

Municipal Bankruptcy: State Authorization Under the Federal Bankruptcy Code

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Abstract

Federal law permits municipalities to seek protection from their creditors by filing for bankruptcy under chapter 9, subject to state approval. The state may attach various requirements before granting authorization, such as approval by a state body prior to filing, state appointment of a trustee, and state control over the municipal debt readjustment plan. The key limit on state authority is that once state consent is given, federal bankruptcy law will pre-empt state actions which prevent the municipal-debtor enjoying the "breathing space" of the automatic stay provisions to formulate a debt readjustment plan, and the power to impair debt. Short of destroying these two primary benefits of chapter 9, federal bankruptcy law does not provide definitive limits on state action.

To the extent that courts construe state intent in ascertaining federal pre-emption, a conditional grant of authorization subject to state requirements would be evidence of state intent not to relinquish control over particular issues affecting the municipal-debtor. As a result, the scope of federal pre-emption already quite narrow reflecting the strong deference to state sovereignty in the bankruptcy code.