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Two Judges Gives Speeches on Municipal Bankruptcy

By William Rochelle

Shortcomings in laws covering government bankruptcies were the topic of speeches given by two bankruptcy judges thousands of miles apart.

Chief U.S. Bankruptcy Judge Cecelia G. Morris from New York will speak this week in Modena, Italy, at the annual conference of the Global Restructuring Organization while Chief Bankruptcy Judge Thomas B. Bennett from Birmingham, Alabama, addressed the Campbell Law Review Symposium in Raleigh, North Carolina, last week. Bennett has first-hand experience from presiding over the Chapter 9 debt restructuring by Jefferson County, Alabama, the largest municipal bankruptcy before Detroit's.

In the international sphere, Morris explained how Argentina's default and subsequent debt restructuring were hobbled by the ``absence of a binding international treaty'' and the consequent inability to bind a few dissenters even when deals were struck with a vast majority of creditors.

Morris pointed out how there have been only 500 municipal bankruptcies since the predecessors to Chapter 9 were first adopted in the 1930s. Bennett developed the theme, discussing how the lack of precedent hasn't answered some of the most basic questions arising when a municipality becomes insolvent.

Both judges raised the issue of consent: When a municipality files bankruptcy, does it consent to the exercise by the bankruptcy judge of all of the powers laid out in Chapter 9? Stated another way, can either the municipality or a creditor argue successfully that exercising a power in the Bankruptcy Code is an unconstitutional violation of a state's sovereign immunity?

Morris pointed out the advantages of consent because the bankruptcy judge can provide protection from court orders and ``eliminate the need for multiple forums to decide issues.''

Bennett argues that the U.S. Supreme Court has had no occasion to decide whether some of the powers given to a bankruptcy judge violate the notion of sovereign immunity. Bennett said it's an ``overstatement'' to interpret the leading 1938 Supreme Court municipal bankruptcy case, U.S. v. Bekins, to mean that filing in Chapter 9 represents consent to all of the powers given a bankruptcy judge by the statute.

In other words, Bennett believes a municipality may be able to file in Chapter 9 and then ``cherry pick" parts of the statute not to be applied. In his analysis, the idea that a Chapter 9 filing represents consent to every power in the statute ``is unsupported by a critical analysis of the Constitutional structure of sovereign immunity."

Bennett touched on another issue that might assist Puerto Rico with its financial problems. As the equivalent of a state, commonwealth is ineligible for Chapter 9. Puerto Rico therefore adopted its own statute that looks similar to Chapter 11. Bondholders started a lawsuit contending the commonwealth statute is unconstitutional as a violation of both Bankruptcy Clause and Contracts Clause in the federal Constitution.

Bennett says there are at least two theories, one espoused by the late Supreme Court Justice Felix Frankfurter, that states do have some power to modify obligations in contracts. For Bennett, exercising those powers ``may obviate the need for a municipal bankruptcy in some cases."