

**WHO DOES BANKRUPTCY?  
MAPPING PENSION IMPAIRMENT IN CHAPTER 9**

VINCENT S. J. BUCCOLA \*

*Abstract*

*Employee retirement benefits constitute the lion's share of the financial burden today confronting distressed cities and towns across the country. Statehouse bargaining may reduce the costs associated with some of these legacy costs, but most jurisdictions protect pension benefits, to varying degrees, as contractual entitlements immune from impairment by the state. Who will bear the burden of municipal financial distress thus turns in part on the question, recently decided in Detroit, whether federal bankruptcy law is competent to reduce these obligations where state law decidedly is not. Yet little has been written on the subject. This Article takes up the legal issues surrounding Chapter 9's efficacy in this regard. It argues, first, that the critical question is who among those involved in the coordinated activities that constitute bankruptcy "does" impairment. It concludes that under federal law the (federal) bankruptcy judge, and not the states or their constituent municipalities, impair contractual obligations. The terrain is less certain with respect to the discourses of state law, and this could well matter. Still, this Article argues, cities and towns will likely be able to use Chapter 9 to shed liabilities associated with locally administered pension plans. Whether wise policy would permit them to do so is another matter.*

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\* Bigelow Teaching Fellow and Lecturer in Law, University of Chicago Law School. I thank Jack Beermann, Peter Canzano, Guy Neal, and David Skeel for their thoughtful criticism of a previous draft.

### ***Introduction***

No one participating in this symposium will be surprised to hear that legacy liabilities play an outsized role in the fiscal problems today confronting many cities and towns across the country. Whereas bond debt took center stage in past waves of public-entity financial distress, now pension and associated retirement liabilities lead general obligations as the dominant source of financial crunch. One study estimates that unfunded pension debt at the state level amounts to trillions of dollars,<sup>1</sup> roughly three times the size of general-obligation liabilities.<sup>2</sup> And it is in distressed jurisdictions in particular that legacy liabilities are likely to be the greatest burden. Detroit, for example, estimates that its pension debt alone exceeds general-obligation debt by a factor of more than four.<sup>3</sup>

The long-term viability of existing retirement benefit packages is in significant doubt.<sup>4</sup> Any number of social and political factors are ripe for blame: demographic trends (especially increasing life expectancies), health care costs, questionable accounting assumptions, and so on.<sup>5</sup> Solutions, as well as explanations, are multifaceted. Fittingly, in a democratic society, the long-term prospects of defined-benefit pension benefits are primarily the domain of legislative and labor bargaining. The last five years have seen a raft of state initiatives altering the package of retirement benefits available to public employees. These include changes to, among other things, benefits formulae, retirement ages, cost-of-

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<sup>1</sup> Robert Novy-Marx & Joshua Rauh, *Public Pension Promises: How Big Are They and What Are They Worth?*, 66 J. FIN. 1211, 1212–13 (2011). These figures account only for benefits already accrued to employees and retirees; the costs associated with obligations yet to accrue may dwarf these. Studies on the financial condition of strictly municipal pensions are hard to come by. The figures presented here are illustrative only.

<sup>2</sup> Robert Novy-Marx & Joshua D. Rauh, *The Liabilities and Risks of State-Sponsored Pension Plans*, 23 J. ECON. PERSP. 191, 192 (2009).

<sup>3</sup> *In re City of Detroit*, Mich., 504 B.R. 191, 194 (Bankr. E.D. Mich. 2013).

<sup>4</sup> See, e.g., Kevin Olsen, *Detroit Pension Funds Could See Benefit Cuts in Bankruptcy Agreement*, BUS. INS. (Feb. 24, 2014, 9:46 AM), <http://businessinsurance.com/article/20140224/NEWS03/140229945?tags=|62|307|77|82> (“Members of the \$2.77 billion Detroit General Retirement System and \$3.4 billion Detroit Police & Fire Retirement System will see their defined benefit plans remain open, but their pension benefits will be cut . . .”).

<sup>5</sup> *Retirement Benefits: Who Pays the bill?*, ECONOMIST, July 27, 2013, at 71.

living adjustments, and mandatory employee contributions.<sup>6</sup> The next five years will undoubtedly bring more change. But for the most part legislation can rectify structural problems on a go-forward basis only. Accrued benefits are generally protected from unilateral state or municipal diminution because they are understood as contractual in nature.<sup>7</sup>

This presents no small problem. In the years to come, many municipalities will be unable (and others unwilling) to make good even on existing obligations. Enter the Federal Bankruptcy Code. Unlike the states, the federal government is constitutionally permitted to reduce the liabilities of bankrupts.<sup>8</sup> Less clear is whether—and, if so, to what extent—Chapter 9 of the Code is capable of reducing the legacy obligations of eligible municipalities.<sup>9</sup> The answers to these questions are bound to have important static, as well as dynamic, consequences. Most obviously, these answers will affect the immediate distribution of the burden of municipal financial distress. Bondholders, local taxpayers and residents, and state and federal governments, will undoubtedly share part of the direct costs.

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<sup>6</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-322, STATE AND LOCAL GOVERNMENT PENSION PLANS: ECONOMIC DOWNTURN SPURS EFFORTS TO ADDRESS COSTS AND SUSTAINABILITY 18–26 (2012) (summarizing legislative changes to state-sponsored pension plans).

<sup>7</sup> The kinds of benefits so protected vary by state. For a thoughtful and comprehensive account of state variation, see Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDUC. FIN. & POL'Y. 617, 623 (2010) (“[N]o changes to a public pension plan can be made that in any way diminish the retirement benefit the participant would have been entitled to . . .”). Constitutional protection does not typically extend to “accrued” retirement health-care benefits, which are subject to legislative change. *But see* L.A. City Attorneys Ass'n v. City of Los Angeles, No. BS135924 (Cal. Super. Ct. Sept. 13, 2013) (holding that contractual aspect of pension promises extends to health-care benefits).

<sup>8</sup> *See* U.S. CONST. art. I, § 8 (“The Congress shall have Power To . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . .”).

<sup>9</sup> Not all cities may petition for relief under Chapter 9. *See* 11 U.S.C. § 109(c) (2012). States are free to choose whether their constituent municipalities may avail themselves. Currently, roughly half of the states permit municipalities to avail themselves of Chapter 9 (some freely, some with permission of the executive). *See Bankrupt Cities, Municipalities List and Map*, GOVERNING, <http://governing.com/gov-data/municipal-cities-counties-bankruptcies-and-defaults.html> (last visited Apr. 16, 2014) (stating half of States allow municipal bankruptcies).

If Chapter 9 can be used to reduce legacy liabilities, then current and former municipal employees will be added to the mix. But Chapter 9's efficacy has important implications for public finance and governance as well. Suppose counterfactually that bankruptcy were to zero out all claims to deferred employee compensation. All else equal, labor would demand greater promised benefits going forward and bond prices would drop. (This is a basic implication of the principle that an investment's yield and risk go together.)<sup>10</sup> Perhaps most critically, the incentive of labor to monitor municipal fiscal decisions would increase relative to other stakeholders. Whether this would be a good or bad development is not immediately clear, but it would be significant.<sup>11</sup>

In Detroit, as readers likely know, Judge Rhodes has held that pension obligations are subject to impairment like other contractual liabilities in Chapter 9.<sup>12</sup> His decision has been certified for interlocutory review.<sup>13</sup> Meanwhile the contested status of municipal pension obligations looms large in California, where the fates of San Bernardino, Stockton, Vallejo, and other cities depend on the meaning of Chapter 9 and its relationship to state law.<sup>14</sup> More

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<sup>10</sup> See EUGENE F. FAMA & MERTON H. MILLER, *THE THEORY OF FINANCE* 290–92 (1972); see generally Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 *AM. ECON. REV.* 261 (1958).

<sup>11</sup> Note, however, that the people or entities that will bear loss depend on the structure of the pension plans in place, which vary markedly by jurisdiction. In most states, at least some local employees participate in state-sponsored plans. To the extent a state is thereby obliged to pay retirement benefits, it is the state rather than individual retirees that will suffer in the first instance from a discharge in bankruptcy. In other words, the residents of a bankrupt municipality will be able to shift retirement costs to the state's tax base. This sort of design feature has important consequences in both the near- and long-term. Any analysis of the political consequences of Chapter 9 must therefore be undertaken at a micro level. Pension arrangements are too varied to admit of a wholesale evaluation. See 11 U.S.C. § 903 (2012) (“This chapter does not limit or impair the power of a State to control . . . a municipality of or in such State in the exercise of the political or governmental powers of such municipality . . .”).

<sup>12</sup> *In re City of Detroit*, Mich., 504 B.R. 191, 195 (Bankr. E.D. Mich. 2013).

<sup>13</sup> Order Granting Motion for Direct Appeal, *In re City of Detroit*, Mich., No. 13-53846 (6th Cir. Feb. 21, 2014), ECF No. 2839.

<sup>14</sup> Tim Reid, *Battle over Pension Debt Looms in San Bernardino Bankruptcy*, CHI. TRIB. (Aug. 30, 2012), <http://articles.chicagotribune.com/2012-08-30/business/sns-rt-us-sanbernardino-bankruptcy->

broadly, the resolution of this question will inform the bargains being reached in cities and legislatures across the country.

The efficacy of Chapter 9 is thus a critical question for those interested in municipal financial distress. But it also appears to call for a complex legal analysis, turning as it does on a number of interlocking federal and state statutory and constitutional rules. (Anyone who has read Judge Rhodes' 143-page eligibility opinion can verify this.)<sup>15</sup> And there has been little in the way of judicial or scholarly treatment.<sup>16</sup> This short Article seeks to clarify the structure of debate and to venture an assessment of the legal merits.

With respect to the structure of analysis, my central thesis is that the validity of the non-trivial arguments for and against pension impairment through Chapter 9 turns on the answer to a deceptively simple question: who "does" impairment in municipal bankruptcy? Is it the federal government? The state government?<sup>17</sup> Is it both?

This bears some explaining. In one sense it is a trivial claim. The Constitution, as we all know, prohibits states, but not the federal government, from impairing contractual obligations.<sup>18</sup> Thus the identity of the "impairer(s)" is obviously critical. Yet the question who does bankruptcy is deeper, so to speak—trickier to pose, harder to answer—than at first it sounds. Consider the following statements

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pensionsbre87t1lh-20120830\_1\_pension-debt-calpers-pension-costs ("San Bernardino . . . filed for bankruptcy on August 1, [2012 and] has listed California Public Employees' Retirement System (Calpers) as its largest creditor, with unfunded pension obligations totaling \$143.3 million."); David L. Dubrow, *Chap. 9: Last Resort for Municipalities*, 375 BOND BUYER, Jan. 18, 2011, at 7 ("Not being able to restructure these [pension] liabilities places serious limitations on the extent to which Vallejo can establish a foundation of long-term economic stability.").

<sup>15</sup> *In re City of Detroit*, 504 B.R. at 197 ("[T]he issue of whether Public Act 436 violates the Michigan Constitution is important because that Act allows the governor to authorize a municipality to file bankruptcy.").

<sup>16</sup> A rare example is David Skeel's recently issued white paper on the subject. See generally DAVID A. SKEEL, JR., CAN PENSIONS BE RESTRUCTURED IN (DETROIT'S) MUNICIPAL BANKRUPTCY? (Inst. for L. & Econ. ed., 2013), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2360302](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2360302).

<sup>17</sup> For this purpose, municipal action counts as state action.

<sup>18</sup> See U.S. CONST. art. I, § 10. In many jurisdictions, the state constitution codifies an additional restriction on state impairment of contracts. Even where the state constitutional provision is textually identical to the federal one, however, judicial interpretation may differ.

from the two judges who have considered the legality of pension impairment in Detroit:

- Kevyn Orr’s recommendation that the governor permit a bankruptcy petition “reflect[ed] that *Emergency Manager Orr* intended to diminish or impair accrued pension benefits if he were authorized to proceed under Chapter 9.”<sup>19</sup>
- “Impairing contracts is what *the bankruptcy process* does.”<sup>20</sup>
- “[The governor’s] authorization did not include a condition prohibiting *the City* from seeking to impair pensions in a plan.”<sup>21</sup>
- “The Bankruptcy Clause of the United States Constitution, and the bankruptcy code enacted pursuant thereto, explicitly empower *the bankruptcy court* to impair contracts and to impair contractual rights relating to accrued vested pension benefits.”<sup>22</sup>

These four sentences suggest four different actors (or activities) who might “do” impairment. Others are easy to imagine. I do not mean to act the scold, disparaging sentences taken out of context as imprecise models of the elegant simplicity Strunk and White recommend. On the contrary, each of these sentences standing alone is easy to justify as a matter of ordinary English usage. I cite them to show how colloquial speech resists, and in some ways complicates, the precise legal questions at stake.

The discharge of a municipality’s debt in Chapter 9 is the culmination of a series of necessary events, and state and federal actors must each “do” some of the requisite steps: the state must authorize its municipality to petition for relief;<sup>23</sup> the municipality

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<sup>19</sup> Webster v. Michigan, No. 13-734-CZ (Ingham Cnty. Ct. July 19, 2013) (emphasis added) (ordering that the governor rescind his authorization for Detroit to file a Chapter 9 petition).

<sup>20</sup> *In re City of Detroit*, 504 B.R. at 244 (emphasis added).

<sup>21</sup> *Id.* at 222 (emphasis added).

<sup>22</sup> *Id.* at 244 (emphasis added).

<sup>23</sup> 11 U.S.C. § 109(c)(2) (2012) (No municipality may be a debtor under Chapter 9 unless it “is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter . . .”).

must in fact petition for relief;<sup>24</sup> the municipality must propose a plan of adjustment complying with the Bankruptcy Code's strictures,<sup>25</sup> and the bankruptcy judge must confirm the plan.<sup>26</sup> A naïve English speaker might be forgiven for thinking it obvious that both state and federal governments do impairment. We often say that a subject *does* an action if it *causes* the action's consequence. Both federal and state apparatuses could be understood to cause debt impairment in Chapter 9 because both are but-for and proximate causes. But as in so many areas of the law, ordinary English proves too much. Here, as elsewhere, the legal rather than English usage prevails.

But of course there is no single "legal" usage. Meaning depends on context. The meaning of an ambiguous term or phrase is subject to the body of discourse in which it is used. Three such discourses are relevant to our question: (a) the Bankruptcy Code; (b) the Federal Constitution; and (c) state law. The remainder of this Article takes up each source of law in turn, evaluating the merits and explaining the implications of each. Its conclusions can be summarized as follows. The theory of Chapter 9 is that the bankruptcy judge, and not the state or municipal debtor, impairs contractual obligations when she confirms a plan of adjustment. Impairment is a federal, and not a state, activity. For constitutional purposes, furthermore, the state activity required under Chapter 9 to present the bankruptcy judge with a plan need not run afoul of the Contracts Clause. As a matter of federal law, that is, the states do not impair contractual obligations when their municipalities shed liabilities in Chapter 9. Matters of usage are more complicated when it comes to state law. In part, this is because of the sheer variety of state law. Painting with a broad brush is bad practice. I do not identify any state law under which participating in Chapter 9 would clearly "impair" pension obligations. Yet, nor can I discount the possibility that it might in some states. In practical terms, this means

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<sup>24</sup> 11 U.S.C. § 301(a) ("A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter."). Unlike in the case of an insolvent individual or corporation, creditors may not involuntarily force a municipality into bankruptcy. *See* 11 U.S.C. § 303.

<sup>25</sup> 11 U.S.C. § 941 ("The debtor shall file a plan for the adjustment of the debtor's debts. If such a plan is not filed with the petition, the debtor shall file such a plan at such later time as the court fixes."). Again the contrast to individual and corporate bankruptcies is evident.

<sup>26</sup> 11 U.S.C. §§ 943, 944 ("The court shall confirm the plan . . .").

state judiciaries will likely have a role to play in the domain of Chapter 9.

Before proceeding, a note is in order about what this Article does not consider. First, it does not take up the normative question of whether pensions *ought* to be impaired as a matter of policy. There are difficult questions, moral and economic, about who is best situated to bear the incidence of municipal financial distress. There is much to say on the topic, but I leave it for another day.<sup>27</sup> Second, this Article does not examine whether the law permits, or indeed requires, that legacy liabilities be impaired *pari passu* with general unsecured debt. There are two doctrines that come into play there via the requirements for confirmation of a plan of adjustment: to be confirmable over creditor objection, a plan must be in the “best interests of creditors”<sup>28</sup> and cannot “unfairly” discriminate<sup>29</sup> among similarly situated creditors. How these requirements are likely to be understood in the Chapter 9 context is beyond this Article’s scope; but they will be important in resolving how great a share of financial distress each kind of creditor is forced to bear.

### ***I. A Brief Account of Chapter 9 and the Nature of Pension Obligations in Bankruptcy***

Prior to the Great Depression, no formal mechanism existed by which the debt of public entities could be restructured *en masse*. In 1933, Congress amended the Bankruptcy Act to allow distressed towns and cities to adjust debts that had become unsustainable as the national economic malaise persisted.<sup>30</sup> This legislation was addressed in particular to the familiar problem of holdout creditors. When a debtor’s liabilities become too great relative to its ability to generate revenue, a measure of relief can be in the best interests of the debtor and its creditors alike. Individual creditors may nevertheless

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<sup>27</sup> For those interested in two elaborations of this idea, see Clayton P. Gillette, *Bondholders and Financially Stressed Municipalities*, 39 FORDHAM URB. L.J. 639, 639–54 (2012); Richard C. Schragger, *Citizens Versus Bondholders*, 39 FORDHAM URB. L.J. 787, 787–93 (2012).

<sup>28</sup> 11 U.S.C. § 943(b)(7).

<sup>29</sup> 11 U.S.C. § 1129(b)(1) (made applicable in Chapter 9 by 11 U.S.C. § 901).

<sup>30</sup> For a thorough and interesting account of the roots and history of municipal bankruptcy, see Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 450 (1993).



withhold consent to a sensible plan of adjustment in an effort to capture a greater share than that to which they would otherwise be entitled. The principal sponsor of the first municipal bankruptcy legislation had just this dynamic in mind: “In every instance where a governmental unit finds itself in financial difficulty and is able to make some satisfactory agreement of adjustment with the majority of its creditors, there is always a small minority who hold out and demand preferential treatment.”<sup>31</sup> The 1933 amendments sought to overcome holdout by permitting a federal judge to approve a settlement acquiesced in by a super-majority of creditors.

The Supreme Court promptly held the amendments unconstitutional, on the puzzling theory that the grant by the federal government of an option to discharge debts intruded on state sovereignty.<sup>32</sup> Congress enacted substantially identical legislation in 1937, and after the “switch in time” the Court upheld the new law.<sup>33</sup> Federal law has provided some kind of municipal bankruptcy process ever since. The regime in effect today was in large measure established with the advent of the Bankruptcy Code in 1978.<sup>34</sup>

Federalism jurisprudence today looks more favorably on national legislative initiatives than it did when *Ashton* was decided. Nevertheless, municipal bankruptcy law has retained a distinctively deferential posture toward state policy. Chapter 9 circumscribes federal authority, making it parasitic on state law, in ways foreign to the rest of the Bankruptcy Code. A brief review of the law’s key features will thus help to suggest why, and in what senses, the states’ understanding of “impairment” is relevant to the status of pension obligations generally.

The process by which obligations are discharged in Chapter 9 is reasonably straightforward. A case commences when a municipality files a petition for relief.<sup>35</sup> As in other modes of bankruptcy, the petition automatically stays creditor efforts to collect

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<sup>31</sup> *To Amend the Bankruptcy Act Municipal and Private Corporations: Hearing Before the Comm. on the Judiciary H.R. on H.R. 1670, H.R. 3083, H.R. 4311, H.R. 5009, and H.R. 5267*, 73d Cong., 22 (1933) (statement of Rep. J. Mark Wilcox).

<sup>32</sup> *Ashton v. Cameron Cnty. Water Improvement Dist.*, 298 U.S. 513, 531 (1936).

<sup>33</sup> *United States v. Bekins*, 304 U.S. 27, 51 (1938).

<sup>34</sup> *See* Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101–1532 (2012)).

<sup>35</sup> 11 U.S.C. § 301 (2012). No involuntary petitions are permitted. *See* 11 U.S.C. § 303.

on debts.<sup>36</sup> The bankruptcy judge must then decide whether the municipality is eligible for relief. For our purposes, one eligibility criterion is especially important: state consent. The municipality is ineligible, and its case must be dismissed, unless it “is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by state law, or by a governmental officer or organization empowered by state law to authorize such entity to be a debtor under such chapter.”<sup>37</sup>

Assuming the municipality is an eligible debtor, the next phase in a Chapter 9 case proceeds much like any other bankruptcy. Claims against the bankrupt are allowed or disallowed; the automatic stay is lifted where appropriate; the debtor moves to assume or reject executory contracts. Critically, though, the bankruptcy judge may not use the Code’s authority to usurp state control over the debtor. The Code’s language in this respect is opaque yet remarkable: Chapter 9 “does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise . . . .”<sup>38</sup>

In due course the municipality files a “plan of adjustment,” setting out categories of creditor and the proposed treatment of their respective claims. Unlike in a Chapter 11 case, the debtor alone is permitted to file or modify a plan; there is no “exclusivity” period.<sup>39</sup> The plan is put to a vote of impaired creditors, the rules of which are familiar to lawyers used to Chapter 11 plans of reorganization.<sup>40</sup> If the plan fulfills a set of enumerated requirements, including that it be approved by at least one class of impaired creditor, that it be “fair and equitable,” that it not unfairly discriminate against any class of creditor, and that it not require the municipality to take any action “prohibited by law,” the bankruptcy judge will confirm it.<sup>41</sup> Confirmation discharges the municipality’s debts.<sup>42</sup> After

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<sup>36</sup> 11 U.S.C. § 922.

<sup>37</sup> 11 U.S.C. § 109(c)(2).

<sup>38</sup> 11 U.S.C. § 903.

<sup>39</sup> 11 U.S.C. §§ 941, 942.

<sup>40</sup> See 11 U.S.C. § 901 (incorporating Chapter 11’s voting rules, including the bankruptcy judge’s power to cram down under certain circumstances a plan garnering the support of at least one impaired class).

<sup>41</sup> H.R. REP. NO. 95-595, at 399–400 (1977).

<sup>42</sup> 11 U.S.C. § 944(b) (“[T]he debtor is discharged from all debts of the time when—(1) the plan is confirmed . . . .”). This is true provided that two other conditions, not relevant here, are satisfied.

confirmation, the “court may,” but need not, “retain jurisdiction” to ensure the municipality complies with the plan.<sup>43</sup>

A natural and critical question is what kinds of “debts” Chapter 9 is competent to discharge, and how these debts relate to municipal pension obligations. The Bankruptcy Code defines a debt as a “liability on a claim.”<sup>44</sup> A “claim” is in turn defined as a “right to payment,” and comprises rights both fixed and contingent, matured and unmatured.<sup>45</sup> In other words, bankruptcy impairs current and future rights to payment. In general, the Code looks to state law to create and define these rights.<sup>46</sup> It takes the debtor’s state-law obligations as given, and then reduces or otherwise restructures them according to the contents of a confirmed plan.

Historically, the states understood public pensions as “gratuities.”<sup>47</sup> They did not create binding obligations in any sense.<sup>48</sup> Two states—Indiana and Texas—retain this understanding.<sup>49</sup> Since a municipal pension “promise” in these states does not grant the beneficiary a right to payment, Chapter 9 is beside the point. An Indiana town can unilaterally adjust the distributions it makes to current and retired employees; the Contracts Clause is no bar.<sup>50</sup> But during the twentieth century, states began to understand pensions as creating enforceable contractual rights in the beneficiary.<sup>51</sup> In some cases the change came through formal constitutional amendment,<sup>52</sup>

<sup>43</sup> 11 U.S.C. § 945(a).

<sup>44</sup> 11 U.S.C. § 101(12).

<sup>45</sup> 11 U.S.C. § 101(5)(a).

<sup>46</sup> See *Butner v. United States*, 440 U.S. 48, 54 (1979) (“Congress has generally left the determination of property rights in the assets of a bankrupt’s estate to state law.”).

<sup>47</sup> Amy B. Monahan, *Statutes as Contracts? The “California Rule” and Its Impact on Public Pension Reform*, 97 IOWA L. REV. 1029, 1035 (2012).

<sup>48</sup> See *id.* (“[Pensions] may be given or withheld at the pleasure of a sovereign power.”).

<sup>49</sup> Monahan, *supra* note 7, at 620. For a comprehensive account of this historical development and of contemporary state treatment of pensions, see generally *id.* (discussing the historical development of state treatment of pensions); see also Monahan, *supra* note 47, at 1035 (same).

<sup>50</sup> Monahan, *supra* note 47, at 1038 (“[E]ven in the absence of explicit language regarding contract formation, statutory language may create a contractual offer that is accepted by performance.”).

<sup>51</sup> See *id.* at 1035 (“In the early to mid-twentieth century, however, nearly every state moved away from this view of public pensions.”).

<sup>52</sup> *E.g.*, HAW. CONST. art. XVI, § 2 (“Membership in any employees’ retirement system of the State or any political subdivision thereof shall be a

in others by judicial decision.<sup>53</sup> Today, the vast majority of states treat pension promises as contractual in nature, granting beneficiaries a right to payment.<sup>54</sup> The nature of this right differs by state. In some states, only accrued benefits are protected contractually; in others, employees can insist on the package of benefits promised as of the date of first employment.<sup>55</sup> These differences will be crucial to the scope and significance of bankruptcy's putative power to impair, but as an analytical matter it need not concern us here. For present purposes, it is enough to see that public employees in most states enjoy a contractual entitlement, not to be impaired *by the state*, to promised benefits. Chapter 9 thus appears on its face a viable way to restructure public-employee pension obligations in the same way as other contractual obligations. To the extent the right to payment on a bond can be impaired, so too, it would seem, can the right to payment on a pension "contract."

But we need to be careful about who exactly is obliged by the pension contract. There is enormous variety in the structure of municipal-employee pension arrangements, and this variety implicates Chapter 9's utility, if not efficacy. This Article is not the place to survey the permutations, but a brief note is warranted. Some pension arrangements can fairly be described as local. A sponsoring municipality negotiates benefit terms, sets contribution rates, contributes assets, manages them, and administers benefits directly. The obligation to pay benefits resides with the municipality;

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contractual relationship, the accrued benefits of which shall not be diminished or impaired.").

<sup>53</sup> *E.g.*, Opinion of Justices, 303 N.E.2d 320, 327–28 (1973).

<sup>54</sup> *See* Monahan, *supra* note 7, at 620. The courts of a handful of states describe pension promises as creating "property" interests. *See id.* at 634–35. Typically, as I have said, bankruptcy law defers to such a characterization. *See* *Butner v. United States*, 440 U.S. 48, 55 (1979). In order to avoid questions about unconstitutional takings, the Code has been interpreted not to permit impairment of property interests. *See* *United States v. Sec. Indus. Bank*, 459 U.S. 70, 81 (1982) ("No bankruptcy law shall be construed to eliminate property rights which existed before the law was enacted in the absence of an explicit command from Congress."). But there is reason to think the courts of these "property" states have used the term only loosely and not to signify the kind of interest protected against uncompensated eminent domain. In practice, pensions in the "property" states may be more akin to gratuities than contracts. *See* Monahan, *supra* note 7, at 618.

<sup>55</sup> *See* Monahan, *supra* note 7, at 622–24.

beneficiaries enjoy a “right to payment” from the municipality itself. Here the analogy to the rights of a bondholder is clear enough: the municipality acts as both promisor and obligor.<sup>56</sup> Other arrangements, however, and indeed the bigger share (measured by members and asset values),<sup>57</sup> involve centralized administration of assets and liabilities, typically at the statewide level. Some of these state-sponsored plans, known as “agent” plans function similarly to locally administered plans: assets are pooled for administrative purposes, but a particular city’s employees have a claim only on assets proportional to the city’s contributions.<sup>58</sup> “Cost-sharing” plans, on the other hand, act as a form of pooled insurance to all of the participating municipalities’ beneficiaries.<sup>59</sup> The obligations of a municipality participating in a cost-sharing arrangement are best understood as belonging to the plan itself—CalPERS, for example—rather than directly to its employees and retirees, who are the plan’s beneficiaries. The plan owes agreed-to benefits whether or not a particular municipality has complied with its funding obligations. For these plans, underfunding of accrued benefits is a statewide, and not immediately a municipal, problem. Here the significance of Chapter 9 is in doubt. If a municipality’s obligations to a state-sponsored, cost-sharing plan can be impaired, the treasuries of other participating municipalities, rather than employees and retirees, will bear the burden in the first instance. The externalities associated with underfunding a cost-sharing plan make political response at the statewide level more likely; and needless to say, the state can cudgel its municipalities, both before and after bankruptcy, in ways that retirees cannot. Thus the significance of pension impairment is likely most significant in the context of locally-sponsored plans and state-sponsored agent plans.

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<sup>56</sup> The *Central Falls* case shows how a plan of adjustment could impair this kind of pension obligation. *In re City of Cent. Falls, R.I.*, 468 B.R. 36, 45–46 (Bankr. D.R.I. 2012).

<sup>57</sup> See Novy-Marx & Rauh, *supra* note 1, at 1215–16 n.4 (estimating that local plans are 20% of the size of state-sponsored plans, measured by assets under management).

<sup>58</sup> See GOVERNMENTAL ACCOUNTING STANDARDS BD., FACT SHEET ON THE GASB’S NEW PENSION STANDARDS: GOVERNMENTS IN COST-SHARING MULTIPLE-EMPLOYER DEFINED BENEFIT PENSION PLANS 1 (Dec. 20, 2012), available at <http://retirement.sc.gov/gasb/Fact%20Sheet%20for%20Cost-Sharing%20Multi-Employer%20Plans%20-%20December%202012.pdf>.

<sup>59</sup> *Id.*

## II. *Who Does Bankruptcy?*

The Constitution permits the federal government but not the states to impair contractual obligations.<sup>60</sup> The constitutions of many states reaffirm their impotence in this respect, often with similar or identical language to that of the Federal Constitution.<sup>61</sup> In addition, some state constitutions specifically disclaim the authority to impair pension entitlements (although this is typically redundant to the extent the state treats pensions as contractual in nature).<sup>62</sup> The viability of Chapter 9 as a mechanism to reduce municipal contractual liabilities thus turns in large measure on the identity of the impairer. Some players in the Detroit bankruptcy saw as much. In their briefing on the city's bankruptcy eligibility, a group of creditors argued that their rights could not be impaired because of these constitutional prohibitions, implicitly contending that if their rights were impaired, it would be by the agency of the state (through the municipality).<sup>63</sup> Judge Rhodes dismissed the argument as "frivolous."<sup>64</sup> "Chapter 9 is a federal law," and in his view this settled the matter.<sup>65</sup>

This is not at all clear, however, at least as a matter of first principle. Many federal laws empower state governments to take action on matters otherwise outside their competence. Think of federal statutes permitting the states to tax federal instrumentalities, to join interstate compacts, or statutes ratifying state practices that

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<sup>60</sup> U.S. CONST. art. I, § 10 ("No State shall . . . impair[] the Obligation of Contracts . . .").

<sup>61</sup> *E.g.*, CAL. CONST. art. I, § 9 ("[L]aw impairing the obligation of contracts may not be passed."); COLO. CONST. art. II, § 11 ("[N]or law impairing the obligation of contracts . . . shall be passed by the general assembly."); FLA. CONST. art. I, § 10 ("No bill of attainder, ex post facto law or law impairing the obligation of contracts shall be passed.");

<sup>62</sup> *E.g.*, MICH. CONST. art. IX, § 24 ("The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby."); N.Y. CONST. art. V, § 7 ("After July first, nineteen hundred forty, membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired.");

<sup>63</sup> See *In re City of Detroit*, Mich., 504 B.R. 191, 230–31 (Bankr. E.D. Mich. 2013).

<sup>64</sup> *Id.* at 231.

<sup>65</sup> *Id.*

would otherwise violate the negative Commerce Clause. Some federal programs condition funding on state implementation of federal aims.<sup>66</sup> Laws of these types enable or encourage state action, but no one would say the resulting legislation is for that reason federal in nature. State laws passed with explicit federal permission do not, for example, justify federal-question jurisdiction in the federal courts.<sup>67</sup> To illustrate in a context closer to home, imagine the following federal statute: “If the legislature of any State shall enact a law purporting to impair the obligations of a contract or contracts, such obligation or obligations are hereby impaired in the manner described by the enacted law.” Assuming this hypothetical statute was constitutionally sound, is it obvious which government would be doing impairment? To be sure, the federal statute would perfect, so to speak, any impairment—but only as a rubber stamp. As long as the law remained in place, the agency of the state would be necessary and sufficient to alter contractual obligations. Certainly it would not be frivolous to say this amounts to a state impairment.

The analysis below takes up these questions of usage. It concludes, consistent with Judge Rhodes’ ultimate disposition,<sup>68</sup> that federal law supports the view that impairment under Chapter 9 is a federal and not state activity. In other words, Chapter 9 is justified as a federal matter. Whether a state’s bankruptcy activities—chiefly petitioning for relief and proposing a plan of adjustment—constitute unconstitutional impairment under state law is another matter. Many state constitutions prohibit impairment through similar language as the Federal Constitution, and in this sense there is reason to suppose a consistent analysis—especially where the state-law matter is one of first impression. But this conclusion is not foregone. It is nothing extraordinary, for example, for a state’s judiciary to interpret its (identically worded) free-speech rights in a manner wholly foreign to the Supreme Court’s First Amendment jurisprudence. This

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<sup>66</sup> One example of such a program is the federal government’s conditioning of highway funding on whether a state permits the sale of alcohol to those under twenty-one years of age. 23 U.S.C. § 158 (2012) (“The Secretary shall withhold 10 per centum of the amount required to be apportioned to any State . . . in which the purchase or public possession in such State of any alcoholic beverage by a person who is less than twenty-one years of age is lawful.”).

<sup>67</sup> *American Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257, 260 (1916) (“A suit arises under the law that creates the cause of action.”).

<sup>68</sup> See *supra* notes 12–16 and accompanying text (introducing Judge Rhodes’ opinion).

observation has an important practical significance. It suggests that a state's courts—not just its legislature and executive—will have a say in deciding whether Chapter 9 will be a valuable arrow in the quivers of local towns and cities.

### A. Chapter 9

By its terms, Chapter 9 premises the impairment of contractual obligations on a series of state actions. The state must authorize a petition; the municipality must file a petition and propose a plan of adjustment.<sup>69</sup> It is at least coherent, then, to describe municipal bankruptcy as supporting a theory of state, or joint state and federal, impairment. Nevertheless, there are a number of good reasons to conclude that Chapter 9's theory of impairment is one of federal and not state action.

The Bankruptcy Code's language, although ultimately ambiguous, is a good place to start. First, note that the statute does not declare expressly whose agency is thought to impair municipal obligations. It speaks rather of how, and when, obligations are to be impaired:

(b) Except as provided in subsection (c) of this section, the debtor is discharged from all debts as of the time when—

- (1) the plan is confirmed;
- (2) the debtor deposits any consideration to be distributed under the plan with a disbursing agent appointed by the court; and
- (3) the court has determined—
  - (A) that any security so deposited will constitute, after distribution, a valid legal obligation of the debtor; and
  - (B) that any provision made to pay or secure payment of such obligation is valid.<sup>70</sup>

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<sup>69</sup> See 11 U.S.C. §§ 941–43 (2012).

<sup>70</sup> 11 U.S.C. § 944(b).



Impairment is achieved, finally, by acts of the bankruptcy judge.<sup>71</sup> Nor are these merely clerical acts. Chapter 9 does not empower a municipality to set whatever terms of impairment it likes, with the bankruptcy judge required to ratify its choices as a formal matter. Instead, the bankruptcy judge must find facts and apply to them a set of legal criteria that are decidedly federal in nature.<sup>72</sup> This sort of final, judicial work is at least consistent with a theory of federal impairment. Consider in this vein the usages of criminal law. A criminal defendant is adjudged guilty, finally, when a judge has imposed sentence. Judgment may issue only after the executive has, among other things, charged the defendant, procured an information or indictment, and put on evidence. Yet the final step is properly judicial. At last the judge must decide whether the evidence presented could support a guilty verdict and, if so, what sentence is merited by law. No one says the executive pronounces guilt; everyone says the judiciary does.

Linguistic and analogical reasoning only go so far. In this instance it is ambiguous. Usage here is better gleaned from historical practice. Members of the Congress that passed the 1937 Act evidently believed that the statute would create an avenue for federal impairment.<sup>73</sup> The House Committee charged with producing the bill urged that it was necessary precisely because states could not impair contractual obligations:

There is no hope for relief through statutes enacted by the States, because the Constitution forbids the passing of State laws impairing the obligations of existing contracts. Therefore, relief must come from Congress, if at all. The committee are not prepared to admit that the situation presents a legislative no-man's land.<sup>74</sup>

The obvious implication is that the municipal bankruptcy law created an avenue for federal and not state impairment. In this the Supreme Court agreed, at least implicitly, when it upheld the law against constitutional scrutiny.<sup>75</sup> Chapter 9 is not the 1937 Act. Some

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<sup>71</sup> *See id.*

<sup>72</sup> *See id.*

<sup>73</sup> *See* H.R. REP. NO. 517, at 3 (1937).

<sup>74</sup> *Id.*

<sup>75</sup> *United States v. Bekins*, 304 U.S. 27, 51 (1938).

particulars have changed. But in broad outline the path to impairment is the same. The longstanding interpretation of the law should liquidate the *statutory* theory of impairment.

Even were the courts ready to set history aside, they would very likely reach the same conclusion as a matter of the rules of statutory construction. If the theory of Chapter 9 were one of state impairment, the law's unconstitutionality would be a straightforward matter. The constitutional avoidance canon would justify a reading of the law premised on federal and not state impairment.<sup>76</sup> To put the conclusion differently, Chapter 9 is conditioned on the view that permitting a petition, filing a petition, and proposing a plan of adjustment do not, singly or in combination, constitute impairment.

## B. The Federal Constitution

The theory of Chapter 9 is that municipal debts are discharged by the confirmation of a plan of adjustment—a federal act—and not by anything the state or debtor municipality must do beforehand. Having fixed the meaning of Chapter 9, one must next ask whether it is constitutionally firm. The precise question is whether the acts required of a state under Chapter 9 constitute “impairment” within the meaning of the Contracts Clause. If they do, then the law is unconstitutional<sup>77</sup>—at least, as I shall explain, as

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<sup>76</sup> See, e.g., *United States v. Jin Fuey Moy*, 241 U.S. 394, 401 (1916) (“A statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional, but also grave doubts upon that score.”); EINER ELHAUGE, *STATUTORY DEFAULT RULES: HOW TO INTERPRET UNCLEAR LEGISLATION* 237–39 (2008) (“Because the U.S. Supreme Court does not itself render common law decisions, one would expect it to invoke this canon somewhat more often than state courts, which can instead invoke the canon against deviations from common law to reduce and police lower court variance.”).

<sup>77</sup> One might suppose that Chapter 9 is a constitutional way to abrogate the ban on state impairment. Article I of the Constitution prohibits states from impairing the obligation of contract, but it also permits Congress to “establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.” U.S. CONST. art. I, § 8, cl. 4. This Congress has done via Chapter 9, at least in the Supreme Court's view. The question is which provision trumps—the grant of power to Congress or the reservation of power from the state? As an interpretive matter, one typically says that the “narrower” or more specific rule sets a limit on the more general. Here, though, neither rule is narrower in any rigorous sense. The set defined by

applied in certain circumstances.

There is precious little law governing the question, but my sense is that courts should and will hold Chapter 9's theory of impairment constitutionally sound. Probably the strongest evidence for this conclusion is precedent, in particular the 1938 Supreme Court decision upholding the constitutionality of municipal bankruptcy.<sup>78</sup> *Bekins* did not have occasion to address expressly the identity of the impairer.<sup>79</sup> The challenge to the law's constitutionality hinged on the Fifth and Tenth Amendments rather than the Contracts Clause, and the Justices appropriately addressed the arguments as framed. Yet the Court's summation of the basic legal problem occasioning the federal law strongly suggests an understanding of the Contracts Clause consistent with Chapter 9's constitutionality:

The natural and reasonable remedy through composition of the debts of the [debtor] was not available under state law by reason of the restriction imposed by the Federal Constitution upon the impairment of contracts by state legislation. The bankruptcy power is competent to give relief to debtors in such a plight . . . .<sup>80</sup>

So, although constitutionality was not challenged on the ground that states would *still* be impairing contracts, it seems to have been a premise of the Court's reasoning that that *was not* true—i.e., that the federal government alone would be doing the impairment.

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each rule includes elements not included by the other. It is easy to posit a state law impairing the obligation of contracts that does not fall within the domain of a federal bankruptcy statute, and equally easy to posit a federal bankruptcy rule that does not permit states to impair contracts. The better argument—as a matter of text, anyway—is that Congress may not authorize states to impair contracts. Note how the structure of the first clause of Article I, Section 10, differs from that of the second and third clauses. Clauses two and three expressly reserve the power of Congress to permit the states powers otherwise barred. *See* U.S. CONST. art. I, § 10. Clause one makes no such reservation. *See id.* This suggests that the restriction is absolute—that it cannot be vitiated by otherwise properly enacted federal law. Nevertheless, this is not a slam dunk argument. One could imagine courts coming to a different conclusion.

<sup>78</sup> *Bekins*, 304 U.S. at 53–54.

<sup>79</sup> *See id.*

<sup>80</sup> *Id.*

The understanding of impairment underlying *Bekins* is today subject to attack, of course. But to attack it one would need countervailing evidence of constitutional meaning, evidence strong enough to dislodge not only *Bekins* and nearly eighty years of municipal bankruptcy, but also the modest presumption that the means Congress uses to pursue legitimate ends are constitutionally firm. Such evidence does not seem to exist. I am not aware of any decisional law holding, for example, that a state violates the Fourteenth Amendment merely by seeking a judicial remedy in federal court. On the contrary, one is more likely to discover the federal courts denying relief to a party on the ground that supplying a judgment would itself amount to an abridgment of a constitutional right.<sup>81</sup> When the constitutionality of an outcome achieved through litigation is in question, it seems to be generally understood that the court's decree is the outcome's legal cause.

Quite apart from notions of *stare decisis*, a holding that the state action inherent in Chapter 9 amounts to impairment would open a Pandora's box, with constitutional ramifications for bankruptcy law far beyond the municipal context. For example, one of the prerequisites to a plan's confirmation is the vote of impaired creditors.<sup>82</sup> Does this mean creditors "impair" contractual obligations by voting for a plan? The states regularly participate as creditors in corporate bankruptcies. Is Chapter 11 thus unconstitutional as applied whenever a state approves a plan discharging liabilities? It would be possible to reconcile contrary conclusions, of course. A vote is one thing, the proposition of a plan of adjustment another entirely. But this sort of problem counsels against upsetting a view with pedigree.<sup>83</sup>

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<sup>81</sup> See, e.g., *Shelley v. Kraemer*, 334 U.S. 1, 20–21 (1948) (holding that the enforcement by a state court of racially discriminatory restrictive covenants would violate the Fourteenth Amendment).

<sup>82</sup> See 11 U.S.C. § 901(a) (2012) (applying section 1126(c) to Chapter 9).

<sup>83</sup> Even supposing the courts were inclined to hold that the state involvement required by Chapter 9 amounted to impairment by the state, it might not matter a whole lot. The courts would consider the constitutionality of Chapter 9 "as applied." That means they would need to identify whether in any given case the plan of adjustment amounted to an unconstitutional "impairment." This is not as simple as it sounds, because the Supreme Court has held that practical, rather than nominal, obligations are what matters when a state reduces the nominal obligations of its cities. *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 512–16

### C. State Law

Apart from the federal prohibition on states impairing contractual (and therefore pension) obligations, the constitutions of many states independently disclaim this authority. These rules are typically framed in terms similar or identical to those of the Federal Contracts Clause. Michigan's constitution, to take one obviously important example, provides that "[n]o . . . law impairing the obligation of contract shall be enacted."<sup>84</sup> In California, similarly, "[a] . . . law impairing the obligation of contracts may not be passed."<sup>85</sup> Not every state constitution contains a "contracts clause," but many do.

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(1942). And for a number of doctrinal reasons, creditor remedies are lacking.

In *Faitoute Iron & Steel Co. v. City of Asbury Park*, the Court upheld a New Jersey composition scheme under which the state altered the maturity and interest rates associated with municipal bonds issued by Asbury Park. *Id.* at 502–16. During the boom of the 1920s, the city had borrowed extensively to fund capital-intensive improvements on the boardwalk. *Id.* at 503. The reduction in tax revenue associated with the Depression, coupled with cost overruns and perhaps shoddy management, meant that the city could not hope to repay its debt. *Id.* at 503. Asbury Park defaulted and was placed under state management akin to receivership. *Id.* at 504. By statute the state's supreme court was permitted to adjust the interest and maturity terms of municipal debt, provided that 85 percent of claimants consented. *Id.* The court approved such an agreement, and dissenting bondholders brought their case to the federal judiciary. *Id.* at 504–05. The Supreme Court upheld the regime against a Contracts Clause challenge. *Id.* at 515–16. In the Court's view, the composition, although it reduced the nominal amount owed on the bonds, did not impair any practical right enjoyed by the bondholders. *Id.* at 512–16. The city's promise to pay was a mere "paper right" because the bondholders' sole remedy, mandamus against local officials to compel a tax, had proved to be an "empty right to litigate." *Id.* at 510.

Congress quickly abrogated *Faitoute*. States may no longer compose the debts of their municipalities absent the consent of each affected creditor; Chapter 9 is now the only route to adjustment of municipal debt. *See* 11 U.S.C. § 903 (2012). But *Faitoute*'s rationale would seem to survive intact with respect to the federal *constitutional* significance of a state composition of municipal debt.

<sup>84</sup> MICH. CONST. art. I, § 10.

<sup>85</sup> CAL. CONST. art. I, § 9.

Some constitutions separately protect retirement benefits, or a class of retirement benefits, from unilateral reduction by the state. These provisions have no analog in the Federal Constitution. In most instances, however, they use the same verb—to impair—to describe what the state may not do. They may also protect retirement benefits from “diminishment,” although that seems to be largely redundant of impairment. Alaska is a good example. Its constitution states: “Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired.”<sup>86</sup> Arizona’s constitution is similar, but not identical: “Membership in a public retirement system is a contractual relationship that is subject to article II, section 25, and public retirement system benefits shall not be diminished or impaired.”<sup>87</sup> Michigan, too, protects a subset of promised benefits, but with language that could be interpreted differently in important respects: “The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.”<sup>88</sup>

My analysis so far has argued that Chapter 9 envisions contractual impairment by the federal government, and not by the states, and that this theory is consistent with the Federal Constitution. Typically one imagines federal law trumping inconsistent state law. But Chapter 9 is unusual. It conditions the bankruptcy court’s authority to impair contracts on the non-displacement of certain aspects of state policy. The most obvious example concerns eligibility. Bankruptcy can give no relief unless the petitioning municipality “is specifically authorized . . . to be a debtor under [Chapter 9] by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter.”<sup>89</sup> Every municipal debtor will have at least colorable authorization. But if within the meaning of a state’s constitution the act of petitioning—or perhaps the act of petitioning plus proposing to adjust debts—were understood to constitute

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<sup>86</sup> ALASKA CONST. art. XII, § 7.

<sup>87</sup> ARIZ. CONST. art. XXIX, § 1. The provision to which this rule applies states that “No bill of attainder, ex-post-facto law, or law impairing the obligation of a contract, shall ever be enacted.” ARIZ. CONST. art. II, § 25.

<sup>88</sup> MICH. CONST. art. IX, § 24.

<sup>89</sup> 11 U.S.C. § 109(c)(2) (2012).

“impairment,” then statutory authorization to petition would be void as *ultra vires*. Last July, Judge Aquilina ordered that Detroit’s bankruptcy petition be withdrawn.<sup>90</sup> Something like this theory seems to have driven her judgment (on a charitable reading, anyway; the precise ground of her decision was opaque).

In like fashion, Chapter 9 reserves to the state the power to control its debtor municipality’s “political or governmental powers.”<sup>91</sup> The exact contour of these powers is not clear. But suppose one of the governmental powers a state wished to restrict—and did restrict, through its constitution—was the power to “impair” contractual obligations. Once again, the meaning of impairment as a matter of the discourse of state law would be critical. If the proposal of a plan of adjustment amounted to impairment under state law, then the bankruptcy judge would have to dismiss the case. To permit a plan of adjustment would usurp a state right that the Bankruptcy Code guarantees.

The terms of state constitutions vary. The interpretation of—the discourses spawned by—these varying terms vary even more. I do not here wish to opine on the nature of any one state’s “impairment” jurisprudence. For a casual observer it is hard to see an obvious reason to understand impairment in Michigan’s contract clause differently from impairment in the Federal Constitution. But on the other hand, state courts frequently read their charters to secure more or different rights than analogous federal provisions.<sup>92</sup> One can imagine a state court divining the following rule from a command that retirement benefits not be impaired or diminished: the state must take all reasonable steps to ensure that (contractual) pension

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<sup>90</sup> See *Webster v. Michigan*, No. 13-734-CZ (Ingham Cnty. Ct. July 19, 2013) (“PA 436 is unconstitutional and in violation of Article IX Section 24 of the Michigan Constitution to the extent that it permits the Governor to authorize an emergency manager to proceed under Chapter 9 in any manner which threatens to diminish or impair accrued pension benefits; and PA 436 is to that extent of no force or effect . . .”).

<sup>91</sup> 11 U.S.C. § 903.

<sup>92</sup> Many state constitutions protect residents from “unreasonable searches and seizures,” for instance, employing language identical to that of the Federal Constitution. Compare U.S. CONST. amend. IV, with, e.g., PENN. CONST. art. I, § 8. Yet the courts of such a state may decide, for example, that although the Supreme Court has discovered in these words a good-faith exception to the exclusionary rule, the identical provision implies nothing of the sort as a matter of state law. See *Commonwealth v. Edmunds*, 586 A.2d 887, 894–905 (Pa. 1991).

obligations are not impaired—by anyone. The crucial point is that the meaning of impairment under the Michigan constitution is not necessarily the same as its meaning under federal law. This is an amateur observation about the nature of constitutional law, but it is central to understanding Chapter 9's possibilities.

I will hazard an empirical prediction. Bankruptcy judges are unlikely to find two distinct concepts of impairment, one under federal, another under state, law—at least absent clear direction from the relevant state's court of last resort. Many bankruptcy judges will leap directly past the interpretive task. Nevertheless, the independence of state law from federal law—and in particular the independent elaboration of its concepts—may have an important consequence. It means that state judiciaries hold a veto power. Their position as the preeminent expositors of state law—not to mention their injunctive power—puts them in a position to nix Chapter 9 as a means by which municipalities can shed pension obligations.

### *Conclusion*

The thrust of this Article has concerned more the structure of a legal question's analysis than the substance of its answer. The arguments concerning pension impairment that have been made in Detroit, and which we will undoubtedly see elsewhere in the near future, have the look of thrift-shop dinnerware. None quite seems to go with another. My primary aim has been to suggest a question that underlies most (but not all) of the non-trivial contentions: namely, who does bankruptcy? On the merits, the answer seems to be the federal government. Some state courts may decide otherwise, and such decisions would narrowly circumscribe Chapter 9's utility in the jurisdiction. But the likelier conclusion is that municipalities may indeed use bankruptcy to shed some of their retirement-benefit obligations—at least where beneficiaries have a right to payment from the municipality itself.

The magnitude and social desirability of these benefit reductions will depend on a number of factors, general and city-specific, that are beyond this Article's scope.