BANKRUPTCY ¶ 81.19 (14th ed. 1978) ("[The bankruptcy judge] should enter the interlocutory decree if, and only if, he is satisfied that the [Chapter IX] plan (1) is fair, equitable, and for the best interest of creditors and does not discriminate unfairly in favor of any creditor or class of creditors . . . .").

[229] Kelley v. Everglades Drainage Dist., 319 U.S. 415 (1943).

[230] *Id.* at 419-20.

dissenting creditor objected to a plan that had the overwhelming support of the class of which he was a member.[231] The bankruptcy court overruled the objection, confirmed the plan, and the creditor appealed.[232] The Supreme Court of the United States reversed on the ground that the proponent of the plan had not submitted evidence sufficient to "permit a reasonable, and hence an informed, estimate of the probable future revenues available for the satisfaction of creditors."[233] Elaborating on what needed to be shown, the Court observed that a wide variety of tax-related issues should be considered:

> [T]he revenues which have in the past been received from each source of taxation, the present assessed value of property subject to each tax, the tax rates currently prescribed, the probable effect on future revenues of a revision in the tax structure. . ., the extent of past tax delinquencies, and any general economic conditions of the District which may reasonably be expected to affect the percentage of future delinquencies.[234]

The Court's emphasis on taxes, and hence taxpayers, is unmistakable. The Court in *Kelley* did not explain why such evidence of feasibility was necessary but clearly it presupposed that special consideration of the ability of the municipality to generate the revenue necessary to fund a plan was vital to confirmation. Creditor approval is not enough when plan funding depends on squeezing more money out of taxpayers. Unlike reorganizing corporations that can project new and additional sources of income, the primary source of revenue over which municipalities have control are real estate tax collections.[235]

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[231] *Id.* at 419 ("[T]he fact that the vast majority of security holders may have approved a plan is not the test of whether that plan satisfies the statutory standard.") (citation omitted).

[232] *Id.* at 417.

[233] *Id.* at 420.

[234] *Id.* at 421.

[235] Twenty-five percent of the revenue of municipal governments comes from state and federal governments. Hajnal & Trounstine, *supra* note 34, at 1136 ("Because a quarter of local government revenues are provided by state

Focusing on the details of tax revenue generation effectively places the interests of taxpayers in the forefront of confirmation of a plan of adjustment.[236]

Feasibility was also at the center of discussion when Congress revised Chapter IX in 1976.[237] By then the *Kelly* decision was understood to require a municipality to project a balanced budget within a reasonable period of time and to tether the condition of feasibility to the "fair and equitable" requirement of Chapter IX[238] With the 1976 revisions, feasibility became an independent requirement and was no longer merely an implication of fair and equitable.[239] The requirement of feasibility continued virtually unchanged with the enactment of the Bankruptcy Code two years later.[240]

Concerns about feasibility have led to denial of confirmation only in few cases since the enactment of the Bankruptcy Code.[241] The bankruptcy court in *Mount Carbon Metropolitan District*[242]

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and federal governments and because much of this federal and state funding is earmarked toward specific functions, local governments may have little power to control the direction of their own spending."); *see also* Chung, *supra* note 78, at 791-92 (distinguishing the drastically limited sources of revenue and options for municipalities as opposed to for-profit corporations' broad array of available financial tools).

[236] *See* Fano v. Newport Heights Irrigation Dist., 114 F.2d 563, 565-66 (9th Cir. 1940) (finding creditor successfully obtained reversal of confirmation of plan of adjustment that reduced principal obligation to bondholders where solvent district held assets worth multiples of bond debt and had experienced low rate of tax delinquencies). One wonders if the outcome would have been different had taxpayers been parties.

[237] *See 1975 Subcommittee Hearings, supra* note 227, at 212-13 (highlighting a lengthy debate about the feasibility requirement in municipal bankruptcies).

[238] *In re* Mount Carbon Metro. Dist., 242 B.R. 18, 33 (Bankr. D. Colo. 1999).

[239] *See* 6 COLLIER ON BANKRUPTCY ¶ 943.LH[2] (16th ed. 2014) ("[T]he inclusion of the feasibility test in the 1976 Act was not intended as a substantive change, since the House considered that feasibility was an element of the fair and equitable rule in Chapter IX cases under the 1937 Act.").

[240] S. REP. NO. 95-989, at 8-9 (1978); H.R. REP. NO. 95-595, at 262 (1977); 124 CONG. REC. H11,100 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards).

[241] *In re Mount Carbon Metro. Dist.*, 242 B.R. at 18.

[242] *Id.*

was one of those cases, and it analyzed feasibility in an instructive way.[243] Mount Carbon was a largely undeveloped Colorado metropolitan district near Denver.[244] Three real estate developers owned a majority of the land within the district.[245] The district owed a note and bondholders approximately $58 million and lacked funds sufficient to develop the infrastructure necessary to permit development of its land.[246] Without infrastructure and development, the district would not have been able to generate tax revenue sufficient to retire its debt.[247] The majority of the debt, however, was owed to one of the developers who agreed to pay the Chapter 9 expenses of the district.[248]

Mount Carbon's plan of adjustment proposed to issue new bonds to pay its pre-bankruptcy debt, and projected that it could pay the new bonds by nearly doubling its current tax rate and selling rights to its water allocation.[249] Increasing the tax rate and selling water rights could raise sufficient funds, however, only if there was "immediate, sustained and complete development" of the land within the district.[250] The bankruptcy court ignored the overwhelming creditor support for the plan because, unlike Chapter 11 reorganization, creditors can neither oust municipal government, nor propose a plan, nor force liquidation.[251] Thus, according to the court, "creditors may accept even a hopelessly infeasible Chapter 9 plan in preference to the non-bankruptcy status quo."[252] Such bias in favor of virtually any plan increases the risk a plan will afford insufficient regard for taxpayers who cannot vote on its confirmation.[253]

The court then conducted a thorough analysis of the feasibility of Mount Carbon's "on the come" funding projections and

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[243] *See id.* at 32-33 (showing differences in Chapter 9 and Chapter 11 feasibility standards).

[244] *Id.* at 23.

[245] *Id.*

[246] *Id.* at 24.

[247] *Id.* at 27.

[248] *In re Mount Carbon Metro. Dist.*, 242 B.R. at 24, 25.

[249] *Id.* at 26-27.

[250] *Id.* at 27.

[251] *Id.* at 34.

[252] *Id.*

[253] *Id.*

concluded they left "no room for error."[254] The court went on to observe that feasibility is not merely a legal standard that is satisfied by the power of the municipality to issue replacement bonds.[255] Feasibility requires that a municipality be able to pay its restructured indebtedness.[256] Without the extensive input of taxpayers, the court in *Mount Carbon* would not have known that the district's projections were incomplete and unsupported by "any evidence that landowners are able and willing to pay."[257] Only a presumption that taxpayers are parties in interest can ensure bankruptcy courts have a sufficient record to determine whether a plan is feasible, and in larger cases, only a taxpayers committee will have the resources to develop such a record.[258] Thus only when courts are concerned about feasibility will the interest of taxpayers be protected.

V. CONCLUSION

Courts should afford a presumption that taxpayers are parties in interest on the issue of the feasibility of a municipal plan of adjustment. Taxpayers may be parties in interest on other matters but should be afforded a rebuttable presumption of standing with respect to feasibility. The presumption of taxpayer standing may be rebutted for plans that do not propose tax increases. Even in no-tax-increase plans, taxpayer input may be appropriate because taxpayers can have particular insight into managerial slack and on those aspects of a plan that would reduce municipal services.[259]

The United States trustee should form a committee of taxpayers in sizeable Chapter 9 cases. An individual taxpayer's return on the investment of contesting feasibility will almost always be inadequate to justify the cost.[260] Without a party

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[254] *In re Mount Carbon Metro. Dist.*, 242 B.R. at 27, 37-38.

[255] *Id.* at 36 ("A feasibility determination based simply upon whether the District can issue Exchange Bonds, as compared to whether it can pay them, would be so superficial as to be meaningless.").

[256] *Id.* at 33.

[257] *Id.* at 37.

[258] *See supra* discussion Part IV(B), ¶1.

[259] *See supra* text accompanying notes 44-45, 114.

[260] *See supra* text accompanying note 196.

adverse to a consensual plan, a bankruptcy court runs the risk of confirming one that will ultimately fail.[261] An estate-financed taxpayers committee will help insure a proper record for the confirmation decision.

Assessment of feasibility is especially important in Chapter 9. The business judgment of the voting constituencies of a Chapter 11 debtor's creditors in a corporate reorganization is likely to be adequate to inform the court's judgment on feasibility.[262] The absence of the alternative of liquidation, and the inability of taxpayers to vote on confirmation, makes it vital that the court give significant attention to the issue of feasibility in Chapter 9. Only the input of taxpayers can insure the court's attention is well informed.

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[261] *See supra* text accompanying note 191.

[262] *See supra* notes 97-111 and accompanying text (discussing the corporate controls and comprehensive data reporting enjoyed by the private sector, compared to the lack thereof in municipal financing).