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# The Next Financial Hurricane? Rethinking Municipal Bankruptcy in Louisiana

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# The Next Financial Hurricane? Rethinking Municipal Bankruptcy in Louisiana

## I. INTRODUCTION: IS THERE A STORM BREWING?

A combination of the recent economic recession, the declining housing market, and growing public pension liability concerns has incited significant chatter about cities and towns in financial crisis.<sup>1</sup> Municipalities are struggling to pay their debts; at the same time, states are severely cutting funds to local governments, forcing them to provide essential services from their dwindling coffers.<sup>2</sup> The mantra “do more with less” sounds good, but the reality is that many governments seem unable to cut spending or raise revenues sufficiently to meet their obligations.<sup>3</sup> Across the nation, many cities struggling to balance their budgets are considering bankruptcy as a solution to the problem.<sup>4</sup> Chapter 9 of the U.S. Bankruptcy Code provides relief to municipalities that can

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1. For the first time in history, Moody’s Rating Agency gave a negative outlook for the U.S. local government sector as a whole. Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 352 (2010).

2. For fiscal year 2010, 48 out of the 50 states “face[d] budget shortfalls,” totaling \$192 billion. Helen Avery, *Judgement Day Nears for the Benighted States*, EUROMONEY, Sept. 1, 2010; see also Ameet Sachdev, *Official: Municipal Bankruptcy Fears Overblown*, CHI. TRIB., Sept. 21, 2010, at 19 (“With states also financially strapped, lifelines to cities may dwindle and bankruptcy could become a more attractive option.”); Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633, 639 (2008).

3. Local governments rely on taxes for revenue, which are collected only once or twice a year. In order to fund projects and provide services that tax revenues cannot immediately fund, they issue municipal bonds. For an overview on why municipalities default on their debt obligations, see Kimhi, *supra* note 2, at 637–47.

4. Los Angeles’s former mayor suggested the city pursue bankruptcy in light of its fiscal woes. Rick Orlov, *City Budget Crisis Bankruptcy: L.A.’s Best Option? Council: Some Advocates Say Filing Would Allow for Pension, Benefits Reform*, DAILY NEWS (Los Angeles, Cal.), Apr. 11, 2010, at A1. Some city officials for Harrisburg, Pennsylvania have recommended the state capital file for bankruptcy to solve its budget deficit of \$164 million over the next five years. *Harrisburg in Crisis: A Burning Issue*, ECONOMIST, Mar. 20, 2010, at 70. Jefferson County, Alabama, encompassing the city of Birmingham, became the largest municipality in history to file for bankruptcy after a settlement deal for the County’s \$3.14 billion debt arising from a court-ordered sewer project fell through. Melinda Dickinson, *Alabama County Files Biggest Municipal Bankruptcy*, REUTERS, Nov. 10, 2011.

no longer meet their financial obligations.<sup>5</sup> Although it is a relatively rare phenomenon, several states, including Louisiana, have witnessed their cities and towns file for bankruptcy.<sup>6</sup>

Municipal bankruptcy is a drastic measure with significant consequences and thus should be considered only as a last resort.<sup>7</sup> Although bankruptcy can give a municipality temporary relief from debt, it can also result in long-term economic damage and adversely affect its neighboring cities or even the state as a whole.<sup>8</sup> Recognizing the gravity of these risks, the Louisiana Legislature enacted conservative legislation that imposes state approval requirements in addition to those set forth by federal law.<sup>9</sup> In order to file, the Louisiana State Bond Commission—comprised of numerous top state officials—must first approve the petition.<sup>10</sup> Even if bankruptcy is pursued as a last resort, these additional state

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5. Only Chapter 9 of the U.S. Bankruptcy Code is available to municipalities. 11 U.S.C. § 109(a) (2008).

6. In 1999, the Lower Cameron Parish Hospital Service District became the first and only Louisiana municipality to file for bankruptcy under Chapter 9. The hospital's chief executive officer stole over \$400,000 in hospital funds by fraudulently charging Medicare \$1.4 million in falsified medical services. The hospital subsequently owed Medicare \$8 million for the overpayments, but only had a liquidation value of \$160,000. The hospital district emerged from bankruptcy a year later, at which time the residents voted to lease the hospital to a private management company. See Mary Chris Jaklevic, *Ex-CEO Pleads Guilty to Medicare Fraud; La. Hospital Exec Faces Five Years in Prison for Bilking Medicare out of \$1.4 Million*, MODERN HEALTHCARE June 25, 2001, at 15; Mary Chris Jaklevic, *Bankrupt But Open: La. Hospital that Owes HCFA Millions Wins Reprieve*, MODERN HEALTHCARE Oct. 16, 2000, at 50.

7. See discussion *infra* Part III.B.2.

8. The main arguments against municipal bankruptcy are summarized by Christopher Smith, *Provisions for Access to Chapter 9 Bankruptcy: Their Flaws and the Inadequacy of Past Reforms*, 14 BANKR. DEV. J. 497, 521–22 (1998). See also discussion *infra* Part III.B.2.

9. LA. REV. STAT. ANN. § 13:4741 (2006); LA. REV. STAT. ANN. § 39:1410.64 (2005); see also discussion *infra* Part IV.C. Federal law requires the states to enact statutes specifically granting access to Chapter 9. 11 U.S.C. § 109(c)(2) (2006); see also discussion *infra* Part III.A.2. Louisiana enacted its municipal bankruptcy statute in 1935. LA. REV. STAT. ANN. § 13:4741 (2006). “Louisiana . . . ha[s] challenging approval requirements, specifically prohibiting Chapter 9 filings unless certain conditions are met.” Daniel J. Freyberg, *Municipal Bankruptcy and Express State Authorization to be a Chapter 9 Debtor: Current State Approaches to Municipal Insolvency—and What Will States Do Now?*, 23 OHIO N.U.L. REV. 1001, 1011 (1997).

10. The State Bond Commission is comprised of the State treasurer, governor, lieutenant governor, president of the senate, speaker of the house, secretary of state, attorney general, commissioner of administration, chairmen of the legislative fiscal committees and two legislators. LA. REV. STAT. ANN. § 39:1401(A) (2005).

approval requirements may present significant hurdles for Louisiana municipal governments to overcome.

This Comment argues that the State Bond Commission approval requirement is sound in theory but not in practice. Because municipal bankruptcy has significant political consequences, obtaining the State Bond Commission's approval may be virtually impossible. Moreover, there is a more qualified person, with fewer political motivations and a more comprehensive understanding of the municipality's predicament who can decide which filings to approve. The fiscal administrator—who is appointed to manage a municipality's financial affairs during a fiscal crisis—is that person. This Comment posits that giving the fiscal administrator filing approval authority will make the management of municipal financial crises more efficient and effective and will ensure that bankruptcy is pursued only as a last resort.

Part II begins with a discussion of national and local trends in municipal bankruptcy. Part III provides a general overview of Chapter 9 of the U.S. Bankruptcy Code with an analysis of the pros and cons of the process. Part IV describes Louisiana's laws on municipal debt, fiscal administration, and bankruptcy authorization. Part V explores the positive and negative aspects of the current legislation. Following this analysis, Part VI recommends amending Louisiana's legislation to authorize the fiscal administrator to approve a Chapter 9 filing and establishing statutory guidelines to assist the fiscal administrator in this decision. As a result of these modifications, this Comment envisions a more predictable and streamlined bankruptcy process for the municipalities of Louisiana.

## II. WILL IT BE A CATEGORY I OR CATEGORY V HURRICANE?

### A. *An Almanac of Municipal Bankruptcy*

Approximately 600 municipalities have filed for Chapter 9 bankruptcy since 1937.<sup>11</sup> Of those cases, some of the most publicized involved California municipalities.<sup>12</sup> In 2009, the city of

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11. Compared with the 15,000 Chapter 11 bankruptcy filings in 2009 alone, municipal bankruptcies are relatively rare. Matt Miller, *Taboo: Chapter 9*, THE DEAL (Mar. 19, 2010, 2:00 PM), <http://www.thedeal.com/newsweekly/2010/03/taboo:-chapter-9/>.

12. The most famous Chapter 9 proceeding involved Orange County, California. *In re Cnty. of Orange*, 183 B.R. 594 (Bankr. C.D. Cal. 1995). In 1994, the County made headlines after its treasurer's high-risk investment scheme failed due to rising interest rates. The County filed for Chapter 9 with

Vallejo became the largest California city to file for Chapter 9 after it failed to meet its financial obligations.<sup>13</sup> Facing \$10 million in debt as a result of unsustainable government employee pension agreements and a debilitated tax base due to residential foreclosures, city officials felt bankruptcy was the *only* remaining option.<sup>14</sup> The City's debt counselor conceded that "Vallejo's finances were so bad and its reserves so exhausted that city officials ran the danger of violating the law had it not filed."<sup>15</sup> Unfortunately, Vallejo's problems worsened after its discharge from bankruptcy. Unable to rehabilitate its image or quell concerns of future insolvency, the City suffered an exodus of businesses and residents, which has stymied its financial recovery.<sup>16</sup> Recognizing the adverse consequences of municipal bankruptcy, the California Legislature considered an amendment to restrict access to Chapter 9 bankruptcy in the 2010 regular session.<sup>17</sup>

Although large cities like Vallejo tend to garner the most media attention, small municipalities, such as utilities and school boards,

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more than \$1.7 billion in debt. In 1996, the court approved the debt readjustment plan, which called for the County to repay a more manageable, reduced portion of its debts. After six years of litigation, the County emerged from bankruptcy and has regained a respectable bond rating. *See A Sobering Event: County's Bankruptcy Filing Rattles Bond Market*, NATION'S CITIES WEEKLY, Dec. 12, 1994, at 1; Jennifer Grzeskowiak, *Chapter 9 Bankruptcy is No Easy Option*, AMERICAN CITY & COUNTY (Apr. 21, 2010); Jay Reeves, *Alabama County on the Ropes: Biggest Municipal Bankruptcy Looms*, FLINT JOURNAL, Aug. 6, 2008, at 1; Keeok Park, *To File or Not to File: The Causes of Municipal Bankruptcy in the United States*, J. PUB. BUDGETING, ACCT. & FIN. MGMT., July 1, 2004, at 228.

13. Avery, *supra* note 2; *see also* In re City of Vallejo, 403 B.R. 72 (Bankr. E.D. Cal. 2009), *aff'd*, 432 B.R. 262 (E.D. Cal. 2010). Vallejo has a population of 120,000 and is located across the bay from San Francisco. Bob Adelman, *Conjuring Magic to Cover States' Debts Fiscal Reality Sets In: State, Unlike the Federal Government, Cannot Print Money to Cover Their Debts, But...*, NEW AMERICAN, Aug. 30, 2010, at 10.

14. J.M. Brown & Sarah Rohrs, *Bankruptcy Good for City, Some Saying: Mortgage Crisis, Wal-Mart's Departure Blamed for Woes that Could Leave Many Out of Work*, CONTRA COSTA TIMES (Walnut Creek, Cal.), Feb. 23, 2008, at A3.

15. Miller, *supra* note 11.

16. Avery, *supra* note 2.

17. Rich Saskal, *Clock Runs Out on California Bills*, BOND BUYER, Sept. 2, 2010, at 1. In 2010, California was the lowest-rated State in the union with ratings of A- by Standard & Poor, Baa1 by Moody's, and BBB by Fitch. *Here's another 'I Told 'Ya so' for the Muni Buyers*, PHIL'S STOCK WORLD (Mar. 11, 2010), <http://www.philstockworld.com/2010/03/11/hers-another-i-told-ya-so-for-the-muni-buyers/>.

actually account for the majority of Chapter 9 filings.<sup>18</sup> For example, Connector 2000, a South Carolina non-profit transportation district financing the construction of a toll road, filed for Chapter 9 in 2010 after toll revenues fell significantly short of expectations.<sup>19</sup> The municipality faced almost \$369 million in bond debt at the time of filing.<sup>20</sup> Although cases involving small municipalities like Connector 2000 are more likely to arise, they are still considered anomalies in the bankruptcy world. Of the 1.6 million bankruptcy cases filed nationwide in the 2010 fiscal year, only 12 were under Chapter 9.<sup>21</sup> However, there has been an overall increase in municipal bankruptcies, especially in the last five years.<sup>22</sup> In 2009, seven municipalities filed for bankruptcy, up from four in 2008.<sup>23</sup> Although these numbers may seem insignificant at first glance, when one considers the impact that a single municipal bankruptcy can have on a population, the numbers should not be casually dismissed.<sup>24</sup>

### *B. The Financial Forecast*

Connector 2000 and Vallejo illustrate the effects of the souring economy that have led financial analysts and economists to speculate that municipal bankruptcies will soon spike.<sup>25</sup> Indeed, the media finds the mere mention of the word “bankruptcy”

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18. Most municipalities that file for Chapter 9 are relatively small. The median population size of municipalities that filed between 1976 and January 2009 was about 1,000. Kimhi, *supra* note 1, at 360.

19. Michael Bathon & Dawn McCarty, *Connector 2000 Association Files Bankruptcy in South Carolina*, BLOOMBERG BUSINESSWEEK, June 25, 2010; Patrick Temple-West, *Chap. 9 Plan in S.C. Hits Pothole*, BOND BUYER, Aug. 16, 2010, at 1.

20. See Temple-West, *supra* note 19.

21. Sachdev, *supra* note 2, at 18.

22. JUDICIAL BUSINESS OF THE U.S. COURTS, 2009 ANNUAL REPORT OF THE DIRECTOR 24 (2009), available at <http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2009/JudicialBusinesspdfversion.pdf>.

23. *Id.*

24. Municipal bond defaults rose from \$329 million in 2007 to over \$7.5 billion in 2008. William M. VanDenburgh, Philip J. Harmelink & Edward M. Werner, *Reevaluating State-Specific Muni Bond Funds*, CPA JOURNAL, Feb. 1, 2010, at 56; see also discussion *infra* Part III.B.

25. Moody's Investors Service released a report in 2009 that called into question the credit quality of all local governments. The rating agency predicted increased negative ratings for municipal bonds throughout the country. VanDenburgh, Harmelink & Werner, *supra* note 24; see also Peter Benvenutti, et al., *An Overview of Chapter 9 of the Bankruptcy Code: Municipal Debt Adjustments*, MONDAQ BLOG (Aug. 23, 2010), <http://www.mondaq.com/unitedstates/article.asp?articleid=108258>.

newsworthy.<sup>26</sup> With the media speculating as to possible bankruptcies in Los Angeles<sup>27</sup> and Detroit,<sup>28</sup> and in light of Jefferson County's recent filing,<sup>29</sup> it is hard not to be concerned about the possibility of widespread governmental bankruptcy. Although analysts concede that there may not be significant increases in Chapter 9 filings in the next few years, they argue the perfect storm is looming just off the radar.<sup>30</sup> This imminent disaster is the estimated \$1 trillion in unfunded public pension liabilities that municipalities nationwide have amassed.<sup>31</sup> Unlike private pensions, public pensions are not federally regulated nor are they guaranteed.<sup>32</sup> As a result, municipalities have been "left in a largely unregulated vacuum, free to make their own choices" about how to fund and pay these benefits.<sup>33</sup> There is a growing concern that local governments will fail to pay their retired workers the pensions they were promised and that the only way to avoid paying them will be to declare bankruptcy.<sup>34</sup>

Despite the media attention, there are others who doubt the possibility of widespread Chapter 9 filings.<sup>35</sup> For example, some municipal bond brokers and analysts have concluded that given the stigma associated with bankruptcy, municipalities will file only as a last resort.<sup>36</sup> They conclude there is simply too much at risk politically. Local government officials "are slow to solve these

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26. Before a municipality even files for Chapter 9, the media is quick to speculate that such a filing will in fact occur. *See, e.g.*, Sharon Smith, *Bankruptcy, 'Option of Last Resort,' Might Not Hurt Harrisburg*, PATRIOT-NEWS (Harrisburg, Pa.), Sept. 19, 2010, [http://www.pennlive.com/midstate/index.ssf/2010/09/bankruptcy\\_option\\_of\\_last\\_reso.html](http://www.pennlive.com/midstate/index.ssf/2010/09/bankruptcy_option_of_last_reso.html); Orlov, *supra* note 4 at A1.

27. Orlov, *supra* note 4, at A1.

28. Nancy Kaffer, *Chapter 9 Among Detroit's Few Options: Budget Crisis Puts City in Danger of Bankruptcy*, CRAIN'S DETROIT BUS., Apr. 12, 2010, at 17.

29. Dickinson, *supra* note 4.

30. James Chatz & Marc S. Zaslavsky, *Pension Reform – The Time has Come, The Time is Now*, MONDAQ BLOG (Sept. 3, 2010), <http://www.mondaq.com/unitedstates/article.asp?articleid=109316>; Gus Lubin, *And Now, Here's the First 11 State Pension Funds That Will Run Out of Money*, BUS. INSIDER, (Oct. 18, 2010), <http://www.businessinsider.com/the-state-pension-funds-in-the-most-trouble-2010-10#6-louisiana-6>.

31. Some estimate the deficit to be as high as \$4 trillion. Benvenutti, et al., *supra* note 25.

32. *Id.*

33. *Id.*

34. Miller, *supra* note 11 (quoting James Berman, debtor counsel for Bridgeport, Connecticut); *see also* Adelman, *supra* note 13, at 10.

35. Luke Baker, et al., *Municipal Bankruptcy: Chapter 9*, WELLS FARGO BANK (Feb. 22, 2010), <http://www.davieswealthms.com/new/daviesfinancial/WF.%20Municipal%20Bankruptcy.%202-22-10.pdf?advisorid=331384>.

36. Eric Young, *Panel: Cities Cut More But Won't Go Bust*, S. F. BUS. TIMES, Mar. 10, 2010.

problems because that would call attention to themselves as bad decision makers.”<sup>37</sup> Instead of bankruptcy, analysts argue that municipalities will continue to make drastic budget cuts and raise taxes to meet rising debt obligations.<sup>38</sup> But there is a point at which the municipality cannot legally cut any more expenses or raise taxes any higher.<sup>39</sup>

*C. Bankruptcy on the Bayou? Municipal Bankruptcy Trends in Louisiana*

Unfortunately, Louisiana is not immune from the economic threat demonstrated by national trends. Numerous Louisiana municipalities have experienced significant financial emergencies as a result of government mismanagement, fraud, large monetary tort judgments, and natural disasters.<sup>40</sup> Although only one Louisiana municipality, a rural Cameron Parish hospital district, has actually completed a Chapter 9 bankruptcy proceeding, several other requests to file were either subsequently withdrawn or rejected by the State.<sup>41</sup>

In 2005, Louisiana suffered “devastation unprecedented in modern U.S. history.”<sup>42</sup> Hurricanes Katrina and Rita collectively

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37. Miller, *supra* note 11 (quoting Jeffrey Cohen, a Denver-based partner at Patton Boggs LLP).

38. See Young, *supra* note 36.

39. See discussion *infra* Part III.B.2.

40. St. Landry Parish faced a financial crisis after local officials failed to make necessary but unpopular budget cuts. See Donald Yacoe, *St. Landry Parish, La., to Meet Payments on Debt, Despite Being Near Insolvency*, BOND BUYER, Feb. 19, 1992, at 2; see also discussion *infra* Part VI.C. The Orleans Parish School Board faced similar fiscal woes due to a “combination of ineptitude and theft.” Editorial, *Taking Control*, TIMES-PICAYUNE (New Orleans), Apr. 5, 2003, at 6. The Orleans Parish District Attorney’s Office asked the State to file for Chapter 9 after a \$15 million judgment was cast against it. See Allen M. Johnson, Jr., *Orleans DA Seeks State OK to File for Bankruptcy*, ADVOCATE (Baton Rouge, La.), Jan. 6, 2009, at B2; see also discussion *infra* Part VI.C. Following Hurricane Katrina, many Louisiana municipalities had uncertain financial futures. See BUREAU OF GOV’T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., MUNICIPAL BANKRUPTCY IN PERSPECTIVE 1 (2006).

41. The Lower Cameron Parish Hospital Service District filed for Chapter 9 bankruptcy in 1999. See Jaklevic, *supra* note 6. The Orleans Parish District Attorney’s Office requested to file after a \$15 million judgment was rendered against it; but it later withdrew its request. Jim Watts, *New Orleans District Attorney Withdraws Bankruptcy Petition*, BOND BUYER, Jan. 12, 2009, at 4; see also discussion *infra* Part VI.C. Tangipahoa Parish’s request to file was rejected by the State in 1988. Yacoe, *supra* note 40, at 2.

42. BUREAU OF GOV’T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., *supra* note 40, at 1.



damaged or destroyed over 200,000 residences, ruined over 18,000 businesses, and displaced over 422,000 citizens.<sup>43</sup> Local governments were forced to shoulder the enormous burden of paying debts, providing services, and rebuilding infrastructure despite having lost a significant portion of their tax bases.<sup>44</sup> Extended emergency federal funding prevented numerous municipalities teetering on the brink of bankruptcy from becoming insolvent.<sup>45</sup> This federal support compensated for the obliterated tax bases and allowed Louisiana and its municipalities to survive the disaster.<sup>46</sup> In fact, Louisiana experienced unprecedented budget growth as a result of recovery spending.<sup>47</sup>

Although Louisiana's financial situation appears to have stabilized, it is uncertain whether these recent budgetary gains can be sustained. Indeed, the Public Affairs Research Council of Louisiana, analyzing U.S. Census Bureau data, concluded the gains will be short-lived.<sup>48</sup> This means that, because the budget increases are merely a consequence of federal relief for an unprecedented environmental disaster, the economic future of Louisiana is not necessarily as secure as current budgetary numbers reflect.<sup>49</sup> Louisiana municipalities experiencing economic hardships in the future probably will not get this kind of federal funding to avoid insolvency.

Adding to the uncertainty is the fact that Louisiana is predicted to exhaust its public pension fund in the next ten years.<sup>50</sup> By 2020, economists predict the pension bill to be \$4.3 billion, or 27% of the State revenue.<sup>51</sup> The pension fund will be depleted unless the government can raise enough revenue to meet the rising costs.<sup>52</sup> As a result, the State may no longer be able to supplement municipal budgets or provide economic relief during crises. If they are unable to operate without state financial assistance, bankruptcy may be an

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43. *Id.*

44. *Id.* Then-governor Kathleen Blanco stated, "I don't think that we've seen a catastrophic event like this before where local governments were completely devastated and in some cases lost their entire tax base." Jennifer Medina & Christine Hauser, *Storm and Crisis: New Orleans; Local Governments Face Bankruptcy, Layoffs or Both*, N.Y. TIMES, Oct. 4, 2005, at A17.

45. JENNIFER PIKE, PUB. AFFAIRS RESEARCH COUNCIL OF LA., STATE AND LOCAL REVENUE AND SPENDING: HOW LOUISIANA COMPARES POST-KATRINA 2 (2010).

46. *Id.*

47. *Id.*

48. *Id.* at 8.

49. *Id.*

50. Lubin, *supra* note 30.

51. *Id.*; see also Avery, *supra* note 2.

52. Lubin, *supra* note 30.

option that Louisiana's municipalities will have to consider. A critical look at both Louisiana's municipal bankruptcy laws and Chapter 9 of the U.S. Bankruptcy Code is thus warranted.

### III. THE FEDERAL "LEVEE": CHAPTER 9 OF THE U.S. BANKRUPTCY CODE

#### A. Chapter 9: An Overview

##### 1. A Brief History

In 1934, Congress enacted Chapter 9 of the U.S. Bankruptcy Code to give court protection for financially distressed municipalities while allowing them to adjust their debts in a manner which enables them to continue providing essential public services.<sup>53</sup> That year, municipalities throughout the nation struggled to maintain fiscal health as a result of the Great Depression.<sup>54</sup> By 1936, over 2,000 municipalities had defaulted on their obligations.<sup>55</sup> Congress originally envisioned the legislation as a temporary solution, but before municipalities could take advantage of the law, the Supreme Court ruled it was unconstitutional as a violation of state sovereignty.<sup>56</sup> In 1937, Congress successfully redrafted the legislation to avoid violating the Tenth Amendment.<sup>57</sup> However, the law remained virtually untouched until the 1970s when the city of New York experienced

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53. See Park, *supra* note 12; see also Melanie Cyganowski, *Guest Words: Muni World Needs to Grasp the Basics of Chapter 9*, BOND BUYER, Aug. 30, 2010, at 6.

54. See Freyberg, *supra* note 9, at 1002.

55. *Ashton v. Cameron Cnty. Water Improvement Dist.*, 298 U.S. 513, 533–34 (1936), (Cardozo, J., dissenting).

56. In reaching its conclusion, the Court reasoned that:

If federal bankruptcy laws can be extended to [a municipality], why not to the state? If voluntary proceedings may be permitted, so may involuntary ones, subject, of course, to any inhibition of the Eleventh Amendment. If the state were proceeding under a statute like the present one, with terms broad enough to include her, apparently the problem would not be materially different. Our special concern is with the existence of the power claimed—not merely the immediate outcome of what has already been attempted. And it is of the first importance that due attention be given to the results which might be brought about by the exercise of such a power in the future.

*Id.* at 530 (citations omitted); see also U.S. CONST. amend. X (“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”).

57. *U.S. v. Bekins*, 304 U.S. 27, 54 (1938); see also Freyberg, *supra* note 9, at 1003–4.

an extreme financial crisis.<sup>58</sup> To make it easier for large cities like New York to utilize Chapter 9, Congress amended the laws to remove the requirement that 51% of a municipality's creditors must agree on the debt readjustment plan.<sup>59</sup> Despite this change and others, very few municipalities have filed for bankruptcy to date.<sup>60</sup> This is due in part to the decision of most states to restrict or forbid access to Chapter 9.<sup>61</sup>

## 2. Requirements for Filing

To file a bankruptcy petition under Chapter 9, a municipality must meet five statutory requirements.<sup>62</sup> First, the entity must qualify as a municipality, defined in the Code as a "political subdivision or public agency or instrumentality of a State."<sup>63</sup> Second, the municipality must demonstrate its insolvency.<sup>64</sup> The Code describes "insolvency" as the municipality "generally not paying its debts as they become due" or its inability "to pay its debts as they become due."<sup>65</sup>

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58. See Freyberg, *supra* note 9, at 1004.

59. ROBIN JEWELER, CONG. RESEARCH SERV., RL 33924, MUNICIPAL REORGANIZATION: CHAPTER 9 OF THE U.S. BANKRUPTCY CODE 3 (2007). A large municipality like New York City generally has hundreds, if not thousands of creditors. It could hardly be expected to successfully negotiate with a majority of its creditors. "Thus, the primary relief generally sought by a debtor—the breathing spell from its importuning and litigious creditors provided by the bankruptcy automatic stay—was unavailable when needed most by the beleaguered city." COLLIER ON BANKRUPTCY ¶ 900.LH (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011).

60. See Freyberg, *supra* note 9 at 1004. Only about 600 municipalities have filed for Chapter 9 bankruptcy since 1937. Miller, *supra* note 11.

61. See Smith, *supra* note 8, at 499.

62. 11 U.S.C. § 109(c) (2006).

63. 11 U.S.C. § 101(40) (2006). Because the Code does not further define what entities are included within these terms, the courts have concluded that an entity is a "municipality" if it is subject to the control of state or municipal public authority. See, e.g., *In re Las Vegas Monorail Co.*, 429 B.R. 317, 323 n.1 (Bankr. D. Nev. 2010) (rejecting a claim by the bond insurer that the company was a municipality and therefore not entitled to Chapter 11 proceedings). States have likewise crafted their own statutory definitions in accordance with the jurisprudential guidance. See Park, *supra* note 12; Smith, *supra* note 8, at 516.

64. 11 U.S.C. § 109(c)(3) (2006).

65. 11 U.S.C. § 101(32)(C) (2006). This imprecise language requires courts to make tough decisions as to whether the municipality filing under Chapter 9 is truly insolvent. For example, during initial bankruptcy proceedings for the city of Bridgeport, Connecticut, the court found the City was not insolvent because it had not exhausted its assets and was simply speculating as to its insolvency. *In re City of Bridgeport*, 129 B.R. 332, 338 (Bankr. D. Conn. 1991).

Third, in order to avoid a violation of state sovereignty, each state must statutorily authorize its municipalities to file for Chapter 9.<sup>66</sup> Today, over half of the states do not have statutes granting their municipalities access to federal bankruptcy court.<sup>67</sup> Only one state, Georgia, explicitly forbids its municipalities from filing for bankruptcy.<sup>68</sup> The remaining states have statutes that range widely in permissiveness. Some allow their municipalities free access to the courts, while others require the approval of various state officials before filing.<sup>69</sup> Louisiana falls on the restrictive end of the spectrum, requiring approval from the State Bond Commission before a municipality can file a petition in bankruptcy court.<sup>70</sup>

The fourth and fifth requirements are designed to promote good faith on the part of the municipality.<sup>71</sup> The fourth requirement is that the municipality must “desire[] to effect a plan to adjust [its] debts.”<sup>72</sup> Basically, this condition ensures the municipality is not simply evading its creditors or buying time to repay its debts.<sup>73</sup> The fifth requirement imposes an obligation on the municipality to attempt to negotiate a debt readjustment plan with its creditors.<sup>74</sup>

If the municipality meets these requirements, it can file a petition, accompanied by a list of its creditors and a proposed debt reorganization plan.<sup>75</sup> If the court accepts the petition, an automatic stay becomes effective, which prevents the collection of any of the

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66. 11 U.S.C. § 109(c)(2) (2006). The legislation was amended in 1994 to address the disagreement as to whether a municipality required express permission to file or if simply not being prohibited from doing so was sufficient. Congress ended the debate by requiring specific authorization by states. *See* Freyberg, *supra* note 9, at 1006–09.

67. *See* Freyberg, *supra* note 9, at 1008–9, nn. 66–70.

68. GA. CODE ANN. § 36-80-5 (Westlaw 2011).

69. *See* Freyberg, *supra* note 9, at 1008–16.

70. LA. REV. STAT. ANN. § 13:4741 (2006); LA. REV. STAT. ANN. § 39:1410.64 (2005).

71. 11 U.S.C. § 109(c)(4) (2006); 11 U.S.C. § 109(c)(5) (2006).

72. 11 U.S.C. § 109(c)(4) (2006).

73. COLLIER ON BANKRUPTCY ¶ 900.02(2)(d) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011).

74. 11 U.S.C. § 109(c)(5) (2006). There are four possible negotiation scenarios contemplated by the legislation. First, and most ideally, the municipality will successfully negotiate a debt plan with its creditors. Second, in the event that the municipality does not obtain the consent of its creditors, as long as it has negotiated in good faith, the municipality will be able to submit its plan. Third, if the court deems negotiations to be impracticable, then the municipality does not have to obtain creditor consent. Finally, if the municipality reasonably believes it will reach an agreement with its creditors during the bankruptcy proceeding, the court will accept the municipality’s petition. COLLIER ON BANKRUPTCY ¶ 900.02(2)(e) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011).

75. 11 U.S.C. § 941 (2006).

municipality's debt obligations during the court proceedings.<sup>76</sup> Once the court confirms the final debt readjustment plan, the municipality is discharged from bankruptcy.<sup>77</sup>

### *B. Pros and Cons of Chapter 9*

Although Chapter 9 can provide hope to a municipality that cannot meet its debt obligations using conventional methods, it also brings a host of potential adverse consequences that can affect not only the municipality, but also its neighboring cities and the state. For this reason, a municipality should carefully weigh all of its options before choosing bankruptcy.

#### *1. Benefits of Chapter 9*

The automatic stay of Chapter 9 is perhaps its greatest benefit.<sup>78</sup> All collection actions, including those by the municipality's own officials and residents, are suspended once the court accepts its petition.<sup>79</sup> This affords some breathing room within which municipal officials can effectively reorganize the debt.<sup>80</sup> Another benefit of Chapter 9 is that only one class of creditors needs to approve the proposed debt readjustment plan for the court to confirm it.<sup>81</sup> As long as the plan is "fair and equitable" and one class of creditors accepts it, the judge can "cram down" the plan onto all other creditors.<sup>82</sup> Thus the tables are turned on the creditors who are now in a relatively weaker bargaining position than the municipality.

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76. 11 U.S.C. § 922 (2006).

77. 11 U.S.C. § 945 (2006).

78. Although the automatic stay is an established element of Chapter 9, one of Vallejo's creditors filed a motion in 2010 to counter the automatic stay. The creditor argued that revenue from the city's credit enhancement program (motor vehicle fees) should go to the bondholders, not the municipality. Maureen Nevin Duffy, *One Towns [sic] Bankruptcy Could Spread to Bond Market*, INSTITUTIONAL INVESTOR, Sept. 1, 2010.

79. 11 U.S.C. § 922 (2006).

80. See JEWELER, *supra* note 59, at 6.

81. *Id.* at 9. A "class of creditors" is a group of creditors entitled to similar treatment in a bankruptcy case.

82. The statute provides that:

[I]f all of the applicable requirements . . . are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan . . . if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

11 U.S.C. § 1129(b)(1) (2006). Chapter 9 incorporates the "cram down" provision of Chapter 11. See 11 U.S.C. § 901(a) (2006).

As a result of Tenth Amendment considerations, the municipality also retains significant governing powers for the duration of a Chapter 9 proceeding.<sup>83</sup> Most significantly, there is no provision for a liquidation of its assets.<sup>84</sup> As a result, the court cannot force a municipality to sell its police car or fire truck inventory in order to pay its debts.<sup>85</sup> Because a municipality must provide basic safety and health services both during and after the bankruptcy proceeding, it would be nonsensical to liquidate the very assets needed to provide such services. Furthermore, the municipality can raise taxes and take on additional loans as administrative expenses, which is particularly useful if it has no remaining assets.<sup>86</sup> Finally, as opposed to a Chapter 11 proceeding where the judge controls most aspects of a business's affairs, the court has a relatively hands-off role in a Chapter 9 proceeding.<sup>87</sup> The presiding judge's duties consist of approving the initial petition, confirming the proposed debt readjustment plan, and overseeing the implementation of the approved plan.<sup>88</sup> If the new debt plan cannot be implemented or confirmed, the court does not have any power to force it upon the municipality.<sup>89</sup>

## 2. Possible Adverse Effects of a Chapter 9 Proceeding

Although Chapter 9 provides significant benefits to a struggling municipality, there are counterbalancing effects it should consider. First, bankruptcy can be the worst neighborhood eyesore imaginable.<sup>90</sup> Given the choice, most people would not choose to live in a failing city.<sup>91</sup> For example, many of the citizens and businesses of Vallejo, California left town as a result of the City's bankruptcy.<sup>92</sup> The City is now offering guided bus tours of foreclosed homes to anyone with a loan pre-qualification letter and

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83. See Freyberg, *supra* note 9, at 1001; see also JEWELER, *supra* note 59, at 2–3, 7.

84. COLLIER ON BANKRUPTCY ¶ 900.01(1) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011).

85. *Id.*

86. *Id.* at ¶ 900.01(2); see also Grzeskowiak, *supra* note 12 (quoting Dan Miller, City Controller of Harrisburg, Pennsylvania, who opined that bankruptcy is a better option in the long-term because the city can retain revenue-producing assets).

87. *Id.* at ¶ 900.01(2)(c).

88. *Id.* at ¶ 900.01(1); Kimhi, *supra* note 1, at 375.

89. *Id.* at ¶ 900.01(1).

90. Kimhi, *supra* note 1, at 382.

91. *Id.* at 352; Lyndee Kemmet, *Detroit Should Avoid Bankruptcy*, DETROIT NEWS, Sept. 9, 2009, at A15.

92. See Avery, *supra* note 2.

a driver's license.<sup>93</sup> This is a terrible scenario for Vallejo; however, the alternative option may not have yielded much better results. Municipal governments can raise taxes and cut services, but there is a point at which this course of action becomes counterproductive. Residents and businesses may choose to relocate to more affordable areas, which will then decrease the municipality's tax base.<sup>94</sup>

Many analysts also argue that bankruptcy will cause irreversible damage to a municipality's bond rating and ability to obtain future credit.<sup>95</sup> In 2010, Fitch Ratings threatened to downgrade the credit rating of municipalities that even *discussed* a Chapter 9 option.<sup>96</sup> Furthermore, a Chapter 9 filing may also adversely affect neighboring cities and the state as a whole.<sup>97</sup> Because a state is strongly tied to its municipalities' financial management, the failure of one city could make the entire state look fiscally incompetent.<sup>98</sup> Indeed, the bond rating agencies also threatened to downgrade the state's credit rating if any of its municipalities file for Chapter 9.<sup>99</sup> This contagion effect is a significant concern of state officials nationwide.<sup>100</sup>

Although a bankruptcy proceeding will probably degrade a municipality's bond rating in the short term,<sup>101</sup> there is no proof it will significantly affect a municipality's ability to obtain loans in the future.<sup>102</sup> In fact, there are examples that indicate the opposite

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93. *Id.*

94. Kimhi, *supra* note 2, at 658. The municipality's tax base is its primary source of revenue. *See supra* note 3.

95. *See* Kimhi, *supra* note 1, at 383–4.

96. *See* Benvenuti, et al., *supra* note 25, at 1. A downgraded credit rating may prevent the municipality from obtaining future loans, bond insurance, and reasonable interest rates. Miller, *supra* note 11.

97. *See* Kimhi, *supra* note 1, at 382–3; Smith, *supra* note 8, at 521.

98. Interview with John Kennedy, Louisiana State Treasurer, in Baton Rouge, La. (Sept. 10, 2010).

99. *See* Kimhi, *supra* note 1, at 383.

100. The chief economist for the Los Angeles County Economic Development Corporation stated that “[d]eclaring bankruptcy would be horrible for the city, horrible for L.A. County and horrible for all of Southern California.” Orlov, *supra* note 4, at A1. A senior research analyst at the Michigan Citizens Research Council opined that a Chapter 9 proceeding would have a domino effect on all local governments, causing them to have more difficulty selling bonds and accessing the credit markets. Kaffer, *supra* note 28, at 17.

101. Grzeskowiak, *supra* note 12; Carolyn Okomo, *Teaching Detroit Educators a Fiscal Lesson*, DAILY DEAL, Aug. 5, 2009 (arguing that filing for Chapter 9 would cause short term damage to the city's bond rating).

102. *See* Benvenuti, et al., *supra* note 25, at 9.

result.<sup>103</sup> For instance, Orange County, California obtained a respectable AA rating within months of its bankruptcy.<sup>104</sup> Such cases suggest the credit markets are receptive to municipalities that have successfully rehabilitated themselves following a Chapter 9 proceeding.<sup>105</sup>

Inarguably, a Chapter 9 proceeding itself is very expensive and can drain precious remaining municipal assets.<sup>106</sup> The debtor counsel for the small town of Westfall, Pennsylvania opined that despite being a debtor in perhaps the most straightforward Chapter 9 case imaginable (there was only one creditor and no subsequent appeal) the town was charged over \$600,000 in attorney and accountant fees.<sup>107</sup> Bankruptcy proceedings involving large municipalities with multiple creditors and subsequent appeals would surely dwarf that sum.<sup>108</sup>

There are good reasons why most economists and scholars say bankruptcy should be an option of last resort.<sup>109</sup> It is very expensive and can cause short-term damage to the economic reputation of the municipality, as well as the state as a whole.<sup>110</sup> However, despite these drawbacks, Chapter 9 has numerous benefits and can be the saving grace for a municipality in distress. If denied the opportunity to file for bankruptcy, the municipality's problems will not go away on their own. The local government will be forced to raise taxes and cut services excessively, which

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103. Orange County obtained a high bond rating shortly after being discharged from bankruptcy. *See* Benvenuti, et al., *supra* note 25, at 9. In Louisiana, the sole municipality to go bankrupt under Chapter 9 received approval from the State for loans within a few years after its proceeding. Press Release, La. Dep't of the Treasury, State Treasurer John Kennedy Announces Statewide Bond Commission Approvals (Oct. 20, 2006), *available at* <http://www.treasury.state.la.us/> (select "News Room," then select "Press Releases").

104. *See* Miller, *supra* note 11. Orange County's bond rating continued to improve to Aaa, the highest rating given by Moody's Investor Services. Benvenuti, et al., *supra* note 25, at 9.

105. *Id.* at 10.

106. *See* J. Gregg Miller, *Pros and Cons of Chapter 9 Bankruptcy*, PENNLIVE.COM (May 16, 2010), [http://www.pennlive.com/editorials/index.ssf/2010/05/pros\\_and\\_cons\\_of\\_chapter\\_9\\_ban.html](http://www.pennlive.com/editorials/index.ssf/2010/05/pros_and_cons_of_chapter_9_ban.html).

107. *Id.*

108. The City of Vallejo had over \$7 million in fees following its Chapter 9 proceeding. Avery, *supra* note 2.

109. *See, e.g.*, Benvenuti, et al., *supra* note 25, at 1; ERIC MONTARTI, ALLEGHENY INSTITUTE FOR PUBLIC POLICY, CHAPTER 9 BANKRUPTCY: WHAT IT MEANS FOR PENNSYLVANIA'S MUNICIPALITIES 2, 4 (2009); Ryan Preston Dahl, *Collective Bargaining Agreements and Chapter 9 Bankruptcy*, 81 AM. BANKR. L. J. 295, 322, 336 (2007).

110. *See* discussion *supra* Part III.B.2.



can have a deleterious effect on its neighboring cities and the state.<sup>111</sup> Therefore, it is prudent to make municipal bankruptcy a viable option for municipalities that have no other feasible course of action left.

#### IV. THE STATE “LEVEE”: LOUISIANA’S LAWS ON DEBT AND BANKRUPTCY

Louisiana enacted a series of laws designed to prevent local government fiscal crises from arising and to help manage such emergencies when they do occur. The State is involved in every step of the municipal financial management process—from creating a budget to filing for bankruptcy. The current legislation has been relatively effective as demonstrated by respectable bond ratings and a dearth of municipal bankruptcies.<sup>112</sup>

##### A. Budget and Debt Requirements

Louisiana municipalities have a statutory obligation to maintain a balanced budget.<sup>113</sup> The State considers fiscal responsibility so important that it has imposed criminal penalties on local government officials that knowingly or intentionally violate the balanced budget requirement.<sup>114</sup> Thus from the outset,

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111. See discussion *infra* Part V.C.4.

112. See BUREAU OF GOV'T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., *supra* note 40, at 4; see also *Credit Ratings of the State of Louisiana*, MOODY'S, <http://www.moodys.com/credit-ratings/Louisiana-State-of-credit-rating-600024555> (last visited Nov. 8, 2011) (Louisiana had a credit rating of Aa1 and a “stable” outlook).

113. LA. REV. STAT. ANN. § 39:746 (2005) (“The amount so borrowed by any parish or municipality shall in no case exceed the estimated income of the parish or municipality as shown by the budget adopted prior to such time, and the tax income collected as shown by the budget shall be dedicated and set aside to the payment of the certificates of indebtedness as they mature.”); see also LA. REV. STAT. ANN. § 39:1305(E) (2005 & Supp. 2011) (“The total of proposed expenditures shall not exceed the total of estimated funds available for the ensuing fiscal year.”).

114. LA. REV. STAT. ANN. § 39:1315 (2005) (“[A]ny public official or officer that violates, either knowingly or intentionally, the provisions of R.S. 39:1305(E), either through the adoption of an original budget or through amendment to a legally adopted budget, shall be a violation of R.S. 14:134 and shall be subject to the penalties contained therein.”); see also *Grant v. Grace*, 858 So. 2d 542, 544–5 (La. App. 1st Cir. 2003), *rev'd on other grounds*, 870 So. 2d 1011 (La. 2004) (“A recommendation by the chief of police to create new peace officer positions without adequate funding in the budget would contravene and impinge on the public duty and fiscal responsibility of the council to legislate a sound budget.”).

municipalities are responsible for forecasting estimated revenues and expenditures to ensure that the numbers balance.

To further ensure that municipalities maintain balanced budgets, the State Bond Commission must approve all municipal debt before it is incurred.<sup>115</sup> If approved, the State Bond Commission continually monitors the debt to ensure it is timely repaid.<sup>116</sup> Thus the State carefully scrutinizes and monitors all voluntarily incurred municipal debt. Municipalities, however, often incur involuntary debt as a result of natural disaster damage, court judgments, and fiscal mismanagement.<sup>117</sup> This kind of debt is usually unforeseeable and thus cannot be effectively predicted or prevented by the municipality.

### *B. Fiscal Crisis—Appointment of the Fiscal Administrator*

The Louisiana Legislature enacted several laws in 1990 that enable state intervention if a municipality's fiscal stability is in jeopardy.<sup>118</sup> Upon a showing that a local government cannot pay its debts, the state legislative auditor, attorney general, and treasurer will publicly convene to review the struggling municipality's financial situation.<sup>119</sup> If the three decide that revenues are insufficient to meet outstanding debts, the attorney general will file a rule to appoint a fiscal administrator to take over the local government's finances.<sup>120</sup> If the court finds that the local government is "reasonably certain to fail to make a debt service payment or reasonably certain to not have sufficient revenue to pay current expenditures," it will appoint a fiscal administrator.<sup>121</sup>

The newly appointed fiscal administrator investigates the financial situation of the municipality and reports his findings to the state treasurer, attorney general, and legislative auditor.<sup>122</sup> This written report contains the expected revenue and obligations for the remainder of the fiscal year, recommended amendments to the budget to ensure payment of the debt, the estimated deficit in the budget, and a recommendation of whether the local government

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115. LA. REV. STAT. ANN. § 39:1410.60 (2005 & Supp. 2011).

116. *State Bond Commission*, LA. DEP'T OF THE TREASURY, <http://www.treasury.state.la.us/Home%20Pages/BondCommission.aspx?@Filter=BC2010> (last visited Oct. 7, 2010).

117. See discussion *infra* Part VI.B.2.

118. LA. REV. STAT. ANN. § 39:1351-4 (2005 & Supp. 2011).

119. LA. REV. STAT. ANN. § 39:1351 (2005 & Supp. 2011).

120. The local government then has between 10 and 20 days to show cause why a fiscal administrator should not be appointed. *Id.*

121. *Id.*

122. LA. REV. STAT. ANN. § 39:1352 (2005 & Supp. 2011).

should be allowed to file for Chapter 9 bankruptcy.<sup>123</sup> A week after the local government receives the report, it must vote on the fiscal administrator's recommended budget changes.<sup>124</sup> If it fails to adopt the recommended changes, the attorney general must ask the court to compel the local government to accept them.<sup>125</sup> Once the new budget is enacted, the fiscal administrator monitors the municipality until he determines that it is fiscally healthy enough to meet its obligations for the current and upcoming years.<sup>126</sup> At that point, the attorney general, local government officials, or the fiscal administrator himself can move to terminate his appointment.<sup>127</sup>

### C. Fiscal Emergency—Access to Chapter 9 Bankruptcy

Although the local government may agree with the fiscal administrator's recommendation to pursue Chapter 9 bankruptcy, it does not have the power to file on its own volition.<sup>128</sup> The legislature enacted two statutes addressing bankruptcy filings to ensure that the petition is neither filed by the municipality nor accepted by the court without State approval.<sup>129</sup> The original statute enacted in 1937 concerns judicial procedure.<sup>130</sup> Louisiana Revised Statutes section 13:4741 forbids Louisiana bankruptcy courts from receiving a Chapter 9 petition from any "parish, municipality, political subdivision, public board or public corporation, taxing district, or other agency of the state" without written approval from the State Bond Commission.<sup>131</sup> In 1990, the

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123. *Id.*

124. LA. REV. STAT. ANN. § 39:1353 (2005 & Supp. 2011).

125. *Id.*

126. LA. REV. STAT. ANN. § 39:1354 (2005 & Supp. 2011).

127. *Id.*

128. LA. REV. STAT. ANN. § 39:1410.64 (2005).

129. LA. REV. STAT. ANN. § 13:4741 (2006 & Supp. 2011); LA. REV. STAT. ANN. § 39:1410.64 (2005).

130. LA. REV. STAT. ANN. § 13:4741 (2006 & Supp. 2011).

131. *Id.* Although Title 13 does not provide definitions for the included terms, the Louisiana Constitution clarifies the scope somewhat, as it defines "political subdivision" as "a parish, municipality, and any other unit of local government, including a school board and a special district, authorized by law to perform governmental functions." LA. CONST. art. VI, § 44(2). "Municipality" refers to "an incorporated city, town, or village." LA. CONST. art. VI, § 44(3). As indicated *supra* in Part III.A.2, specificity as to what municipalities are included in the law is critical to avoiding questions of whether a particular entity qualifies as a municipality under Chapter 9. There has not yet been a controversy over the status of a Louisiana entity, but, if one arises, section 13:4741's sister statute should clarify the issue. *See infra* note 133 (citing Louisiana Revised Statutes sections 39:1410.64 and 39:1410.60).

legislature enacted a somewhat duplicative statute, which specifically applies to municipalities.<sup>132</sup> Louisiana Revised Statutes section 39:1410.64 prohibits municipalities from filing without written approval from the State Bond Commission.<sup>133</sup> At first glance, these approval requirements may seem insignificant, but the State Bond Commission is actually an extremely powerful state body.

Created in 1968, the State Bond Commission manages the debt of the State and its municipalities.<sup>134</sup> The Commission is comprised of the governor, lieutenant governor, president of the senate, speaker of the house, treasurer, secretary of state, attorney general, and chairmen of several senate and house committees.<sup>135</sup> After reviewing the municipality's petition, the State Bond Commission members (or their designated representatives) vote to authorize the Chapter 9 filing.<sup>136</sup> Their decision is final and there is no appeals process if the filing is denied.<sup>137</sup>

If a municipality succeeds in obtaining the State Bond Commission's approval to file, it faces an additional hurdle before it can submit its debt readjustment plan to the court. Louisiana Revised Statutes sections 39:1410.64 and 39:619 require the written approval from the State Bond Commission, governor, and attorney general before the court can accept the proposed plan.<sup>138</sup>

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132. LA. REV. STAT. ANN. § 39:1410.64 (2005).

133. LA. REV. STAT. ANN. § 39:1410.64 (2005). Affected entities include political subdivisions, parishes, municipalities, school districts, public boards, subdivisions, taxing districts, road and subroad districts, sewerage districts, drainage and subdrainage districts, levee districts, waterworks and subwaterwork districts, irrigation districts, road lighting districts, harbor and terminal districts, taxing districts, and public or political corporations. The scope of this statute is probably broad enough to include any entity that may have been legislatively overlooked in section 13:4741. LA. REV. STAT. ANN. § 39:1410.60 (2005 & Supp. 2011).

134. In 1972, the powers, functions, and duties of the State Bond and Tax Board were transferred to the State Bond Commission. *See* LA. REV. STAT. ANN. § 39:1408 (2005); *see also* LA. CONST. art. VII, § 8(B) (“No bonds or other obligations shall be issued or sold by the state directly or through any state board, agency or commission, or by any political subdivision of the state, unless prior written approval of the bond commission is obtained.”).

135. LA. REV. STAT. ANN. § 39:1401 (2005 & Supp. 2011).

136. LA. ADMIN. CODE tit. 71, pt. 3, §103(R) (1975) (“Meetings of the commission shall be conducted in accordance with *Robert’s Rules of Order*.”).

137. *Id.*

138. Louisiana Revised Statutes section 39:1410.64 requires State Bond Commission approval prior to a municipality putting a debt readjustment plan into effect or seeking its final confirmation. LA. REV. STAT. ANN. § 39:1410.64 (2005). Likewise, Louisiana Revised Statutes section 39:619 prevents a municipality from “tak[ing] any action to carry out any plan of readjustment of its debts” or petitioning for a confirmation of the plan without written approval

By enacting these duplicative and exacting laws, the Louisiana Legislature severely limited a municipality's ability to file for bankruptcy.

V. A LEAK IN THE STATE "LEVEE": PROBLEMS WITH THE CURRENT LAW

The problem with the current law is that in trying to be prudent, the Louisiana Legislature made municipal bankruptcy a virtual impossibility instead of an option of last resort.<sup>139</sup> It appears the Legislature wanted municipalities to pursue Chapter 9 only after careful consideration and a thorough analysis of all potential options.<sup>140</sup> But a closer look at the effects of the legislation reveals that the State Bond Commission approval requirement is "a significant hurdle for any local governmental entity contemplating bankruptcy."<sup>141</sup> For a municipality saddled with crippling debt, this hurdle appears insurmountable.

A. A Virtual Non-Option

The State's stance on municipal bankruptcy has consistently been that its disadvantages outweigh any advantages it might have for a local government in financial crisis.<sup>142</sup> Even during the widespread financial emergency caused by Hurricanes Katrina and Rita, the State was adamant in its assertion that it would not consider allowing its political subdivisions to file for bankruptcy.<sup>143</sup> Given the lack of other viable options, the Public Affairs Research Council of Louisiana implored the State to either accept additional federal funding or open up its own coffers to assist the struggling municipalities.<sup>144</sup> The State eventually

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from the State governor and attorney general. LA. REV. STAT. ANN. § 39:619 (2005 & Supp. 2011).

139. It is unknown why the State Bond Commission permitted Lower Cameron Parish Hospital Services District to file for Chapter 9 in 1999. The State Bond Commission's records date back to 2000 and the current Director was unaware of the particularities of the situation. Interview with Lela Folse, acting Director of the State Bond Commission, in Baton Rouge, La. (Oct. 22, 2010).

140. See discussion *supra* Part IV.

141. See BUREAU OF GOV'T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., *supra* note 40, at 8.

142. *Id.* at 6.

143. *Id.*

144. *Id.*

accepted federal assistance, but it has remained adamant that it will not entertain municipal bankruptcy petitions.<sup>145</sup>

The Chairman of the State Bond Commission put another nail in the coffin of municipal bankruptcy when he made a “commitment to the rating agencies and bond insurers that he will not vote to allow any municipality in the state to enter into bankruptcy.”<sup>146</sup> The Chairman surely intended to benefit the State with such promises.<sup>147</sup> In light of the rating agencies’ tendency to downgrade municipal bond ratings at the mere mention of the word “bankruptcy,” it is understandable for the State to display open hostility toward Chapter 9. However, these words also have the effect of virtually eliminating the option for municipalities in financial crisis.<sup>148</sup>

### *B. Political Nature of the State Bond Commission*

The main problem with the approval requirement lies in the controversy over municipal bankruptcy and the political nature of the State Bond Commission. Most politicians revile Chapter 9 due to its stigma and potential to ruin political careers.<sup>149</sup> Not many politicians would openly advocate bankruptcy for fear of backlash at the polls. Although there are no proven long-term effects of municipal bankruptcy, politicians will inevitably take the blame for the short-term effects on the municipality’s neighbors and the State.<sup>150</sup> As a result, state politicians focused on the next election might overlook the fact that bankruptcy could benefit the municipality and the State in the long run.<sup>151</sup> By leaving the decision to approve a bankruptcy filing in the hands of a powerful group of politicians, politics, rather than prudent policy, is likely to be the primary influence.

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145. See PIKE, *supra* note 45, at 2.

146. See BUREAU OF GOV’T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., *supra* note 40, at 8.

147. *Id.* The state treasurer is the Chairman of the State Bond Commission. LA. REV. STAT. ANN. § 39:1401(C) (2005).

148. “[T]he bankruptcy option has been removed from the table for local governments by state officials concerned about the stigma of bankruptcy and its potential impact on other governmental entities in the state.” BUREAU OF GOV’T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., *supra* note 40, at 1.

149. Municipal bankruptcy is “political suicide.” Los Angeles County supervisor Zev Yaroslavsky opined that “[a]fter Orange County declared bankruptcy, not one of their board members ever won election again.” Orlov, *supra* note 4, at A1.

150. See discussion *supra* Part III.B.2.

151. See discussion *infra* Part VI.C.4.

Interest groups also play a significant role in a politician's decision-making process.<sup>152</sup> At the state level, interest groups may represent creditors and other groups opposed to a municipal bankruptcy proceeding.<sup>153</sup> Because Chapter 9 puts municipal creditors in a position of relative weakness as compared to the local government, these interest groups would certainly lobby state officials on the State Bond Commission to reject any bankruptcy petition. The problem is that these groups generally promote their own interests without considering the effects their requests will have on the municipality or the State as a whole.<sup>154</sup>

The members of the State Bond Commission are also motivated by different issues that can prevent them from making decisions that are in the best interest of a municipality in crisis. The legislative branch members have their particular constituents in mind while the executive branch members are concerned with the State as a whole. These diverging interests actually have the same effect on the members' decision-making process. The legislative members are not likely to vote for a bankruptcy proceeding in another voting district that may adversely affect their constituents. Similarly, the executive members would be reluctant to relieve one municipality's suffering at the expense of the State. In both instances, allowing the municipality to file for Chapter 9 could hurt the politicians at the polls.<sup>155</sup> State politicians rarely receive political benefits (votes and campaign support) for helping one particular town or parish in trouble.<sup>156</sup> In fact, there can be considerable backlash for supporting a municipal bankruptcy.<sup>157</sup> This is not the kind of publicity the members of the State Bond Commission are looking for and it is bound to weigh on their minds when it comes time to vote.

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152. Kimhi, *supra* note 1, at 379.

153. In most states, labor unions exert considerable influence on state officials. Because labor contracts can be voided under a Chapter 9 proceeding, the unions have been particularly vocal in their admonishment of Chapter 9. *See* Duffy, *supra* note 78. Although Louisiana is a "Right to Work" state, public employee groups or creditors representing certain industries could conceivably lobby against a municipal bankruptcy proceeding if it would adversely affect their interests. *See* LA. REV. STAT. ANN. § 23:981–87 (2010).

154. Kimhi, *supra* note 1, at 379.

155. Miller, *supra* note 11.

156. Kimhi, *supra* note 1, at 391.

157. Miller, *supra* note 11.

*C. Inherent Problems in the Political Process*

There is also inherent delay and conflict in the political process that can make municipal bankruptcy unavailable when it is needed most.<sup>158</sup> Because it is a last resort option, the residents of a municipality in crisis can suffer from a lack of services and exorbitant taxes for a considerable amount of time before the local government pursues Chapter 9. Instead of gaining access to the benefits of Chapter 9 that would immediately relieve some of their burden, the people will continue to suffer while the State deliberates the municipality's petition. And because it appears that the State Bond Commission is unlikely to authorize a filing, the municipality's problems may continue for the foreseeable future.

Some might argue that the people *should* bear the risk of municipal insolvency because they are in a position to prevent it by virtue of their vote.<sup>159</sup> This argument overlooks the fact that despite the political process, the municipality's citizens cannot control the government's financial situation.<sup>160</sup> Once their ballots have been cast, citizens are limited in their ability to affect political decisions. Furthermore, the people are completely powerless to prevent financial crises arising from involuntary debt as a result of natural disaster damage, court judgments, and the like. To demand that the people bear the burden indefinitely because they were supposedly in a position to prevent the crisis runs contrary to the reality of the situation.<sup>161</sup> Because the people were not at fault, they should not be forced to suffer the consequences alone.

*D. Lack of Ex Ante Features*

The lack of statutory guidance for its decision-making process exacerbates the effects of the political nature and inherent bias of the State Bond Commission.<sup>162</sup> The Legislature did not establish any list of factors or other criteria for the State Bond Commission to consider in determining whether the municipality should be permitted to file.<sup>163</sup> The decision is entirely at the whim of the State Bond Commission. Furthermore, there is no requirement for a written justification of its decision nor is there a process for appealing a rejection.

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158. Freyberg, *supra* note 9, at 1021.

159. Kimhi, *supra* note 2, at 656–60.

160. *Id.* at 657.

161. *Id.*

162. LA. REV. STAT. ANN. § 39:1410.64 (2005).

163. LA. REV. STAT. ANN. § 13:4741 (Supp. 2011).



The Civil law system of Louisiana generally embraces the *ex ante* statutory structure.<sup>164</sup> Such laws seek to provide general guidance and solutions before considering the facts of a given situation. Many Louisiana statutes are consistent with *ex ante* drafting and include criteria and factors for the courts to consider in deciding cases.<sup>165</sup> The result of this guidance is greater predictability in the outcome of a legal decision and stability in the jurisprudence over the course of time. Under the current law, a municipality will have no guess as to how the State Bond Commission will decide—aside from some members declaring they will never approve a filing.<sup>166</sup>

#### VI. BLUEPRINT FOR THE NEW “LEVEE”: PROPOSED AMENDMENTS TO THE LAW

In order to revitalize the municipal bankruptcy option, the decision to file should be placed in the hands of a politically disinterested yet intimately involved and knowledgeable person. Using legislative guidelines, this person would draw from his in-depth analysis of the municipality and his financial expertise to determine whether bankruptcy is the best solution. This ideal person is the fiscal administrator.

Because the current law does not tie the fiscal administrator to the municipal bankruptcy process other than requiring him to recommend whether the municipality should be permitted to file for Chapter 9, some legislative changes are necessary. First, Louisiana Revised Statutes sections 13:4741 and 39:1410.64 should be amended to require review and approval from a state-appointed fiscal administrator as a prerequisite for filing. The state government will retain the power of appointment, but the decision to file will be passed from the State Bond Commission to the fiscal administrator.<sup>167</sup> Second, the Legislature should enact guidelines to assist the fiscal administrator in his decision to authorize a filing and to ensure he considers the interests of the State.<sup>168</sup>

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164. See A.J.G.M. Sanders, *The Characteristic Features of the Civil Law*, INST. OF FOREIGN AND COMPARATIVE LAW (1981); Julio C. Cueto-Rua, *The Future of the Civil Law*, 37 LA. L. REV. 645 (1977).

165. See Cueto-Rua, *supra* note 164.

166. See BUREAU OF GOV'T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., *supra* note 40, at 8.

167. The attorney general, treasurer, and legislative auditor nominate an individual to be fiscal administrator. LA. REV. STAT. ANN. § 39:1351 (2005).

168. Currently, the fiscal administrator can recommend only a Chapter 9 filing and there are no guidelines to assist him in doing so. LA. REV. STAT. ANN. § 39:1351 (2005).

*A. Fiscal Administrator's Power to Authorize a Chapter 9 Filing*

The Fiscal Administrator is the proper person to authorize a municipal bankruptcy proceeding. First, the Fiscal Administrator is not a politician, so the political ramifications of a Chapter 9 proceeding will not influence his decision to file. Second, the Fiscal Administrator is the most knowledgeable person to make the decision given the fact that he has immersed himself in the municipality's financial situation. Third, unlike state politicians who must split their efforts and time among all areas of the State, the Fiscal Administrator is focused solely on the municipality in crisis. Lastly, the Fiscal Administrator is accountable to the State and the municipality for his decisions, which ensures a proper degree of governmental oversight.

*1. Non-Political Figure*

Unlike the members of the State Bond Commission who are elected officials, the fiscal administrator is not concerned with the political implications of a bankruptcy filing. As explained above, state politicians are not likely to make decisions that would jeopardize their chances for reelection.<sup>169</sup> Although cognizant of the near-term effects of a municipal bankruptcy filing, the fiscal administrator is more focused on taking actions that will benefit the municipality and the State in the long run.<sup>170</sup> Because he does not have a constituency or a political reputation to protect, the fiscal administrator can make politically unpopular decisions that will benefit the municipality and the State past the next election.

Moreover, the fiscal administrator is not influenced by creditors and interest groups in his decision-making process. Because he has no incentive to make decisions in line with their agenda, he is free from the pressures normally exerted on state officials.<sup>171</sup> For example, if inconsequential government jobs should be cut, the fiscal administrator will not be swayed by

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169. See discussion *supra* Part V.B.

170. The fiscal administrator's sole duties involve analyzing and fixing the municipality's budget. The appointment can last many months, and sometimes even years. See *Parish to Have Money Manager*, TIMES-PICAYUNE (New Orleans, La.), Jan. 1, 1992, at B5; *Auditor: Cotton Valley Must Cut \$25K*, THE TIMES (Shreveport, La.), Sept. 23, 2009, at 1. See also discussion *supra* Part IV.B.

171. A state receiver took over the finances of the city of Chelsea, Massachusetts in 1990. Unlike the City's officials, the receiver was able to "break free" from the "paralyzing grip" of labor unions that had been a major cause of the City's financial problems. Kimhi, *supra* note 2, at 671-2.

protests or other organized efforts that might be effective against politicians. Thus, the fiscal administrator can focus on determining the best solutions for the municipality without being subjected to external political pressures.<sup>172</sup>

Permitting the fiscal administrator to authorize a municipal bankruptcy filing would not amount to a radical change in the law. The State has already made the policy decision to intervene in municipal affairs during financial crises. The current law grants the fiscal administrator significant power to make budgetary decisions on behalf of the local government. The State then enforces the fiscal administrator's recommendations through the court if the municipality does not voluntarily adopt them.<sup>173</sup> The justification for this intervention is that the municipality is deemed incapable of solving its problems on its own and thus requires state assistance. The State vested significant powers in the fiscal administrator with the intent that he will cure the municipality's insolvency; therefore, the authority to permit a Chapter 9 filing—also intended to remedy insolvency—is a logical extension of the fiscal administrator's power under the current law.

### *2. Most Knowledgeable of the Municipality's Situation*

The fiscal administrator is arguably the most knowledgeable person regarding the municipality's financial situation. As a result of his statutory responsibilities, the fiscal administrator will become intimately acquainted with the municipality's finances.<sup>174</sup> His principal duty is to conduct a comprehensive investigation of the municipality's financial affairs.<sup>175</sup> He has unfettered access to municipal documents and records and can interrogate municipal officials as he deems necessary.<sup>176</sup> Once he has fully analyzed the municipality's situation and determined how it arrived at its current predicament, he then decides what steps must be taken in order to get the municipality back to fiscal health. The municipal

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172. *Id.*

173. LA. REV. STAT. ANN. § 39:1353 (Supp. 2011); *see also* discussion *supra* Part IV.B.

174. The fiscal administrator must investigate three aspects of the municipality's finances. He must first estimate the revenue and expenditures for both the remainder of the current fiscal year and the following year. He must then recommend budget amendments that will ensure the municipality's ability to pay its debts for the next fiscal year. Finally, he must calculate how much additional revenue is required if the proposed budgetary changes will not enable the municipality to meet its financial obligations. LA. REV. STAT. ANN. § 39:1351 (2007).

175. LA. REV. STAT. ANN. § 39:1352 (2005).

176. *Id.*

officials technically have the option to reject the fiscal administrator's proposals; however, the statute dictates that the attorney general *must* ask the court to order the implementation if the proposals are rejected.<sup>177</sup> After the new budget is in place, the fiscal administrator continues to monitor the municipality's progress.<sup>178</sup> In sum, the fiscal administrator analyzes the situation in depth, pinpoints the budgetary problems, corrects them, and observes the new procedures in action. Thus, he is now in the best position to forecast the economic future of the municipality to determine if filing for bankruptcy under Chapter 9 is necessary.

#### *4. Total Focus on the Municipality's Situation*

The fiscal administrator is also in the best position to make the decision because he is completely devoted to analyzing the problem and devising a solution. Unlike the members of the State Bond Commission who have numerous other duties to perform, the fiscal administrator is consumed with solving the municipality's problems. An appointment can last anywhere from six months to several years.<sup>179</sup> Certainly none of the State Bond Commission members could afford to spend a few weeks, much less several months, in the affected city. With this immersion comes a true appreciation for the situation and the people affected by the crisis. The fiscal administrator is the best person to authorize the filing because he in essence has become part of the municipality.

#### *5. Accountability*

Some may question the power of a fiscal administrator because he is not an elected official. Indeed, concerns have been raised about the appointment of a fiscal administrator to a home rule entity without its consent.<sup>180</sup> These fears should be allayed by the

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177. LA. REV. STAT. ANN. § 39:1353 (Supp. 2011) ("If the governing authority of the political subdivision fails to adopt such budget or budget amendments, or if the revisions made by the governing authority of the political subdivision do not meet the approval of the fiscal administrator, the attorney general *shall* take a rule against the political subdivision . . . to show cause why the court should not order the adoption and the implementation of the budget without the revisions disapproved by the fiscal administrator.") (emphasis added).

178. LA. REV. STAT. ANN. § 39:1354 (Supp. 2011).

179. See *Parish to Have Money Manager*, TIMES PICAYUNE (New Orleans, La.), Jan. 1, 1992, at B5; *Auditor: Cotton Valley Must Cut \$25K*, THE TIMES (Shreveport, La.), Sept. 23, 2009, at 1.

180. BUREAU OF GOV'T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., *supra* note 40 at 15. "Local governmental autonomy or home rule exists

fact that the Legislature took pains to clarify under what circumstances a fiscal administrator will be appointed.<sup>181</sup> The court must determine that the municipality is either reasonably certain to fail to pay its debts or does not have sufficient funds to pay for its current expenditures.<sup>182</sup> Once appointed, the fiscal administrator is not an unimpeachable figure. Both the State and the municipality can request the court to terminate his appointment.<sup>183</sup> Furthermore, any showing of fraud, negligence, or misconduct is grounds for termination.<sup>184</sup> Thus, the fiscal administrator is accountable to the State, the municipality, and the court for his actions, ensuring that he operates within the bounds of his legislative authority.

### *B. Statutory Guidance*

#### *1. Who Should the Fiscal Administrator Be?*

With the proposed amendment, the fiscal administrator's appointment becomes more significant and should therefore be reconsidered. The State should choose the most qualified individual to ensure that he is capable of handling the monumental task of analyzing a municipality's budget and identifying and fixing its financial problems. Currently the law simply states that the court must determine that the individual has the requisite "education, experience and qualifications to enable him to perform the duties of fiscal administrator."<sup>185</sup> The Legislature should establish additional guidelines for the selection of the fiscal administrator. First, the fiscal administrator should not be an elected official to ensure that he is free from political bias. Second, he should be an expert in government finances. Therefore the Legislature should provide an illustrative list of qualified individuals, including certified public accountants with experience in government finances and former bankruptcy judges.<sup>186</sup> These

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only to the extent that the state constitution endows a local governmental entity with two interactive powers: the power to initiate local legislation and the power of immunity from control by the state legislature." *New Orleans Campaign for a Living Wage v. City of New Orleans*, 825 So. 2d 1098, 1103 (La. 2002).

181. LA. REV. STAT. ANN. § 39:1351(A)(2) (Supp. 2011).

182. LA. REV. STAT. ANN. § 39:1351(B) (Supp. 2011).

183. LA. REV. STAT. ANN. § 39:1354 (2007).

184. LA. REV. STAT. ANN. § 39:1351(C) (Supp. 2011).

185. LA. REV. STAT. ANN. § 39:1351(B) (Supp. 2011).

186. The fiscal administrators appointed to St. Landry Parish and the Town of Glenmora were accountants. *Parish to Have Money Manager*, TIMES-PICAYUNE

additional qualifications provide more substantive guidance and help ensure that the State appoints the most qualified person.

The State should also consider the proposed fiscal administrator's residence in relation to the municipality. Because the local government is responsible for paying the fiscal administrator, the Legislature should ensure that its financial burden is as small as possible.<sup>187</sup> The fiscal administrator's travel expenses will be borne by the municipality, so his residence should be no more than 50 miles away.<sup>188</sup> If it is impossible to find a qualified person within this distance, the court may authorize a reasonable extension of this radius.

## 2. Guidelines to Assist the Fiscal Administrator

The Legislature should establish guidelines to assist the fiscal administrator in his decision-making process to ensure that he authorizes a filing in accordance with the State's interests. The fiscal administrator must adhere to these guidelines and provide written justification for filing along with his approval. The court will review the fiscal administrator's reasoning to ensure that he has approved the filing in accordance with the legislative guidance.

First, a Chapter 9 filing should be authorized only under certain circumstances. How the municipality arrived at its current financial crisis should be a determining factor. A critical distinction should be made between voluntary and involuntary debt.<sup>189</sup> A municipality that voluntarily takes on debt and then fails to repay its creditors through its own misfeasance should rarely be permitted to take advantage of Chapter 9. Voluntary debt thus weighs heavily against a municipal bankruptcy filing. However, in most cases, the fiscal administrator will correct such budget mismanagement through adoption of his budgetary amendments.<sup>190</sup>

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(New Orleans, La.), Jan. 1, 1992, at B5; Billy Gunn, *State Controlling Glenmora's Finances*, ALEXANDRIA DAILY TOWN TALK, Aug. 12, 2006, at 5A.

187. The fiscal administrator appointed to St. Landry Parish commuted from Alexandria to manage the Parish's finances. The Parish police jury commented that it would have preferred someone closer because the fiscal administrator's mileage costs would be added to his hourly wages. *Parish to Have Money Manager*, TIMES PICAYUNE (New Orleans, La.), Jan. 1, 1992, at B5.

188. This distance is based on the fact that there is a major city within 50 miles of most Louisiana cities. Northern Louisiana would present the most problems because the cities are more dispersed in this region. The court would have to use its discretion in granting an extension of the 50 mile radius.

189. See discussion *supra* Part II.C.

190. LA. REV. STAT. ANN. § 39:1352 (Supp. 2011).

Therefore, financial crises caused by voluntary debt mismanagement will usually not require the fiscal administrator to even consider bankruptcy as a solution.

Debt that is incurred involuntarily, such as by natural disaster, a large monetary court judgment, or criminal malfeasance in office, justifies the municipality getting favorable treatment over its creditors.<sup>191</sup> Because the municipality incurred the debt through no fault of its own, the fiscal administrator may consider bankruptcy under the following three circumstances. First, if the fiscal crisis is caused by a natural disaster and neither the federal nor state government provides sufficient assistance to cover the municipality's debt, the filing may be authorized.<sup>192</sup> Second, if there is a significant judgment assessed against the municipality, the fiscal administrator may authorize a filing if (1) the appeals process has been exhausted, and (2) the local government attempted to negotiate a settlement in good faith.<sup>193</sup> Finally, if the municipality's financial problems are attributed to criminal actions of a local government official, the fiscal administrator may permit a Chapter 9 filing.<sup>194</sup> There may be other circumstances under which a municipality experiences a financial crisis due to involuntary debt. The fiscal administrator may authorize a filing in such a case, but must provide written reasons for his decision.

In addition to meeting one of these threshold requirements, the fiscal administrator must also determine that bankruptcy is the only remaining viable option for the municipality. The State is

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191. See LA. REV. STAT. ANN. § 14:134 (Supp. 2011).

192. For example, after Hurricane Katrina left New Orleans underwater and in financial shambles, had the federal government not stepped in to provide extended emergency funding, the City may have faced bankruptcy. Before the funding was extended in 2006, the Public Affairs Research Council of Louisiana argued that Chapter 9 might be a solution to the problem that was not going to go away otherwise. BUREAU OF GOV'T RESEARCH & THE PUB. AFFAIRS RESEARCH COUNCIL OF LA., *supra* note 40, at 3.

193. Exorbitant judgments against a municipality can have devastating effects—they unexpectedly wipe out any surplus, or worse, can be so large as to equal or exceed the municipality's entire budget for the year. In 2008, the Orleans Parish District Attorney's Office suffered such a judgment. The Office was still paying off an exorbitant judgment from a few years before and had no way to pay the new multimillion dollar judgment. See discussion *supra* Part VI.C.1.

194. The criminal actions of one municipal official can have devastating effects on the whole municipality. The Lower Cameron Parish Hospital Services District amassed over \$1 million in debt as a result of fraudulent actions on the part of its chief executive officer. See *supra* note 6. The criminal action must rise above the level of misfeasance of office. LA. REV. STAT. ANN. § 14:134 (Supp. 2011). The type of crime this Comment envisions involves deliberate actions like the fraud committed in Lower Cameron Hospital Services District.

obviously very concerned with keeping bankruptcy as a last resort option.<sup>195</sup> To meet the State's intent, the fiscal administrator should authorize the filing only if all other options have been exhausted or no other reasonable course of action remains. Through his examination of the municipality's budget, the fiscal administrator must make the following determinations. First, the fiscal administrator must certify that taxes have been raised to the highest level possible without creating an unreasonable burden on the citizens, and that all revenue-producing assets are utilized to their maximum capacity.<sup>196</sup> In addition, the fiscal administrator must justify any non-essential services that have not been cut from the budget.<sup>197</sup> Although it is unlikely, the fiscal administrator must inquire into the possibility of borrowing more money. If the municipality's credit rating has not dropped so far as to prevent it from obtaining additional loans, then it must pursue that option if feasible and in its best interests. If all possible revenues have been raised, all possible expenses have been cut, the municipality cannot obtain additional loans, and there is still a deficit that will not be extinguished within the following fiscal year, then the fiscal administrator may authorize a Chapter 9 filing.

### *C. Benefits of the Proposed Legislation*

Empowering the fiscal administrator to authorize a Chapter 9 bankruptcy filing streamlines the entire financial crisis procedure and ensures that if the municipality opts for bankruptcy, it is truly a well-thought-out decision. State involvement is now centralized in one person—the person who is in the best position to make such a decision. The process for handling municipal financial crises will be more efficient because the fiscal administrator has the authority to choose whatever course of action is in the best interest of the municipality, including a Chapter 9 filing. The roadblock of obtaining approval from the State Bond Commission is removed from the chosen path to recovery. Once the fiscal administrator determines that bankruptcy is the most prudent option, the municipality may immediately take advantage of the benefits of Chapter 9. In this collection-free sanctuary, the municipality can more effectively negotiate with its creditors to develop the most

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195. See discussion *supra* Part IV.

196. This requirement is an extension of the federal rule requiring a municipality to be insolvent, which further ensures that a municipality has exhausted its resources. 11 U.S.C. § 101(32)(C) (2006).

197. This requirement ensures that the municipality has made all practical budget cuts before seeking bankruptcy.



reasonable and advantageous debt readjustment plan possible. Most situations will not result in bankruptcy, but in the rare instance where the fiscal administrator decides that bankruptcy is the best option, allowing him to authorize the filing will provide more timely relief to the municipality drowning in debt.

### *1. A Reduction in Municipal Bankruptcies*

One might assume that shifting the filing decision to the fiscal administrator will result in more bankruptcies. This conclusion overlooks the fact that in every instance where a Louisiana fiscal administrator took control of a municipality's finances, the local government recovered from its fiscal crisis.<sup>198</sup> For example, in 2006, the State appointed a fiscal administrator to the small town of Glenmora in Rapides Parish after it had defaulted on a \$204,990 federal government loan.<sup>199</sup> The fiscal administrator discovered the causes of the town's anemic revenue, which included faulty utility billing, corruption, and traffic ticket fixing.<sup>200</sup> After a year under the auspices of the fiscal administrator, the town was able to avoid bankruptcy after selling its hospital and a nursing home.<sup>201</sup>

In 1992, a similar situation occurred when St. Landry Parish defaulted on its general obligation bonds amounting to \$1.2 million.<sup>202</sup> As a result of a depressed oil and gas market, several municipalities in the area had also faced financial crunches yet managed to stay solvent by making difficult budget cuts.<sup>203</sup> The Parish's officials were unwilling to make similar cuts, leading the fiscal administrator to conclude that the local officials' "lack of budget discipline" was the main cause of the fiscal crisis.<sup>204</sup> After implementing the fiscal administrator's recommended budget amendments, the Parish was able to avoid bankruptcy.<sup>205</sup> History

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198. The lack of Louisiana Chapter 9 bankruptcy cases indicates that the fiscal administrator was effective in all cases. To date there have been less than ten fiscal administrators appointed. Editorial, *Taking Control*, TIMES-PICAYUNE (New Orleans, La.), Apr. 5, 2003, at 6.

199. See Michelle Millhollon, *State Studies How to End Towns' Financial Woes*, ADVOCATE (Baton Rouge, La.), Aug. 21, 2009, at B10.

200. Gunn, *supra* note 186. Traffic ticket fixing involves the illegal dismissal of traffic tickets. Small municipalities often rely on traffic ticket payments to supplement their budget. If enough tickets are "fixed," the municipality will lose revenue.

201. *Auditor: Cotton Valley Must Cut \$25K*, THE TIMES (Shreveport, La.), Sept. 23, 2009, at 1; Millhollon, *supra* note 199, at B10.

202. Yacoe, *supra* note 40, at 2.

203. *Id.*

204. *Id.*

205. *Id.*

suggests that the appointment of a fiscal administrator leads to fiscal recovery, not insolvency. This should reduce fears that the broadening of the fiscal administrator's authority will lead to additional bankruptcy filings.

### *2. Prevention of Repeat Bankruptcies*

There have been at least two municipalities nationwide that have emerged from bankruptcy only to find themselves back in Chapter 9 proceedings a few years later.<sup>206</sup> Although recurring bankruptcies are certainly not the norm, they raise the question of whether Chapter 9 is effective as a long-term solution. The municipalities' problem was that they emerged from Chapter 9 without having addressed the causes of their fiscal crisis.<sup>207</sup> Chapter 9 does not solve underlying issues with a municipality's financial management—that is something that the municipality will have to address on its own. In Louisiana, state intervention via the fiscal administrator prior to a bankruptcy filing helps prevent recurring financial crises. The fiscal administrator is solving not only the current financial emergency but also the core problems of the municipality's financial management.<sup>208</sup> Even if the municipality opts for Chapter 9, it is unlikely to experience financial crisis again because it has new budgetary procedures in place.

### *3. Prevention of Hasty Filings*

The proposed amendment will also prevent municipalities from requesting permission to file for Chapter 9 as a knee-jerk reaction to financial crises. When a fiscal emergency arises suddenly, as a result of a natural disaster or large monetary judgment against the municipality, the officials' instinct may be to seek bankruptcy before fully exploring their options. For example, when the Fifth Circuit awarded a \$15 million judgment to a wrongly convicted death row inmate, the Orleans Parish District Attorney's Office sought permission to file for bankruptcy within weeks of the verdict.<sup>209</sup> The judgment equaled the Office's total annual budget,

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206. The city of Macks Creek, Missouri filed for Chapter 9 in 1998 and again in 2000. A Texas city, Westminster, filed for Chapter 9 in 2000 and later in 2004. Kimhi, *supra* note 1, at 381.

207. *Id.*

208. By amending the municipality's budget, the fiscal administrator helps to avoid future financial problems due to budget mismanagement.

209. *Thompson v. Connick*, 553 F. 3d 836, 842–43 (5th Cir. 2008), *rev'd*, 131 S. Ct. 1350 (2011); *see also* Johnson, *supra* note 40, at B2.

which understandably sent the district attorney into a panic.<sup>210</sup> But following meetings with the state treasurer and attorney general, the district attorney withdrew his request three days later, most likely due to the state officials' advice that his request would be rejected because the appeals process had not been exhausted.<sup>211</sup> In times of fiscal crises like this one, a disinterested party, like a fiscal administrator, is better able to analyze the situation and make a decision based on reason rather than emotion. If a bankruptcy filing is ultimately authorized, it will be a result of careful thought and consideration.

#### *4. Prevention of Long Term Contagion Effects*

A final question remains about the justification of a Chapter 9 filing. Because a bankruptcy may adversely affect neighboring municipalities as well as the State, how can the benefit to one municipality outweigh the detriment to others? The answer comes down to a balancing of near- and long-term state interests.

Although a municipal bankruptcy may have a contagion effect on its neighbors and the State by temporarily downgrading their bond credit ratings, there may be long-term contagion effects that result from *not* allowing the municipality to pursue Chapter 9. For example, if a municipality is denied a Chapter 9 option, it has no choice but to increase taxes to unreasonable levels and cut services to try to repay its creditors.<sup>212</sup> When police, prison and public hospital funds are cut to barebones levels, these service providers cannot properly function. Crime will rise, prisons will become overcrowded and dangerous, and the quality of hospital care will diminish. These problems will not be contained within the municipal boundaries. Neighboring towns will feel the consequences: crime levels may increase, prisoners from overcrowded prisons may be transferred to other parishes, and patients may be forced to find care at other hospitals. Furthermore, these effects may be felt much longer than the temporary decrease in the municipality's credit rating. In the long run, it will benefit the State and its political subdivisions to afford a financially distressed municipality access to Chapter 9. Municipal bankruptcy

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210. Watts, *supra* note 41.

211. The district attorney "withdrew his request of the State Bond Commission while his office pursue[d] and exhaust[ed] the standard appeals process of the Thompson judgment through the federal courts." Allen M. Johnson, Jr., *Orleans DA Drops Request for Bankruptcy*, *ADVOCATE* (Baton Rouge, La.) Jan. 9, 2009, at A10.

212. *See supra* note 3.

should not be embraced as a panacea, but it should remain available as an option of last resort.

## VII. CONCLUSION

There is no question that Louisiana's current municipal bankruptcy laws will deter municipalities from considering bankruptcy as an option. However, the law should not be aimed at preventing bankruptcy; rather it should seek to ensure that bankruptcy is chosen in only the direst of circumstances, when no other option exists. Municipal bankruptcy is not a preferable course of action. It can have severe consequences on both the municipality itself and the State. But there are times when bankruptcy is the best option for the local government and its people. It is possible that municipal crises will occur more frequently in the next decade. Louisiana may face times when more municipalities require the assistance of a fiscal administrator. Given such a possibility, it is wise to amend the legislation now so the procedures are as comprehensive and sensible as possible. In other words, it is better to fix the levee now before the next hurricane hits.

Broadening the fiscal administrator's authority to allow him to authorize a municipality to file for bankruptcy will ensure bankruptcy is chosen as a last resort. The shift in authority will also streamline the process, and in the instance that Chapter 9 is deemed necessary, it gives the municipality quicker access to the benefits of Chapter 9, most notably the automatic stay. To assist the fiscal administrator in his decision-making process, the Legislature should also enact guidelines and a set of conditions to be met before a bankruptcy petition can be filed. As a result of these amendments, a local government will receive comprehensive, impartial assistance from the fiscal administrator, who will have the power to pursue all options in order to put the municipality back into financial health.

Louisiana's municipalities have managed to overcome various financial crises without resorting to Chapter 9 bankruptcy. However, it is prudent to examine the current legislation to ensure that it properly meets the needs of Louisiana's municipalities, especially in uncertain economic times. In 1986, the mayor of Tallulah "issued a proclamation asking God to help his financially devastated city."<sup>213</sup> The State can help prevent such desperation in

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213. The City's prayers were answered when a fiscal administrator was appointed to bring it back to fiscal health. A year later, the fiscal administrator

the future by amending its laws to ensure that Chapter 9 bankruptcy is a viable option for municipalities that have no hope of recovering on their own.

*Lauren M. Wolfe\**

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had succeeded in saving the City. *Tallulah, La. Shows Signs of Turnaround*, DALL. MORNING NEWS, Sept. 14, 1987, at 13A.

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