

Constitutionalized Consent: Preemption of State Tax Limits in Municipal Bankruptcy

John Patrick Hunt[†]

Many states impose absolute limits on municipal taxes, such as a one percent maximum property tax. States also commonly require electoral approval of municipal taxes. California's Proposition 13 is the best-known example of such state-imposed requirements. Such restrictions reduce municipal flexibility in dealing with financial distress and may contribute to municipal financial distress.

This Article argues that Congress may constitutionally preempt such rules in the exercise of its bankruptcy power. Preemption of state tax limits in bankruptcy should be found to lie within Congress's power under the Bankruptcy Clause. The Clause has been interpreted to provide expansive authority to legislate on the subject of insolvency—that is, a person's general inability to pay debts. Taxation is intimately bound up with municipal ability to pay debts. Indeed, taxation occupies a position in municipal debt collection roughly analogous to that of property in non-municipal debt collection. The Supreme Court's understanding of the scope of the Bankruptcy Clause has consistently evolved in the direction of finding broader authority under the Clause to meet novel conditions, such as the unprecedented potentially impending municipal debt crisis brought on by a squeeze between pension obligations that cannot be changed and taxes that cannot be increased.

The most serious objection to the Article's thesis may be that preempting state tax limits would violate the Tenth Amendment. This Article argues that the requirement that states consent to their municipalities' bankruptcies cures any Tenth Amendment problem. Perhaps somewhat surprisingly, the power of state consent to municipal bankruptcy is such that it authorizes municipalities to propose bankruptcy plans that would otherwise violate state law, including the state constitution. The landmark decisions in Detroit and Stockton, which held that municipal bankruptcy trumped state constitutional protections for municipal retirees, are recent and prominent cases that embrace this proposition.

[†] Professor of Law and Martin Luther King, Jr. Research Scholar, University of California, Davis School of Law (King Hall), jphunt@ucdavis.edu. The author thanks Afra Afsharipour, Katherine Florey, Darien Shanske, and Samuel Weinstein for helpful discussions. Connor Capestany, Brenn Coyle, and Hongyu (Jenny) Zhao provided very useful research assistance. Thanks also to King Hall Dean Kevin Johnson and Senior Associate Dean for Academic Affairs Madhavi Sunder for financial support of this work. All opinions and errors are the author's own.

Just as state constitutional protections for creditors yield to municipal bankruptcy, so too would state constitutional limits on municipal taxes yield to a revised municipal bankruptcy statute that preempted them.

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Introduction

Municipal bankruptcy has attracted a great deal of attention recently, with high-profile cases completed in Vallejo¹ and Stockton,² California; Jefferson

1. See Bobby White, *Bankruptcy Exit Approved for City*, WALL ST. J. (Aug. 6, 2011), <http://www.wsj.com/articles/SB10001424053111903885604576486402778541450>.

2. See Katy Stech, *Stockton, Calif., To Exit Bankruptcy Protection on Wednesday*, WALL. ST. J. (Feb. 24, 2015, 4:58 PM), <http://www.wsj.com/articles/stockton-calif-to-emerge-from-bankruptcy-protection-on-wednesday-1424815104>.

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County, Alabama;³ and Detroit, Michigan.⁴ A third California case, in San Bernardino, is continuing.⁵ As city leaders, residents, and creditors work through the implications of these cases, the President of the Federal Reserve Bank of New York fears the filings may presage more bankruptcies as municipal governments contend with often-dire financial prospects.⁶

According to prominent scholars, the central problem that municipal bankruptcies solves is “excessive” debts, in particular debts owed to employees such as pensions and retiree health benefits.⁷ Indeed, the landmark *Detroit*⁸ and *Stockton*⁹ decisions made headlines because of their rulings that municipal bankruptcy can be used to impair pension and retiree health obligations.¹⁰

This Article seeks to broaden the focus of the discussion beyond municipal debts to include municipal revenues. After all, financial distress does not result whenever there are high debts; it results when there are insufficient

3. See Barnett Wright, *It's Over. Jefferson County Today Emerges from Bankruptcy Following Sale of New Sewer Warrants*, AL.COM (Dec. 3, 2013, 10:51 AM), http://blog.al.com/spotnews/2013/12/its_over_jefferson_county_emer.html.

4. See Christine Ferretti, *Detroit Emerges from Bankruptcy Today*, DET. NEWS (Dec. 10, 2014, 11:29 AM), <http://www.detroitnews.com/story/news/local/wayne-county/2014/12/10/detroit-bankruptcy/20192957>.

5. See Ryan Hagen, “Major Step Forward” for San Bernardino Bankruptcy, SUN (Apr. 1, 2016, 5:48 PM), <http://www.sbsun.com/government-and-politics/20160401/major-step-forward-for-san-bernardino-bankruptcy> (“The end to the city’s three-year-old bankruptcy is in sight . . .”).

6. See William C. Dudley, President and Chief Exec. Officer, Fed. Reserve Bank of N.Y., Opening Remarks for the Chapter 9 and Alternatives for Distressed Municipalities and States Workshop (Apr. 14, 2015) (arguing that Detroit and Stockton bankruptcies “may foreshadow more widespread problems” and that “[w]e need to . . . address[] the underlying issues before any problems grow to the point where bankruptcy becomes the only viable option”).

7. See Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Role in Municipal Bankruptcy*, 125 YALE L.J. 1150, 1184 (2016) (“Because the financial distress of many municipalities stems in large part from obligations such as pensions that cannot easily be restructured outside bankruptcy, additional filings can reasonably be anticipated.”); *id.* at 1224 (arguing that state insolvency regimes that attempt to remedy distress caused by cities’ “profligate pension arrangements” might be unconstitutional); Michael W. McConnell, *Extending Bankruptcy Law to States*, in WHEN STATES GO BROKE: THE ORIGINS, CONTEXT, AND SOLUTIONS FOR THE AMERICAN STATES IN THE FISCAL CRISIS 229, 229 (Peter Conti-Brown & David A. Skeel, Jr. eds., 2012) (“The principal advantage of bankruptcy, under current fiscal circumstances, is to allow cities and counties to force renegotiation of contractual obligations such as pay, retirement, pensions, and health care.”); David A. Skeel, Jr., *What Is a Lien? Lessons from Municipal Bankruptcy*, 2015 U. ILL. L. REV. 675, 694 (“There . . . are strong normative grounds for the conclusion that pensions can be restructured, at least in some circumstances.”); David A. Skeel, Jr., *When Should Bankruptcy Be an Option (for People, Places, or Things)?*, 55 WM. & MARY L. REV. 2217, 2244-45 (2014) (arguing for state bankruptcy regime providing for restructuring of state pensions); David A. Skeel, Jr., *Is Bankruptcy the Answer for Troubled Cities and States?*, 50 HOUS. L. REV. 1063, 1082 (2013) (“There is a strong argument . . . that the unfunded portion [of municipal pensions] can be restructured in bankruptcy.”).

8. *In re City of Detroit*, 504 B.R. 97 (Bankr. E.D. Mich. 2013).

9. *In re City of Stockton*, 478 B.R. 8 (Bankr. E.D. Cal. 2012).

10. See, e.g., Monica Davey et al., *Detroit Ruling on Bankruptcy Lifts Pension Protections*, N.Y. TIMES (Dec. 5, 2013), <http://www.nytimes.com/2013/12/04/us/detroit-bankruptcy-ruling.html>; Jim Christie & Peter Henderson, *Court Lets Stockton, Calif. Cut Retiree Health Care*, REUTERS (July 27, 2012), <http://www.reuters.com/article/usa-bankruptcy-stockton-idUSL2E8IS0A720120728>.

revenues to service those debts. It stands to reason that increasing revenues, not just cutting obligations, can be part of municipal financial rehabilitation.

This Article focuses on one major obstacle to increasing municipal revenues. Many states impose absolute limits on municipal taxes, such as a one percent maximum property tax. States also commonly impose electoral requirements on municipal taxes, such as a requirement that new sales taxes be approved by two-thirds of the municipality's residents. California's Proposition 13 is the best-known example of such state-imposed requirements.¹¹ Many other states have since adopted similar rules.¹²

This Article argues that Congress may constitutionally preempt such rules in the exercise of its power under the Bankruptcy Clause.¹³ The Supreme Court has interpreted the Clause to provide Congress expansive authority to "establish uniform laws on the subject of any person's general inability to pay his debts."¹⁴ Taxation is intimately bound up with municipal ability to pay debts. Indeed, taxation occupies a position in municipal debt collection roughly analogous to that of property in non-municipal debt collection.¹⁵ The Supreme Court's understanding of the scope of the Bankruptcy Clause has consistently evolved in the direction of finding broader authority under the Clause to meet novel conditions. Further, the squeeze between pension obligations that cannot be changed and taxes that cannot be raised presents a novel set of conditions, one that threatens to bring a municipal debt crisis.¹⁶

The more serious objection to preemption of state tax limits in bankruptcy might be that preemption would violate state sovereignty, as protected by the Tenth Amendment. But, crucially, a municipality cannot enter bankruptcy unless its state authorizes it to do so. Municipal bankruptcy precedents, starting with the Supreme Court's 1938 decision in *United States v. Bekins*,¹⁷ have always held that state consent to municipal bankruptcy cures the Tenth Amendment problem.

Perhaps somewhat surprisingly, the force of state consent to municipal bankruptcy is such that it empowers the bankrupt municipality to take actions that would otherwise violate state law, including the state constitution.¹⁸ Historically, this ability was implicit. For example, the Court in *Bekins* held that states could impair contracts in bankruptcy, which necessarily meant that state constitutional provisions forbidding the impairment of contracts gave

11. CAL. CONST., art. XIII A, § 1(a).

12. See discussion *infra* Section I.A.

13. U.S. CONST. art. I, § 8, cl. 4.

14. *Cont'l Ill. Bank & Tr. Co. v. Chi., Rock Island, & Pac. Ry. Co.*, 294 U.S. 648, 670 (1935) (quoting *Kunzler v. Kohaus*, 5 Hill 317, 321 (N.Y. Sup. Ct. 1843)).

15. See discussion *infra* Section II.B.1.

16. See discussion *infra* Section II.A.2.

17. *United States v. Bekins*, 304 U.S. 27, 54 (1934).

18. See discussion *infra* Section III.B.

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way.¹⁹ The broader proposition—that municipalities can do in bankruptcy what is otherwise forbidden—has since been made explicit. For example, the landmark decisions in *Detroit* and *Stockton* expressly held that municipal retirees found no succor in state constitutional provisions forbidding the impairment of contracts and protecting state pensions. Because of the supremacy of federal bankruptcy law, retiree health benefits and pensions could be cut in bankruptcy, notwithstanding the Michigan and California constitutions.²⁰ This Article argues that the same principle applies to state constitutional provisions that obstruct municipalities from use of their otherwise existing taxing power. State consent to a revised municipal bankruptcy statute that preempted such provisions should be sufficient to cure federal and state constitutional problems with such a statute.

As noted, the role that revenue increases play in solving municipal financial distress in bankruptcy court has received comparatively little attention, even as scholarly interest in municipal bankruptcy has increased. Recent articles have discussed the claims of residents on bankrupt municipalities,²¹ possibilities for aligning municipal bankruptcy more closely with the goals of bankruptcy law in general,²² the role of state oversight in municipal bankruptcy,²³ and even the possible use of bankruptcy for reforming how municipalities are governed.²⁴ But papers discussing the role of taxes in municipal bankruptcy are relatively rare.

One recent article does argue that Congress intended that tax increases be considered in municipal bankruptcy and considers potential standards for judicial implementation of that intent.²⁵ Another discusses fiscal constraints imposed by states on municipalities as part of the problem of municipal financial distress and mentions state tax levy limits in passing.²⁶ Still, neither of these papers explores state tax limits in depth or puts forth a proposal for

19. *Bekins*, 304 U.S. at 54.

20. *See In re City of Detroit*, 504 B.R. 97, 149-54, 161 (Bankr. E.D. Mich. 2013) (finding that impairment of Detroit municipal pensions in bankruptcy does not violate federal or Michigan constitution); *In re City of Stockton*, 478 B.R. 8, 14-16 (Bankr. E.D. Cal. 2012) (finding that impairment of Stockton municipal retiree health benefits in bankruptcy does not violate federal or California constitution).

21. *See* Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118 (2014).

22. *See* Laura Napoli Coordes, *Restructuring Municipal Bankruptcy*, 2016 UTAH L. REV. 307.

23. *See* Juliet M. Moringiello, *Goals and Governance in Municipal Bankruptcy*, 71 WASH. & LEE L. REV. 403 (2014).

24. *See* Gillette & Skeel, *supra* note 7.

25. *See* John Patrick Hunt, *Taxes and Ability To Pay in Municipal Bankruptcy*, 91 WASH. L. REV. 515 (2016).

26. *See* Christopher J. Tyson, *Exploring the Boundaries of Municipal Bankruptcy*, 50 WILLAMETTE L. REV. 661, 668 (2014) (citing “state tax levy limits” as possible cause of local fiscal distress).

eliminating them. Apart from a single paragraph in a 2011 article by a practitioner,²⁷ the subject of this Article appears to be unexplored.

This Article proceeds as follows. Part I outlines state-imposed limits on municipal taxes, including electoral requirements, and presents a proposal to amend the Bankruptcy Code to preempt such requirements.

Part II analyzes whether state tax limit preemption is within Congress's power under the Bankruptcy Clause. It argues that preemption serves the central bankruptcy-law objectives of debtor rehabilitation and creditor recovery, stressing both that the Supreme Court views the Clause as conferring expansive powers on Congress and that over time the Court has adopted a broadening view of Congress's power under the Clause. Part II also addresses a principal argument that preemption lies beyond Congress's power: that Congress may not use the Bankruptcy Clause to impair the rights of noncreditors. This Part argues that Supreme Court precedent and the Bankruptcy Code both illustrate that Congress may impair and has impaired noncreditor rights.

Part III analyzes the potential Tenth Amendment objection to state tax limit preemption. It presents the core argument that state consent to municipal bankruptcy answers Tenth Amendment objections. Part III also addresses two potential objections: first, that tax's special relationship to sovereignty makes state tax limits invulnerable to preemption, and second, that federalism's function of protecting individual liberty forecloses state tax limit preemption.

Part IV addresses the possibility that states might circumvent preemption of state tax limits by requiring, as a condition of access to bankruptcy, that municipalities abide by such limits. Part IV notes that it is not clear that states have such authority. Even if they do, there is reason to believe they would not exercise it. Finally, it argues that Congress arguably could condition a state's access to municipal bankruptcy on its refraining from insisting on tax limits for its bankrupt municipalities.

I. State Tax Limits and a Proposal for Their Preemption in Municipal Bankruptcy

A. State Tax Limits

This Article is concerned with two types of state measures that restrict local taxes: tax limits and electoral requirements. Tax limits restrict local taxes to particular levels. Electoral requirements mandate popular elections for tax measures so that such measures cannot be adopted by the ordinary governing body of a municipality.

27. See Thomas Moers Mayer, *State Sovereignty, State Bankruptcy, and a Reconsideration of Chapter 9*, 85 AM. BANKR. L.J. 363, 383 (2011).

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Perhaps the best-known example of such restrictions is found in California's Proposition 13, a voter initiative enacted in 1978.²⁸ Proposition 13 and subsequent enactments effectively banned all property tax rate increases, other than those imposed for infrastructure improvements, by limiting the property tax rate for general purposes to one percent of the property's assessed value.²⁹ The assessed property value itself is prohibited from rising more than two percent per year, even if the property's appreciation is greater.³⁰

California cities and counties can adopt a variety of taxes other than the *ad valorem* property taxes capped by Proposition 13. These include parcel taxes, sales taxes, hotel taxes, utility taxes, and business taxes.³¹ However, local taxes are subject to electoral approval by the voters—governing bodies such as city councils cannot simply adopt them. Approval requires a majority, fifty-five percent, or two-thirds of the voters, depending on the taxing entity and the type of tax.³²

California's 1978 tax revolt started a trend. Eighteen additional states enacted property tax limits by 1990.³³ In 1978, Michigan voters approved the "Headlee Amendment," which amended the state constitution to limit the growth in local revenues from assessment increases to the rate of inflation.³⁴ In Massachusetts, 1980 saw the adoption of "Proposition 2½," which set both the maximum property tax rate and the maximum rate of property-tax growth at 2.5%.³⁵ Also in 1980, the New York legislature enacted a six percent limit on the growth of the assessed value of homes.³⁶ In Colorado, the 1992 Taxpayer

28. CAL. CONST. art. XIII A, § 1(a).

29. See *id.* § 1(a), (b)(2)-(3). Such increases require a two-thirds vote, *id.* § 1(b)(2), unless they are for school facilities, in which case they require a fifty-five percent vote, *id.* § 1(b)(3). One other exception is that increases are permitted to repay indebtedness approved by voters prior to July 1, 1978, *id.* § 1(b)(1). However, this provision can be expected to have little effect on contemporary municipal bankruptcies.

30. See *id.* § 2(b).

31. Mac Taylor, *A Look at Voter-Approval Requirements for Local Taxes*, CAL. LEGIS. ANALYST'S OFF. 2 (Mar. 20, 2014), <http://www.lao.ca.gov/reports/2014/finance/local-taxes/voter-approval-032014.pdf>. Other municipalities, such as school districts, community college districts, and special districts such as fire, water, and flood control districts, can enact fewer types of taxes. *Id.*

32. *Id.* at 5. While general taxes require only a simple majority, "special" taxes require a two-thirds vote. Special taxes include those levied by special districts, school districts, and community college districts; taxes dedicated to a specific purpose; and all parcel taxes. *Id.* Taxes to support school facilities bond measures can be enacted with a fifty-five percent vote. CAL. CONST. art. XIII A, § 1(b)(3).

33. ISAAC WILLIAM MARTIN, *THE PERMANENT TAX REVOLT: HOW THE PROPERTY TAX TRANSFORMED AMERICAN POLITICS* 112 tbl.5.1 (2008). By contrast, only six states enacted tax limits in the period before 1978. *Id.*; see also *id.* at 181-84 (presenting statistical analysis indicating that 1978 was a "turning point" for state property tax limitation legislation).

34. MICH. CONST. art. IX, § 31; see also *Headlee Amendment*, MICH. IN BRIEF (Apr. 1, 1998), <http://www.michiganinbrief.org/edition06/text/issues/issue-31.htm>.

35. MARTIN, *supra* note 33, at 113-15. Massachusetts gubernatorial candidate Edward J. King was able to beat incumbent Michael Dukakis in the primary election in part because of his proposal to limit property taxes, which he called the "Massachusetts Thirteen." *Id.* at 114; see also Div. Local Servs., *Levy Limits: A Primer on Proposition 2 ½*, MASS. DEP'T OF REVENUE 3 (2007), <http://www.mass.gov/dor/docs/dls/publ/misc/levylimits.pdf>.

36. MARTIN, *supra* note 33, at 120.

Bill of Rights requires electoral approval to increase local taxes and to spend existing local tax revenues if these revenues grow at a rate higher than the sum of the rates of inflation and population growth.³⁷

Commentators have argued that Proposition 13 made prudent fiscal management more difficult for California municipalities³⁸ and that the tax limitations and electoral requirements have contributed to the financial distress suffered by California municipalities,³⁹ including the San Jose school district,⁴⁰ Orange County,⁴¹ and the City of Vallejo.⁴² Similar assertions have been made respecting other states that followed California's lead and enacted tax-revolt measures of their own.⁴³

37. *State Finances: Constitutional Provisions*, COLO. DEP'T TREASURY, <https://www.colorado.gov/pacific/treasury/constitutional-provisions-0>.

38. See, e.g., STEVEN P. ERIE ET AL., PARADISE PLUNDERED: FISCAL CRISIS AND GOVERNANCE FAILURES IN SAN DIEGO 68 (2011) ("Although the reduction in property taxes certainly hurt [San Diego's] finances, the more important aspect of Proposition 13 was its limit on all other forms of taxes, requiring voter approval for all proposals to increase taxes to pay for specific city services."); *id.* at 70 (noting that instead of straightforward revenue measures like trash fees, "in the aftermath of Proposition 13, Mayor Wilson and the city council expanded the dubious practice of using pension fund earnings to ease the stress on the city's day-to-day budget"); Michael B. Marois & James Nash, *California Schools Suffer Under Proposition 13 Tax Cap's Chaos*, NEWSMAX (July 11, 2011), <http://www.newsmax.com/US/BBEXCLUDE-BNALL-BNCOPY-BNSAC/2011/07/12/id/403281> ("Before Proposition 13, cities, counties, school districts and other local agencies could set their own tax rates and collect and spend the proceeds as they saw fit."); see also Erin Adele Scharff, *Powerful Cities?: Limits on Municipal Taxing Authority and What to Do About Them*, 91 N.Y.U. L. REV. 292, 296 n.15 (2016) (collecting sources on the financial distress created by Proposition 13).

39. See, e.g., Alicia Munnell et al., *Are City Fiscal Woes Widespread? Are Pensions the Cause?*, CTR. FOR RETIREMENT RES. 3 (Dec. 2013), <http://crr.bc.edu/briefs/are-city-fiscal-woes-widespread-are-pensions-the-cause> (arguing that "the requirement for a super majority for any revenue increase made it more difficult for policymakers to raise taxes" and that this difficulty is part of the explanation for California municipalities' financial distress); Joseph Scott McVicker, *The California Budget Crisis*, 29 REV. BANKING & FIN. L. 353, 355-56 (2010) (observing that Proposition 13 requires a two-thirds electoral majority for local tax increases and arguing that "Prop. 13 is heavily to blame for the current fiscal distress of California").

40. See David L. Gregory, *Labor Contract Rejection in Bankruptcy: The Supreme Court's Attack on Labor in NLRB v. Bildisco*, 25 B.C. L. REV. 539, 540 n.2 (1984) (reporting that "many claim" Proposition 13's tax cuts contributed to San Jose school district bankruptcy).

41. See MARK BALDASSARE, WHEN GOVERNMENT FAILS: THE ORANGE COUNTY BANKRUPTCY 13 (1998) (arguing that Proposition 13's tax limits led county officials to pursue risky investment strategies that eventually failed, precipitating the county's bankruptcy); Omer Kimhi, *Chronicle of a Local Crisis Foretold—Lessons from Israel*, 39 FORDHAM URBAN L.J. 679, 682 n.12 (2012) ("Although the [Orange County] bankruptcy was the result of bad investments made by the county's treasurer, California shares much of the responsibility. California shifted costs to its local governments, but at the same time limited, through Proposition 13, their ability to generate revenues."); James E. Spiotto, *Municipal Finance and Chapter 9 Bankruptcy*, 17 MUN. FIN. J., Spring 1996, at 1, 3 (arguing that a "revenue-starved" Orange County took excessive investment risks to make up for the "artificial and unrealistic tax cap and similar constitutional limits on taxation" imposed by Proposition 13 and related legislation).

42. See Christine Sgarlata Chung, *Government Budgets as the Hunger Games: The Brutal Competition for State and Local Government Resources Given Municipal Securities Debt, Pension and OBEP Obligations, and Taxpayer Needs*, 33 REV. BANKING & FIN. L. 663, 679-80 (2014) (noting that Vallejo officials attributed the city's financial woes in part to Proposition 13).

43. See Joshua Sapatichne et al., *Beyond State Takeovers: Reconsidering the Role of State Government in Local Fiscal Distress, with Important Lessons for Michigan and Its Embattled Cities*, MICH. ST. UNIV. EXTENSION 3 (Aug. 31, 2015), http://msue.anr.msu.edu/uploads/resources/pdfs/beyond_state_takeovers.pdf ("Michigan's particular

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But it is not just that tax limits may have helped cause municipal financial distress. Tax limits and electoral requirements make it more difficult for cities to deal with financial distress once it arrives.⁴⁴ When a municipality cannot pay its debts, the solution could include increasing revenue, in addition to reducing the debt load and/or cutting expenses. State tax limits and electoral requirements make it difficult for the municipality to raise additional funds and thus may interfere with successful restructuring. If state tax limits were removed, municipalities would have more flexibility to address their financial distress by raising property taxes and other taxes.⁴⁵

For the remainder of the Article, limits on municipal taxation and electoral requirements for municipal taxation will be referred to as “state tax limits.” This Article considers whether Congress may attack the problem of municipal financial distress by preempting state tax limits in municipal bankruptcy.

B. The Proposal

In brief, Chapter 9 of the Bankruptcy Code allows an insolvent⁴⁶ municipality to receive bankruptcy protection by filing a petition.⁴⁷ The petition stays collection activity against the municipality⁴⁸ and gives the municipality an opportunity to present a plan of adjustment.⁴⁹ The plan must meet a number of requirements and upon a determination that the requirements are met, the bankruptcy court will confirm the plan.⁵⁰ Confirmation of the plan leads, in the ordinary course, to discharge of the municipality’s debts.⁵¹

States can choose whether their municipalities can enter municipal bankruptcy. A municipality cannot enter Chapter 9 bankruptcy unless it is

mix of stringent limitations on local revenue [in combination with other factors] creates conditions that drive up the potential for local fiscal distress.”); Vladimir Kogan, *Causes of Fiscal Crises in State and Local Governments*, in *EMERGING TRENDS IN THE SOCIAL AND BEHAVIORAL SCIENCES* 1, 4 (Robert A. Scott & Stephen M. Kosslyn eds., 2015) (explaining local fiscal crises around the country, in part, because “[s]ince the 1970s . . . government officials have faced even greater constraints [beyond existing balanced-budget requirements] in their fiscal authority and flexibility owing to the passage of tax and expenditure limitations . . . often through mechanisms of direct democracy”).

44. See *Why Some California Cities Are Choosing Bankruptcy*, MOODY’S INV. SERV. 1 (Aug. 17, 2012) (“Proposition 13, the state’s constitutional property tax limitation, restricts the ability of municipalities to adjust tax rates, thereby capping property tax revenues at a time when flexibility is most needed.”).

45. See Scharff, *supra* note 38, at 303 (“[V]irtually all municipalities are authorized to impose property taxes . . .”).

46. 11 U.S.C. § 109(c)(3) (2012) (requiring insolvency as a condition of municipal bankruptcy).

47. *Id.* § 921.

48. *Id.* § 901(a) (incorporating § 362 of the Bankruptcy Code into Chapter 9); *id.* § 362 (providing for automatic stay of collection against bankrupt debtors in general); *id.* § 922 (providing for automatic stay of collection actions particularly relevant to municipal debtors).

49. *Id.* § 941.

50. *Id.* § 943(b) (listing plan confirmation requirements).

51. *Id.* § 944(b) (providing for discharge when plan is confirmed, “the debtor deposits any consideration to be distributed under the plan with a disbursing agent appointed by the court” and the court determines that the consideration is valid).

“specifically authorized” to do so by state law or by an authorized state officer.⁵² Once a municipality enters bankruptcy, however, the municipality itself drives the process. For example, the municipality is the only party that may propose a plan of adjustment of debts.⁵³ However, states may be able to use the authorization requirement to impose conditions on how the municipality conducts the bankruptcy.⁵⁴

Chapter 9 currently seems to require the plan of adjustment to abide by state tax limits. Section 943(b)(4) of the Bankruptcy Code provides that a plan for adjustment of debts in municipal bankruptcy is to be confirmed if “the debtor is not prohibited by law from taking any action necessary to carry out the plan.”⁵⁵ Section 943(b)(6) requires as a condition of confirmation that “any regulatory or electoral approval necessary under applicable nonbankruptcy law in order to carry out any provision of the plan has been obtained, or such provision is expressly conditioned on such approval.”⁵⁶

Thus, under current law, it appears that if a state limits *ad valorem* property taxes to 1% of the assessed value of property, then a plan of adjustment cannot call for an increase to 1.5% of assessed value. Likewise, it appears that if state law provides that new sales taxes must be approved by a two-thirds majority of the voters, a plan of adjustment may not call for an increase in sales taxes without such a vote.

This Article proposes amendments to these two provisions of the Code.⁵⁷ Section 943, as amended, would read (additions underlined):

§ 943. Confirmation

....

(b) The court shall confirm the plan if—

....

(4) the debtor is not prohibited by law from taking any action necessary to carry out the plan, except that a plan may be confirmed if actions necessary to carry out the plan include the adoption of tax levels or increases in excess of limits provided by state law and the debtor is not otherwise prohibited by law from taking any action necessary to carry out the plan;

....

52. *Id.* § 109(c)(2).

53. *Id.* § 941.

54. *See infra* Part IV.

55. *Id.* § 943(b)(4).

56. *Id.* § 943(b)(6).

57. This Article is not the first to argue for normatively desirable changes to municipal bankruptcy law even when those changes may require amending the Code. *See* Gillette & Skeel, *supra* note 7, at 1206 (noting that the authors’ proposal to use municipal bankruptcy to effect local governance reforms has the “potential for impasse” where elections to change local governance are required and suggesting “express amendment of Chapter 9 to trump city charter amendment provisions” as one way of dealing with the issue).

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(6) any regulatory or electoral approval necessary under applicable nonbankruptcy law in order to carry out any provision of the plan has been obtained, or such provision is expressly conditioned on such approval, except that a plan may provide for tax increases notwithstanding any requirement of state law that such increases are subject to electoral approval

The practical effect of these revisions would be that the city council or other governing body in charge of the municipality⁵⁸ would be able to levy or increase taxes that the municipality is otherwise empowered to levy⁵⁹ without regard to state law limits on the absolute level of taxes and without holding an election. For example, the city council of a bankrupt city in California would be able to propose in its plan of adjustment to raise the *ad valorem* property tax rate to 1.5% or the sales tax rate by 1% without holding a local election.⁶⁰ Only the debtor may propose a plan of adjustment under Chapter 9,⁶¹ so the court itself would not be imposing tax increases.⁶²

The proposal would not lead to tax increases without limit. Tax increases beyond a certain level probably do not produce more revenue,⁶³ so municipalities presumably would not pursue such increases, at least intentionally. The officials who impose the taxes through the bankruptcy plan

58. States have varying ways of dealing with municipal financial distress, and the ordinary governing body's authority may be displaced under state law in the event of distress. *See The State Role in Local Government Financial Distress*, PEW CHARITABLE TR. 14-17 (July 2013), http://www.pewtrusts.org/~media/assets/2016/04/pew_state_role_in_local_government_financial_distress.pdf (surveying state approaches to intervention in the affairs of distressed local governments). Detroit's bankruptcy petition, for example, was filed with the state governor's authorization by an appointed emergency manager. *See* Matt Helms et al., *Detroit Files for Chapter 9 Bankruptcy Amid Staggering Debts*, DETROIT FREE PRESS, July 19, 2013, at A1.

59. Municipalities vary in the types of taxes they are permitted to levy. *See* Scharff, *supra* note 38, at 303 ("While virtually all municipalities are authorized to impose property taxes, fewer have sales tax authority, and only a fraction of cities have income tax authority.") (citing *Cities and State Fiscal Structure*, NAT'L LEAGUE OF CITIES 16 tbl.1A (2015), http://www.nlc.org/Documents/Find%20City%20Solutions/Research%20Innovation/Finance/NLC_CSF_S_Report_WEB.PDF).

60. Cities in bankruptcy have on occasion been able to get electoral approval for tax increases. *See* Katy Stech, *Stockton: Bankruptcy Exit Should Move Ahead*, WALL ST. J. (Nov. 29, 2014, 12:04 AM), <https://www.wsj.com/articles/stockton-bankruptcy-exit-should-move-ahead-1417221905> (reporting that Stockton passed a 0.75% sales tax increase during its bankruptcy).

61. 11 U.S.C. § 941 (2012) ("The debtor shall file a plan for the adjustment of the debtor's debts.").

62. Thus, the set of issues presented when a federal court imposes or orders a tax increase are not presented by the proposal here. *See* *Missouri v. Jenkins*, 495 U.S. 33, 51 (1990) ("It is accepted by all parties, as it was by the courts below, that the imposition of a tax increase by a federal court [is] an extraordinary event.").

63. This idea is popularly known as the "Laffer Curve." *See, e.g.,* Jude Wanniski, *Taxes, Revenues, and the 'Laffer Curve'*, 50 PUB. INT. 3 (1978). However, the concept far antedates Ronald Reagan's advisor Arthur Laffer. *See, e.g.,* ADAM SMITH, *THE WEALTH OF NATIONS* 308-09 (1776). For empirical evidence on the "Laffer Curve" or "revenue hill" for U.S. cities, see Andrew Haughwout et al., *Local Revenue Hills: Evidence from Four U.S. Cities*, 86 REV. ECON. & STAT. 570, 582-83 (2004).

would remain accountable to the voters through elections to office.⁶⁴ In the case of a local city council, this accountability would give councilmembers a reason not to impose tax increases they are unable to explain. The council would be freed from supermajority tax approval requirements and from absolute limits on tax levels.

The tax increases that would be authorized under the proposal are those “provide[d] for” in the plan or “necessary to carry out the plan.” The plan in question is one “for the adjustment of the debtor’s debts.”⁶⁵ Thus, tax increases would be authorized under the proposal only if necessary for the plan’s proposed treatment of the municipality’s existing debts.

II. The Bankruptcy Power

This Part argues that preemption of state tax limits is within the bankruptcy power. First, it makes the affirmative case, based on the close relationship between the taxing power and the key bankruptcy objectives of debtor rehabilitation and creditor recovery, as well as the broad and expanding nature of the bankruptcy power. Second, it argues that established and asserted limits on the bankruptcy power do not rule out state tax limit preemption. Most significantly, it contends that Congress may impair the rights of noncreditors such as municipal taxpayers in the exercise of the bankruptcy power.

A. The Bankruptcy Power and State Tax Limit Preemption

Congress has broad power under the Bankruptcy Clause to fashion laws that serve the core bankruptcy objectives of debtor rehabilitation and creditor recovery. Preemption of state tax limits serves both objectives by making additional funds available to the debtor. Therefore, preemption would likely be found to be within the bankruptcy power. Many municipal bankruptcy plans call for tax increases, underscoring the fact that such increases facilitate debtor rehabilitation and creditor recovery.⁶⁶

1. Preemption and Bankruptcy Objectives

In holding that Detroit could seek to cut its contract obligations in bankruptcy, the Bankruptcy Court for the Eastern District of Michigan

64. This accountability would be direct if the local city council directs the bankruptcy, as has happened in California. *See, e.g.*, Joe Mozingo, *A Broken City*, L.A. TIMES, June 14, 2015 (reporting that San Bernardino’s city council approved the city’s plan of adjustment). The accountability would be indirect if an appointed emergency financial manager directed the bankruptcy, as happened in Detroit. *See Helms, supra* note 58, at A1.

65. 11 U.S.C. § 941 (2012).

66. *See infra* note 123 and accompanying text.

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observed, “impairing contracts is what the bankruptcy process does.”⁶⁷ Impairing contracts can aid the financial rehabilitation of the debtor, which is recognized as one of the central concerns of Chapter 9,⁶⁸ as well as of the other reorganization chapters, such as Chapter 11.⁶⁹

At the same time, state laws prohibiting the impairment of contracts are not the only ones Congress may preempt using the bankruptcy power.⁷⁰ For example, § 1123(a)(5) of the Bankruptcy Code requires that a Chapter 11 reorganization plan provide for means of its implementation “notwithstanding any otherwise applicable nonbankruptcy law.”⁷¹ In its bankruptcy, California utility Pacific Gas & Electric argued that this provision entitled it to sell or transfer assets under a reorganization plan without approval of the California Public Utilities Commission, even though state law required such approval.⁷² The Ninth Circuit held that § 1123(a)(5) expressly preempted conflicting state law.⁷³ Although the court found, as a matter of statutory interpretation, that the scope of the preemption was limited to matters relating to the debtor’s financial condition because of another provision of the Bankruptcy Code,⁷⁴ there was no suggestion that preemption was limited to state law impairing contract obligations.

67. See *In re City of Detroit*, 504 B.R. 97, 150 (Bankr. E.D. Mich. 2013); see also *id.* (“The Bankruptcy Clause necessarily authorizes Congress to make laws that would impair contracts. It long has been understood that bankruptcy law entails impairment of contracts.” (quoting *In re City of Stockton*, 478 B.R. 8, 15 (Bankr. E.D. Cal. 2012))).

68. See *In re City of Desert Hot Springs*, 339 F.3d 782, 789 (9th Cir. 2003) (“[Chapter 9] provides a debtor with an array of bankruptcy powers to enable it to achieve financial rehabilitation.” (quoting *In re Richmond Sch. Dist.*, 133 B.R. 221, 225 (Bankr. N.D. Cal. 1991))); *In re Hardeman Cty. Hosp. Dist.*, 540 B.R. 229, 232 (Bankr. N.D. Tex. 2015) (“Confirmation of the Plan will be the final step in the rehabilitation . . . of the Hospital,” a Chapter 9 debtor); *In re City of Stockton*, 526 B.R. 35, 59 (Bankr. E.D. Cal. 2015) (“[Chapter 9’s] policy of successful rehabilitation of debtors.”).

69. See *Johnson v. Home State Bank*, 501 U.S. 78, 85 (1991) (“debtor rehabilitation chapters”); *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984) (“[T]he policy of Chapter 11 is to permit successful rehabilitation of debtors”); *Nicholas v. United States*, 384 U.S. 678, 687 (1966) (observing that “the goal” of Chapter XI is “the ultimate rehabilitation of the debtor”); *SEC v. Am. Trailer Rentals Co.*, 379 U.S. 594, 607 (1965) (holding that Chapters X and XI are “two distinct methods of corporate rehabilitations”); *Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 278 (1940) (purpose of bankruptcy act for farmers was to “effectuate a broad program of rehabilitation of distressed farmers”); *Case v. L.A. Lumber Prods. Co.*, 308 U.S. 106, 125 (1939) (stating that in bankruptcy the debtor “invokes the aid of the federal courts in reorganization or rehabilitation”).

70. Cf. *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 517 (1938) (“Bankruptcy proceedings constantly modify and affect the property rights established by state law. A familiar instance is the invalidation of transfers working a preference, though valid under state law when made.”).

71. 11 U.S.C. § 1123(a)(5) (2012).

72. *PG&E v. California*, 350 F.3d 932, 935 (9th Cir. 2003).

73. *Id.* at 946 (“The issue is . . . not whether there is express preemption under § 1123(a), but rather its extent.”).

74. *Id.* at 949 (“We hold that the scope of preemption under the ‘notwithstanding’ clause of § 1123(a) is the same as under the ‘notwithstanding’ clause of § 1142(a), and that otherwise applicable nonbankruptcy laws ‘relating to financial condition’ are expressly preempted under both §§ 1123(a) and 1142(a).”). The court remanded for further consideration of whether the state requirement of Commission approval to transfer assets was preempted under the standard it set forth. *Id.* It does not appear that the lower courts ever ruled on the preemption issue.

The Chrysler bankruptcy provides another example of preemption of state laws other than those prohibiting impairment of contracts. In that case, state dealer laws restricted the termination of Chrysler dealers by providing “statutory notice and waiting periods for wind-downs and buy-back requirements for terminations with or without cause.”⁷⁵ The Bankruptcy Court for the Southern District of New York found that § 365 of the Bankruptcy Code, establishing the debtor’s right to reject contracts, preempted the state dealer laws.⁷⁶

The *PG&E* and *Chrysler* cases indicate that Congress may preempt state law generally—not just state prohibitions on contract impairment—in the service of bankruptcy objectives. Preempting state tax limits can assist the municipality in righting its finances, because a municipality with more flexibility to raise revenue can more easily be rehabilitated. But freeing the municipality from state tax limits also serves another critical bankruptcy objective, one that has not received as much attention in recent municipal bankruptcy opinions: creditor recovery. This Section argues that realizing recoveries for creditors, like rehabilitating debtors, is “what the bankruptcy process does.”⁷⁷

Bankruptcy historically has been understood as primarily a device for creditor recovery. Under English bankruptcy laws in effect at the time of the Revolution, “[r]elief was not *for* debtors, but *from* debtors.”⁷⁸ James Madison defended the Bankruptcy Clause in the *Federalist* on the ground that it would help creditors.⁷⁹ Accordingly, “[t]he idea of a bankruptcy law as a means of providing a fresh start for distressed debtors was foreign to the framers.”⁸⁰ The very first bankruptcy statute enacted in the United States was “purely a creditor’s remedy,”⁸¹ and voluntary bankruptcy did not even exist in the United

75. *In re Old Carco LLC (f/k/a Chrysler LLC)*, 406 B.R. 180, 199 (Bankr. S.D.N.Y. 2009).

76. *See id.* at 199-207 (Bankr. S.D.N.Y. 2009) (discussing field and conflict preemption and finding state dealer laws preempted). *See generally* Jeffrey B. Ellman & Brett J. Berlin, *Bankruptcy Code Preemption of State Law*, 21 J. BANKR. L. & PRAC. 3 (2012) (discussing preemption of state law in recent bankruptcy cases).

77. *In re City of Detroit*, 504 B.R. 97, 150 (Bankr. E.D. Mich. 2013).

78. Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 8 (1995); *see also id.* (noting that the “overriding purpose” of English bankruptcy law was “to aid creditors in the collection of debts”); *Cont’l Ill. Nat’l Bank & Tr. Co. v. Chi., Rock Island & Pac. Ry. Co.*, 294 U.S. 648, 668 (1935) (“The English law of bankruptcy, as it existed at the time of adoption of the Constitution, was conceived wholly in the interest of the creditor and proceeded upon the assumption that the debtor was necessarily to be dealt with as an offender.”).

79. THE FEDERALIST NO. 42 (James Madison) (arguing that a uniform bankruptcy law would “prevent . . . many frauds where the parties or their property may lie or be removed into different states”).

80. Tabb, *supra* note 78, at 43. Instead, “[t]he model [the Framers] had in mind was the one in existence in England, where bankruptcy was a collective collection remedy that creditors could invoke involuntarily against a merchant trader who had committed an act of bankruptcy.” *Id.* at 43-44 (internal quotations omitted).

81. *Id.* at 14; *see also* *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 373 (2006) (noting that the act of 1800 was “like the English law, chiefly a measure to benefit creditors”).

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States until 1841.⁸² Throughout the nineteenth century, bankruptcy statutes were typically sought by creditors, not debtors.⁸³ The first permanent bankruptcy statute, enacted in 1898, was no exception.⁸⁴ Indeed, southern congressmen representing debtor interests tried to have the 1898 Act repealed in 1902, 1903, 1909, and 1910.⁸⁵

The increasing solicitude for debtors after 1898 reflects the addition of a second policy, not the replacement of the original pro-creditor policy. The Supreme Court continues to recognize the centrality of creditor relief in bankruptcy. It has stated repeatedly—most recently in *Katz* in 2006—that the bankruptcy power includes the “subject of the relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his *and their* relief.”⁸⁶ Lower courts also continue to recognize the centrality of creditor recovery to bankruptcy policy.⁸⁷

Scholars, too, find that a central purpose of bankruptcy law is the protection of creditors.⁸⁸ Indeed, it has been argued, albeit in reference to pre-Code law, that creditor protection is a more fundamental feature of bankruptcy than debtor rehabilitation.⁸⁹ Perhaps the most famous scholarly exposition of the idea that bankruptcy operates for creditors and not just for debtors is the “creditors’ bargain” theory of corporate bankruptcy, which describes

82. Tabb, *supra* note 78, at 17.

83. *Id.* at 19.

84. *Id.* at 24 (observing that the 1898 Act had its “origins with the credit industry”). Although the 1898 Act is credited with “usher[ing] in the modern era of liberal debtor treatment in United States bankruptcy laws,” nevertheless, “[m]uch of the 1898 Act was directed not a debtor relief, but rather at facilitating the equitable and efficient administration and distribution of the debtor’s property to creditors.” *Id.* at 24-25.

85. *Id.* at 27.

86. *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 371 (2006) (emphasis added) (quoting *Wright v. Cent. Union Life Ins. Co.*, 304 U.S. 502, 513-14 (1938)); *Ry. Labor Execs. Ass’n v. Gibbons*, 466 U.S. 457, 466 (1982); *United States v. Bekins*, 304 U.S. 27, 47 (1938); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 n.18 (1935); *Cont’l Ill. Nat’l Bank & Tr. Co. v. Chi., Rock Island, & Pac. Ry. Co.*, 294 U.S. 648, 673 (1935). The phrase appears to have originated in *In re Reiman*, 20 F. Cas. 490 (No. 11,673) (S.D.N.Y. 1874), *cited with approval in Hanover Nat’l Bank v. Moyses*, 186 U.S. 181, 187 (1902).

87. *In re River W. Plaza-Chicago, LLC*, 664 F.3d 668, 671 (7th Cir. 2011) (“A central purpose of bankruptcy . . . is to maximize creditor recovery.” (quoting *Corp. Assets, Inc. v. Paloian*, 368 F.3d 761, 767 (7th Cir. 2004))); *In re Daufuskie Island Props.*, 431 B.R. 626, 640 (Bankr. D.S.C. 2010) (“[T]he ultimate goal of any bankruptcy proceeding is to create and maximize value and benefits for creditors of the estate and other parties involved in the case to share.”).

88. See Lawrence Ponoroff, *Constitutional Limitations on State-Enacted Bankruptcy Exemption Legislation and the Long Overdue Case for Uniformity*, 88 AM. BANKR. L.J. 353, 391 (2014) (“[T]he purpose of the federal bankruptcy law is not wholly confined to providing a fresh start for debtors; rather, bankruptcy policy seeks to accommodate the interests of creditors as well as debtors.”).

89. Louis Edward Levinthal, *The Early History of Bankruptcy Law*, 66 U. PA. L. REV. 223, 225 (1918) (“All bankruptcy law . . . no matter when or where devised and enacted, has at least two general objects in view . . . [I]t seeks to protect the creditors, first, from one another and, secondly, from their debtor. A third object, the protection of the honest debtor from his creditors, by means of the discharge, is sought to be attained in some of the systems of bankruptcy, but this is by no means a fundamental feature of the law.”).

bankruptcy as a procedural mechanism for the efficient collection of debts.⁹⁰ This Article does not go as far as some commentators and argue that the creditors' bargain is the right framework for municipal bankruptcy.⁹¹ Certainly, municipal rehabilitation is a central feature. Nevertheless, the prominence of the creditors' bargain theory shows how close creditor recovery lies to bankruptcy's core. Further, bankruptcy law's emphasis on creditor recovery is not limited to private bankruptcy. A deep concern with creditor recovery pervades the legislative history of the municipal bankruptcy statutes.⁹²

Creditor recovery thus holds a central place in bankruptcy policy, even though recovery received comparatively little attention in the landmark *Stockton* and *Detroit* decisions. But it is important to remember that state tax limit preemption is unusual because it serves two objectives: not just creditor recovery but also debtor rehabilitation. Although the bankruptcy objective of creditor recovery is often in tension with the bankruptcy objective of debtor rehabilitation, that is not the case when the issue is preemption of state tax limits.

2. The Broad and Expanding Bankruptcy Power

There is ample support for the general proposition that bankruptcy law looks out for creditors as well as debtors. That proposition does not in itself tell us just how Congress can go about pursuing the objectives of creditor recovery and debtor rehabilitation. Nothing speaks directly to Congress's power—or lack thereof—to preempt state tax limits. Congress has never tried to do so, and non-municipal debtors lack taxing power. However, the Court's general statements on the reach of the bankruptcy power indicate both that it is broad and that it has expanded over time to meet new conditions. These statements suggest that the bankruptcy power encompasses preemption of state tax limits to meet the relatively new condition of a municipal debt crisis brought on in part by tax revolt.

The Supreme Court has rarely attempted to capture the extent of the bankruptcy power in a discrete formulation. Indeed, the Court has stated that “[t]he subject of bankruptcies is incapable of final definition.”⁹³ However, on at

90. See Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 857 (1982) (“[The] discharge-centered view of bankruptcy is correct neither from an historical nor from a realistic appraisal of the presence and operation of most of the provisions in the federal bankruptcy laws over the years.”).

91. See Jonah Peppiatt, *The Waterfall of Tiers: A Relocation Cost-Based Theory of Municipal Insolvency and a Proposal for a New Municipal Bankruptcy Regime*, 32 EMORY BANKR. DEV. J. 335, 350-54 (2016) (arguing for adapting the creditors' bargain theory of bankruptcy for use in municipal cases).

92. See Hunt, *supra* note 25, at 530-44.

93. *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 513-14 (1938); see also *Cont'l Ill. Bank & Tr. Co. v. Chi., Rock Island, & Pac. Ry. Co.*, 294 U.S. 648, 669-70 (finding that the limitations on the Bankruptcy Clause “have never been explicitly defined, and any attempt to do so now

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least one occasion, the Court has suggested a phrase to sum up the power, and on that occasion, its formulation was expansive. In *Continental Illinois Bank & Trust Co. of Chicago v. Chicago, Rock Island & Pacific Railway Co.*,⁹⁴ the Court approvingly quoted *Kunzler v. Kohaus*.⁹⁵ In *Kunzler*, the Court for Correction of Errors of New York upheld Congress's nineteenth-century extension of bankruptcy to persons other than traders and found that Congress was authorized "to establish uniform laws on the subject of any person's general inability to pay his debts."⁹⁶ Given the connection between financial inflexibility and insolvency, preemption of state tax limits in municipal bankruptcy would seem to fall within the "subject of the [municipality's] general inability to pay [its] debts."

More common than attempts to encapsulate the bankruptcy power are affirmations of Congress's broad authority in exercising that power. Early on, in *Sturges v. Crowninshield*,⁹⁷ the Supreme Court held that "the Legislature may exercise an extensive discretion" regarding the scope of the bankruptcy power.⁹⁸ More recently, the Court, affirming the constitutionality of the Regional Rail Reorganization Act, referred to the "broad scope of congressional power under the Bankruptcy Clause."⁹⁹ Moreover, the Court has found that the Necessary and Proper Clause further extends Congress's power under the Bankruptcy Clause, although the Court has not specified the scope of the extension.¹⁰⁰

would result in little more than a paraphrase of the language of the Constitution without advancing far toward its full meaning").

94. 294 U.S. 648 (1935).

95. 5 Hill 317 (N.Y. 1843).

96. *Cont'l Ill.*, 294 U.S. at 667 (quoting *Kunzler*, 5 Hill at 321); see also *Hanover Nat'l Bank v. Moyses*, 188 U.S. 181, 187 (1902) (approvingly citing *Kunzler*); *Ashton v. Cameron Cty. Water Improvement Dist. No. 1*, 298 U.S. 513, 537 (1938) (approvingly quoting same language from *Kunzler*). The dissent in *Ashton* suggested that the 1934 Act was within the bankruptcy power, *id.* at 534-37 (Cardozo, J., dissenting), and the majority did not disagree with that suggestion. See *id.* at 527 ("[W]e assume for this discussion that the enactment is adequately related to the general 'subject of bankruptcies.'").

97. 17 U.S. (4 Wheat.) 122 (1819).

98. *Id.* at 195 (rejecting a strict division between insolvency and bankruptcy laws on the ground of Congress's discretion to define the scope of bankruptcy law). More broadly, *Sturges* "rejected a challenge to the state act based on the argument that the federal power in bankruptcy was exclusive but warned in dictum that a federal statute would preempt conflicting state legislation." Peter J. Coleman, *Sturges v. Crowninshield*, in *THE OXFORD GUIDE TO UNITED STATES SUPREME COURT DECISIONS* 297, 297 (Kermit L. Hall ed., 1999).

99. Reg'l Rail Reorganization Act Cases, 419 U.S. 102, 154 (1974) (holding Congress was authorized under the Bankruptcy Clause to compel conveyance of railroad properties to Conrail, where conveying railroads could seek compensation under the Tucker Act if Conrail was not able to pay the constitutional minimum for the properties).

100. See *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 513 (1938) ("To this specific grant [of bankruptcy power], there must be added the powers of the general grant of clause eighteen."); see also *id.* ("The subject of bankruptcies is incapable of final definition. The concept changes."); see also *id.* at 514-15 (holding that Bankruptcy Code can extend period for exercise of equity of redemption that would otherwise exist under state law). Scholars have likewise described bankruptcy law in expansive terms. See, e.g., Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 762 (1991) ("Bankruptcy law is a response to the

The Court recognizes, of course, that the Bankruptcy Power has limits,¹⁰¹ but it has, by and large, declined to state what they are. In only one case—inapplicable to the subject at hand—has the Court found a statute to lie outside Congress’s power under the Bankruptcy Clause. In *Railway Labor Executives’ Ass’n v. Gibbons*,¹⁰² the Court held that a bankruptcy statute must not be too similar to a private bill. It found that a bankruptcy statute that protected the employees (and presumably harmed the creditors) of a single named railroad was not a “uniform” bankruptcy law and therefore lay outside the Bankruptcy Power.¹⁰³ Preemption of state tax limits is a law of general applicability: it would apply in all states that authorize municipal bankruptcy and impose state limits on municipal taxes. Thus, it presents no issue with uniformity in the sense recognized in *Gibbons*.

Congress’s power under the Bankruptcy Clause has been understood not just as broad, but also as expanding to meet changing needs. The Supreme Court has consistently approved expansions of bankruptcy law under the Bankruptcy Clause. As Professor Jonathan Lipson recently observed, “In the vast majority of cases since [the framing era], our approach has been to side with the bankruptcy power, and against any constitutional rule, standard, norm, or value that may constrict it.”¹⁰⁴

The Supreme Court itself foreshadowed Lipson’s observation. In the *Continental Illinois* case, the Court summarized the history of the bankruptcy power: “From the beginning, the tendency of legislation and of judicial interpretation has been uniformly in the direction of progressive liberalization in respect of the operation of the bankruptcy power.”¹⁰⁵ The Court reviewed American bankruptcy law’s origins in English law,¹⁰⁶ early statements that the subjects of Congress’s powers were not to be understood as limited to their English antecedents,¹⁰⁷ the steady expansion of the persons who could be in bankruptcy from traders to “practically all classes of persons and corporations,”¹⁰⁸ the evolution of the law from one concerned wholly with

problem of financial distress—not only as an economic, but as a moral, political, personal, and social problem that affects its participants.”)

101. See *Cont’l Ill.*, 294 U.S. at 669.

102. 455 U.S. 457 (1982).

103. *Gibbons*, 455 U.S. at 470-71 (“[The challenged act] is nothing more than a private bill A law can hardly be said to be uniform throughout the country if it applies only to one debtor and can be enforced only by the one bankruptcy court having jurisdiction over that debtor.”); see also Jonathan C. Lipson, *Debt and Democracy: Toward a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 685 (2008) (“Bankruptcy relief—or at least the discharge—must have some meaningfully public interest to come within the bankruptcy power. Otherwise, it is *ultra vires*.”).

104. Lipson, *supra* note 103, at 609. See generally KENNETH N. KLEE, BANKRUPTCY AND THE SUPREME COURT 123-33 (2008) (discussing Supreme Court’s bankruptcy power jurisprudence).

105. *Cont’l Ill.*, 294 U.S. at 668.

106. *Id.* at 668.

107. *Id.* at 668-69.

108. *Id.* at 670.

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aiding creditors to one protecting the “honest but unfortunate” debtor,¹⁰⁹ and the introduction in 1867 of the debtor’s ability to propose a composition of debts.¹¹⁰ It concluded:

The fundamentally and radically progressive nature of these extensions becomes apparent upon their mere statement; but all have been judicially approved or accepted as falling within the power conferred by the bankruptcy clause of the Constitution. Taken altogether, they demonstrate in a very striking way the capacity of the bankruptcy clause to meet new conditions as they have been disclosed as a result of the tremendous growth of business and development of human activities from 1800 to the present day. And these acts, far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.¹¹¹

The expansion of the Court’s understanding of the bankruptcy power apparently has continued even through the Rehnquist era of increased solicitude for states’ interests.¹¹²

Preemption of state tax limits can be seen as an example of use of the bankruptcy power to “meet new conditions.” It does not appear that municipalities have ever faced anything quite like the combination of pension costs and tax limits that could lead to widespread financial distress.¹¹³ Preemption addresses this novel problem in a manner that is consistent with the Court’s understanding of the Bankruptcy Clause as a dynamic and flexible device.

B. Potential Limits on the Bankruptcy Power

Despite the breadth and flexibility of the bankruptcy power, it does have limits. This section discusses principles that do or might limit the bankruptcy power. First, it addresses the proposition that the bankruptcy power is limited to adjusting the affairs of insolvent debtors, which does not interfere with state tax preemption in municipal bankruptcy because municipal debtors must be

109. *Id.* at 670-71.

110. *Id.* at 671.

111. *Id.*

112. Lipson, *supra* note 103, at 637-38 (“In the case of vertical [federal-state] relations, bankruptcy appears to be an exception to the Rehnquist Court’s robust protection for states from federal judicial power.”); *see also id.* at 675 (further discussing bankruptcy exceptionalism).

113. State tax limits are a phenomenon of the past forty or so years. *See supra* Section I.A. Cities currently face high unfunded pension and health care costs. *See, e.g., Cities Squeezed by Pension and Retiree Health Shortfalls*, PEW CHARITABLE TR. 1 (Mar. 8, 2013), <http://www.pewtrusts.org/en/research-and-analysis/reports/0001/01/01/cities-squeezed-by-pension-and-retiree-health-care-shortfalls> (“Thirty cities at the center of the nation’s most populous metropolitan areas faced more than \$192 billion in unpaid commitments for pensions and other retiree benefits, primarily health care, as of fiscal 2009.”). The author’s research has not turned up any indication that such a combination has existed in previous eras of American history.

insolvent. Next, it addresses the language of some cases suggesting that bankruptcy must involve the distribution of estate property. This language cannot apply to municipal bankruptcy because tax revenue, not property, is what backs municipal debt. Finally, it addresses the most significant challenge: the contention that Congress cannot impair the rights of noncreditors using the bankruptcy power. Supreme Court precedent and existing Bankruptcy Code provisions are inconsistent with this contention. Moreover, the contention's major academic defender, Professor Thomas Plank, relies on a way of defining the bankruptcy power that the Supreme Court has rejected.

1. Insolvency and Distribution of Property

Some potential limits on the bankruptcy power do not apply to state tax limit preemption in municipal bankruptcy. For example, it has been argued that debtor insolvency is a constitutional prerequisite to bankruptcy.¹¹⁴ The Bankruptcy Code already imposes insolvency as a requirement for municipal bankruptcy, and this Article does not propose changing that requirement.¹¹⁵ Any constitutional insolvency requirement would not bar preemption of state tax limits.

Similarly, courts have sometimes stressed the distribution of property in discussing the bankruptcy power.¹¹⁶ These descriptions look toward liquidation of the debtor's assets as the basic operation of bankruptcy. Liquidation of municipal property to satisfy debts generally is not possible, either inside¹¹⁷ or outside bankruptcy.¹¹⁸ Accordingly, descriptions of the bankruptcy power in

114. See KLEE, *supra* note 104, at 130-31; Thomas E. Plank, *Bankruptcy and Federalism*, 71 *FORDHAM L. REV.* 1063, 1093-95 (2002) [hereinafter Plank, *Bankruptcy and Federalism*]; Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 *TENN. L. REV.* 487, 546-56 (1996) [hereinafter Plank, *Constitutional Limits of Bankruptcy*].

115. 11 U.S.C. § 109(c)(3) (2012) (“An entity may be a debtor under chapter 9 of this title if and only if such entity . . . is insolvent . . .”).

116. See, e.g., *In re Klein*, 14 F. Cas. 716, 718 (C.C.D. Mo. 1843) (No. 7865) (“[The bankruptcy power] extends to all cases where the law causes to be distributed the property of the debtor among his creditors; this is its least limit. Its greatest is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of congress.”). This language from *Klein* has appeared in subsequent Supreme Court opinions. See *Ry. Labor Execs.’ Ass’n v. Gibbons*, 455 U.S. 457, 466 (1982); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 n.18 (1935); *Hanover Nat’l Bank v. Moyses*, 186 U.S. 181, 186 (1902).

117. The House Judiciary Committee report on H.R. 8200, the predecessor to the 1978 Bankruptcy Reform Act, stated that liquidation of the debtor “is not possible in a municipal case.” H.R. REP. NO. 95-595, at 400 (1977). In municipal bankruptcy, the court is forbidden from interfering with the municipality’s property or revenue. See 11 U.S.C. § 904(2) (2012) (“[U]nless the debtor consents or the plan so provides, the court may not . . . interfere with . . . any of the property or revenues of the debtor.”). Reflecting the restrictions on interfering with municipal property, municipal bankruptcy does not feature creation of a bankruptcy estate. See § 541 (providing for creation of bankruptcy estate); *id.* § 901(a) (not incorporating § 541 by reference into chapter 9).

118. See ROBERT M. AMDURSKY & CLAYTON P. GILLETTE, *MUNICIPAL DEBT FINANCE LAW: THEORY AND PRACTICE* 340 (2d ed. 2013) (“The general rule is that execution will not be awarded to enforce a judgment against a municipal corporation absent a statute to the contrary.”); Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 *YALE J. ON*

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terms of liquidation are incomplete. The Court has recognized this proposition not just in the context of municipal bankruptcy,¹¹⁹ but also earlier in its approval of compositions without liquidation in the nineteenth century¹²⁰ and in the approval of railroad reorganization provisions that did not require liquidation.¹²¹

Instead of liquidation of property, collection of debts from municipalities focuses on tax increases. The taxing power of the state is the main source of recovery for municipal creditors, and municipal debts are traditionally collected through a writ of mandamus requiring that taxes be increased to cover the debts.¹²² Congress intended that municipalities raise taxes, within limits, in bankruptcy,¹²³ and municipal bankruptcy reorganization plans commonly call for tax increases.¹²⁴ Bankruptcy facilitates the gathering and distribution of property when the debtor's property is the main source of funds for debt recovery, so it is reasonable to suppose that bankruptcy can facilitate taxes where the debtor's taxing power is the main source of funds for debt recovery. The debtor's taxing power in municipal bankruptcy is a rough analog of the debtor's property in nonmunicipal bankruptcy.

2. Impairment of Noncreditor Rights

Perhaps the most powerful objection to lifting state tax limits in municipal bankruptcy is that doing so would trample the rights of third parties—either

REG. 351, 371 (2010) (“Even if the locality is in default, the creditors are unable to take municipal property as payment for their loans, and the locality retains complete control of all its public assets.”).

119. See *United States v. Bekins*, 304 U.S. 27, 47 (1938) (holding municipal bankruptcy statute within bankruptcy power and citing *In re Reiman* and *Continental Illinois*).

120. See *In re Reiman*, 20 F. Cas. 490, 497 (S.D.N.Y. 1874) (No. 11,673) (holding that the composition statute “relate[s] to the subject of bankruptcies” (internal quotation marks omitted)). The opinion of future Supreme Court Justice Blatchford in *Reiman* was cited with approval in *Hanover National Bank*, 486 U.S. at 187, and was later effectively adopted by the Supreme Court. *Cont’l Ill. Nat’l Bank & Tr. Co. v. Chi., Rock Island, & Pac. Ry. Co.*, 294 U.S. 648, 672 (1935).

121. See *Cont’l Ill.*, 294 U.S. at 671-72 (finding that railroad reorganization, not necessarily involving liquidation, “cannot be distinguished in principle from the composition with creditors authorized by the act of 1867, as amended by the act of 1874”); *id.* at 675 (stating that railroad reorganization statute “is within the power conferred by the bankruptcy clause of the Constitution”).

122. See Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 445 (1993) (“[T]he principal remedy, in practice, was one that has no analogy in private law: the issuance of a writ of mandamus requiring imposition of new taxes.”).

123. See generally Hunt, *supra* note 25 (discussing legislative history of municipal bankruptcy statutes and Congress’s intention that taxes be raised in bankruptcy up to the limit of the city’s ability to pay). The importance of taxes to municipal debt collection does not in itself mean that Congress may abrogate state tax limits in municipal bankruptcy, because a writ of mandamus for debt collection generally may order only taxes authorized by state law. McConnell & Picker, *supra* note 122, at 447-48. Nevertheless, the relative importance of taxes and relative unimportance of property sales in municipal debt collection indicate that facilitating municipal taxes is related to the subject of bankruptcies.

124. See Hunt, *supra* note 25, at 558-59 (reporting that Stockton and San Bernardino, California and Central Falls, Rhode Island proposed plans calling for tax increases, while Jefferson County, Alabama’s plan called for increased sewer rates).

taxpayers who would be protected by procedural or substantive limits on raising state taxes or residents whose state-law right to vote on municipal taxes might be taken away. It is questionable whether state-law tax limit provisions create individual “rights” in residents or taxpayers.¹²⁵ It is also questionable whether municipal residents—who would presumably include most if not all municipal taxpayers—are “noncreditors.”¹²⁶ However, assuming that state tax preemption does impair noncreditor rights, then an objection could be leveled that the impairment is beyond Congress’s bankruptcy power.

Although the rights impaired in bankruptcy usually belong to creditors, Supreme Court precedent and existing Bankruptcy Code provisions indicate that Congress may exercise the bankruptcy power to impair the rights of noncreditor parties. At the same time, the most sustained defense of the contrary position, found in two articles by Professor Thomas Plank,¹²⁷ rests on an argument that the Court has rejected.

The Supreme Court confirmed that bankruptcy may interfere with the rights of a noncreditor in *Wright v. Central Union Fire Insurance Co.*¹²⁸ In *Wright*, an insurance company bought land formerly belonging to Wright at a foreclosure sale while Wright’s bankruptcy was pending.¹²⁹ The bankruptcy statute extended the redemption period—the period during which Wright could reclaim the land by paying the creditor—beyond what state law provided.¹³⁰ The insurance company sought a decision that Wright was limited to the shorter state redemption period.¹³¹ It argued that the bankruptcy statute’s purported extension of the redemption period was unconstitutional, contending that “under the Bankruptcy Clause Congress is confined to legislation for the adjustment of the debtor-creditor relationship,”¹³² and that the purchaser at a foreclosure sale is not a creditor.

The Court assumed that the insurance company was not a creditor when it bought at the foreclosure sale¹³³ and rejected the insurer’s argument. The Court

125. See, e.g., *United States v. Carlton*, 512 U.S. 28, 33 (1994) (“Tax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code.”).

126. See *Anderson*, *supra* note 21, at 1123 (arguing that municipal residents are in effect creditors of the bankrupt municipality, in the sense that “everyone (liberal, conservative, and libertarian alike) assumes that residents have some claim to share in [a] city’s present and future revenues”).

127. See Plank, *Bankruptcy and Federalism*, *supra* note 114; Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114.

128. 304 U.S. 502 (1938).

129. *Id.* at 509.

130. *Id.* at 513.

131. *Id.* at 505-06.

132. *Id.* at 514.

133. *Id.* (“While there may be no relation of debtor and creditor between the bankrupt and the purchaser of his property at judicial sale, we think the purchaser at a judicial sale does enter into the radius of the bankruptcy power over debts.”). In this case, the insurance company was purchasing at the foreclosure sale on its own mortgage, *id.* at 505, 509, so its argument that it was not a creditor could have been questioned. The Court, however, did not take this tack in deciding the case—it seemed to assume for the sake of argument that the insurance company was not a creditor. *Id.* at 514-15. Professor

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found that “until the right of redemption expires the rights of the purchaser are subject to the power of the Congress over the relationship of debtor and creditor and its power to legislate for the rehabilitation of the debtor.”¹³⁴ The Court thus held that the bankruptcy power does not extend just to the relationship of debtor and creditor but also to the rehabilitation of the debtor. If, as argued, preemption of state tax limits is a reasonable way of legislating “for the rehabilitation of the debtor,” then *Wright* supports the constitutionality of preemption.

Existing provisions of the Bankruptcy Code also call for impairment of noncreditor rights. For example, an innocent person who has received a gift from an insolvent debtor—or who has bought property from an insolvent debtor for less than “reasonably equivalent value”—may be called on to return what she or he has received under the Bankruptcy Code’s fraudulent-transfer provision.¹³⁵ Even if state law permits the recipient to keep the gift,¹³⁶ the Bankruptcy Code takes it away in order to make property available for distribution and/or reorganization.¹³⁷

The fraudulent transfer provision, which is recognized as a fundamental part of bankruptcy law, does not seem to have been challenged on constitutional grounds. Another provision has been more controversial. A co-owner of property with the debtor may lose her or his property rights in bankruptcy. Section 363(h) of the Code authorizes the trustee to sell both the

Thomas Plank argues that the Court in effect found that the purchaser became a creditor when it bought at the foreclosure sale subject to the right of redemption. Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 543-44. However, the Court’s use of “and” in referring to the “power of Congress over the relationship of debtor and creditor and its power to legislate for the rehabilitation of the debtor.” *Wright*, 304 U.S. at 514, suggests that the bankruptcy power extends beyond adjustment of debtor-creditor relations.

134. *Wright*, 304 U.S. at 514.

135. *See* 11 U.S.C. § 548(a)(1) (2012). If the recipient of the fraudulent transfer gave value and acted in good faith, the recipient may keep what has been transferred to the extent of the value given. *See id.* § 548(c); 5 COLLIER ON BANKRUPTCY ¶ 548.06[4] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2015).

136. Every state has a fraudulent transfer law. *See* John E. Sullivan III, *Future Creditors and Fraudulent Transfers*, 22 DEL. J. CORP. L. 955, 960 n.7 (1997). In most states these laws track the Bankruptcy Code. *See* 5 COLLIER ON BANKRUPTCY, *supra* note 135, at ¶ 548.01[2][a][i] (“Most states have adopted the 1984 UFTA [Uniform Fraudulent Transactions Act] For the most part, the UFTA tracks section 548.”). However, there are instances where a transfer would be impervious to attack under the state’s fraudulent-transfer law but subject to avoidance under bankruptcy law. *See id.* (noting that UFTA “has expanded defenses” relative to § 548); *compare* 11 U.S.C. § 548(a)(1) (2012) (two-year statute of limitations), *with* LA. CIV. CODE ANN. art. 2041 (2016) (providing for statute of limitations of one year after obligee learns or should have learned of the avoidable transfer).

137. The Supreme Court has in one case stated that fraudulent conveyance claims are “quintessentially suits at common law that more nearly resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors’ hierarchically ordered claims to a pro rata share of the bankruptcy res.” *Granfinanciera v. Nordberg*, 492 U.S. 33, 56 (1989). The issue in *Granfinanciera* was the transferees’ right to a jury trial, not the extent of Congress’s powers under the Bankruptcy Clause, and the Court did not address the ways in which § 548’s substantive provisions differ from state fraudulent-transfer law. Courts continue to recognize that “*Granfinanciera* involved a federal-law claim” *Exec. Benefits Ins. Agency v. Arkison (In re Bellingham Ins.)*, 702 F.3d 553, 564 (9th Cir. 2012), *aff’d*, 134 S. Ct. 2165 (2014).

estate's interest and the co-owner's interest, provided certain conditions are met.¹³⁸ One bankruptcy court stated, as one of two independent grounds for its ultimate decision,¹³⁹ that this provision exceeded Congress's power under the Bankruptcy Clause.¹⁴⁰ However, this decision does not appear to have been followed in any case. At least one court has rejected the same constitutional challenge,¹⁴¹ and sales under § 363(h) apparently continue to be routine.¹⁴²

It might be observed that in each of these situations, the noncreditor probably is or was in some sort of voluntary relationship with the debtor. The foreclosure buyer in *Wright* had lent the debtor money and taken a security interest in the debtor's property. The transferee in a fraudulent transfer typically has consented, or at least not objected to, the transfer. The co-owner of property with the debtor could seek to end the joint tenancy, tenancy in common, or tenancy by the entirety. However, this observation does not distinguish the examples given from the case of local taxation, because the payer of local taxes typically has some voluntary relationship with the taxing entity. Residents subject to property tax can move out of the city. Buyers paying sales or hotel taxes can shop or stay elsewhere. Indeed, a leading model of local finance, the Tiebout model, is built on the insight that payers can avoid a municipality's taxes by forgoing the municipality's benefits.¹⁴³

Professor Thomas Plank has stressed the limits of the Bankruptcy Power. He argues that bankruptcy law "may not expand the rights of debtors or their creditors beyond that necessary to adjust their relationship, and it may not otherwise adversely affect the rights or legal relations of Third Parties, that is, persons who are neither the debtor nor creditors of the debtor."¹⁴⁴ Assuming that preemption of state tax limits is viewed as "adversely affect[ing] the

138. See 11 U.S.C. § 363(h) (2012).

139. See *In re Persky*, 134 B.R. 81, 105 (Bankr. E.D.N.Y. 1991) (concluding that interests in property at issue—ownership and survivorship interest in property held by the entireties—were not covered by § 363(h) and that § 363(h) exceeds Congress's constitutional powers).

140. See *Persky*, 134 B.R. at 94-99.

141. See *In re Bernier*, 176 B.R. 976, 984 (Bankr. D. Conn. 1995) (holding that Supreme Court precedent which defines the reach of the bankruptcy power "cannot even by implication be read to protect non-creditor third party property rights from the collection-distribution scheme at the core of the bankruptcy process where those rights are inextricably intertwined with those of a bankruptcy estate").

142. See *Sapir v. Sartorius*, 230 B.R. 650, 654 (Bankr. S.D.N.Y. 1999) ("[*Persky*] is rarely cited and never, to the best of this Court's knowledge, followed for the proposition that property owned by the entireties is not subject to sale by a trustee under Section 363(h) of the Bankruptcy Code. On the other hand, numerous cases decided in this Circuit and elsewhere since *Persky* . . . have continued to apply Section 363(h) to authorize the sale of property owned as tenants by the entireties."). *Sapir*'s observation about the frequency of sales under § 363(h) has been cited with approval more recently. See *In re Prosser*, No. 06-30009 (JKF), 2008 WL 2677863, at *3 n.5 (D.V.I. July 1, 2008).

143. See, e.g., Wallace E. Oates, *On Local Finance and the Tiebout Model*, 71 AM. ECON. REV., May 1981, at 93, 93.

144. Plank, *Bankruptcy and Federalism*, *supra* note 114, at 1091; *id.* at 1064 ("Congress may use its power to enact bankruptcy law only to adjust the relationship between an insolvent debtor and his, her, or its creditors."); see also Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 563 ("Congress may not, in a bankruptcy law, appropriate the property or impair the rights of third parties for the benefit of the insolvent debtor or his, her, or its creditors.").

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rights” of taxpayers or residents, and that they are “third parties,”¹⁴⁵ Plank’s principle might dictate that such preemption is impermissible.

However, Plank’s claim can be contested, at least in the field of municipal bankruptcy, a subject that Plank does not address in this connection.¹⁴⁶ Plank’s argument is principally an originalist one, based on detailed surveys of bankruptcy law before and at the time of the Constitution.¹⁴⁷ Plank finds that bankruptcy laws of this period did not provide for impairment of third-party rights.¹⁴⁸ However, this finding alone does not demonstrate that the constitutional power was or is so limited, as Plank seems to recognize at one point.¹⁴⁹ Indeed, scholars, including Plank,¹⁵⁰ report no indication that Framing-era law included municipal bankruptcy at all.¹⁵¹ Yet municipal bankruptcy presumably lies within Congress’s power.

More broadly, the Supreme Court has rejected this form of originalist analysis of the scope of the bankruptcy power. One of the clearest statements of this rejection is in *Adair v. Bank of America National Trust & Savings Ass’n*,¹⁵² in which the Court found, “The powers granted by the bankruptcy clause of the Constitution . . . are not limited to the bankruptcy law and practice in force in England or the States at the time of its adoption.”¹⁵³ Other statements are in a similar vein.¹⁵⁴

145. See *supra* notes 125-126 and accompanying discussion.

146. Plank does discuss municipal bankruptcy in connection with a second limit on the Bankruptcy Power that he asserts: a requirement that debtors be insolvent to invoke bankruptcy protection. See Plank, *Bankruptcy and Federalism*, *supra* note 114, at 1093 & n.115; Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 547.

147. See Plank, *Bankruptcy and Federalism*, *supra* note 114, at 1076-89; Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 499-533; see also *Cont’l Ill. Nat’l Bank & Tr. Co. v. Chi., Rock Island, & Pac. Ry. Co.*, 294 U.S. 648, 668 (1935) (“[T]he notion that the framers of the Constitution, by the bankruptcy clause, intended to limit the power of Congress to the then-existing English law and practice upon the subject long since has been dispelled.”).

148. See Plank, *Bankruptcy and Federalism*, *supra* note 114, at 1066-67 (explaining that the “Non-Expropriation Principle,” one of four principles Plank derives from the original understanding of the constitutional phrase “subject of Bankruptcies,” dictates that “Congress may not . . . diminish . . . the rights or prerogatives of parties outside of the debtor-creditor relationship”); Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 564.

149. See Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 528 (“[Evidence of] an awareness of the English bankruptcy acts . . . does not by itself show an expectation that Congress’s powers would be limited by those acts.”).

150. See Plank, *Bankruptcy and Federalism*, *supra* note 114, at 1076-89 (not mentioning the possibility of municipal bankruptcy); Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 499-533 (not mentioning the possibility of municipal bankruptcy).

151. See, e.g., Tabb, *supra* note 78, at 6-15 (surveying English antecedents of American bankruptcy laws, the drafting and adoption of the Constitution, and early American bankruptcy law without mentioning municipal bankruptcy).

152. 303 U.S. 350 (1938).

153. *Id.* at 354.

154. See *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 513 (1938) (stating of the constitutional grant to legislate on the “subject of bankruptcies,” “[i]t has been recognized that it is not limited to the connotation of the phrase in England or the States, at the time of the formulation of the Constitution”); *Cont’l Ill. Nat’l Bank & Tr. Co. v. Chi., Rock Island, & Pac. Ry. Co.*, 293 U.S. 648, 668 (1935) (“[T]he notion that the framers of the Constitution, by the bankruptcy clause, intended to limit

Plank also argues that the “basic thrust of bankruptcy law since the early 1700s” supports the no-third-party-impairment principle.¹⁵⁵ However, as discussed above,¹⁵⁶ and as he recognizes,¹⁵⁷ certain aspects of the Code do violate the principle. Even assuming Plank is right that the Bankruptcy Code usually does not allow for impairment of third-party rights, that argument may show only that Congress has not seen fit to use the full extent of its power.

III. The Tenth Amendment

This Part argues that federal preemption of state tax limits in municipal bankruptcy is consistent with the Tenth Amendment and the Supreme Court’s federalism decisions more broadly. First, it shows that under current law, the question in evaluating state tax limit preemption under the Tenth Amendment is whether the state validly consented to the arrangement. Second, it argues that states can give valid consent to an arrangement that permits municipalities to violate state law requirements, including the state constitution. Third, it argues that state consent to a municipal bankruptcy system that includes state tax preemption would not be found to be unduly coerced. Fourth, it answers two objections: the objection that there is something unique about state taxation that makes preemption unconstitutional and the objection that preemption is unconstitutional because federalism protects individuals and not just states.

A. The Sufficiency of State Consent

It might be objected that the preemption of state tax limits in municipal bankruptcy violates the Tenth Amendment because municipal taxation is inherently or traditionally a local function and thus cannot be regulated by Congress. The Supreme Court more or less agreed with this objection when it invalidated the first municipal bankruptcy act in 1936. However, this decision came in the midst of a shift in Tenth Amendment doctrine. Since the New Deal—with a notable departure in the period 1976-1985—the Court has not conceived of the Tenth Amendment as a limit on the substantive subject matter Congress can regulate. Instead, since the 1990s, the Tenth Amendment has forbidden Congress to press state governments into service in support of its regulatory programs. As a corollary, when a program is, on its face, voluntary for a state, the Court has asked whether Congress has given the state a real choice about participating or instead has effectively forced the state into service by coercing its consent.

the power of Congress to the then existing English law and practice upon the subject long since has been dispelled.”).

155. Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 560.

156. *See supra* notes 135-142 and accompanying text.

157. *See* Plank, *Constitutional Limits of Bankruptcy*, *supra* note 114, at 564-81 (noting that certain provisions of the Bankruptcy Code violate the asserted requirement that Congress not create direct benefits or liabilities for non-debtors and noncreditors that do not exist outside of bankruptcy).

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1. Municipal Bankruptcy Is Upheld as the Court Changes Its View of the Tenth Amendment

The view of the relationship between state and federal power that prevailed at the Supreme Court in the late nineteenth and early twentieth centuries has been called “dual federalism.”¹⁵⁸ Dual federalism held that federal and state governments were separate sovereigns with separate zones of authority.¹⁵⁹ Accordingly, the Court held during this period—contrary to earlier precedents dating back to *Gibbons v. Ogden*¹⁶⁰—that the Tenth Amendment “reserved a zone of activities to the states and that even federal laws within the scope of the commerce clause were unconstitutional if they invaded that zone.”¹⁶¹ Congress’s power under the Bankruptcy Clause was also limited by the principle of dual federalism during this period.¹⁶² This principle was an important part of the context in which the first municipal bankruptcy statute was passed, held to violate the Tenth Amendment, and replaced with a nearly identical statute that the Court found did not invade state sovereignty.

The first municipal bankruptcy statute (the “1934 Act”) was enacted in response to a widespread crisis of local insolvency that arose from the Great Depression.¹⁶³ Mindful of the Tenth Amendment as then understood, legislators included provisions intended to preserve state authority. The 1934 Act provided that nothing in it should “be construed to limit or impair the power of any State to control by legislation or otherwise any political subdivision thereof in the exercise of its political or governmental powers.”¹⁶⁴ The federal court was forbidden to “interfere with any of the political or governmental powers of the taxing district.”¹⁶⁵ Only voluntary petitions were permitted—municipalities

158. See ERWIN CHERMERINSKY, *CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES* 256 (5th ed. 2015).

159. *Id.*

160. See 22 U.S. (9 Wheat.) 1, 197 (1824). (“[T]he sovereignty of Congress, though limited to specified objects, is plenary as to those objects.”). The Court held that state sovereignty did not impose an independent limit on Congress’s exercise of its enumerated powers.

161. CHERMERINSKY, *supra* note 158, at 256; see also *Hammer v. Dagenhardt*, 247 U.S. 251, 275 (1918) (invalidating federal law prohibiting shipment of products of mines that employed child labor on the ground that the law in effect regulated production, a “matter purely local,” and therefore infringed “the local power always existing and carefully reserved to the states in the Tenth Amendment to the Constitution”).

162. See *Ashton v. Cameron Cty. Water Dist. No. 1*, 298 U.S. 513 (1936).

163. See Act of May 24, 1934, Pub. L. No. 73-251, § 78, 48 Stat. 798, 798, *invalidated by Ashton*, 298 U.S. 513 (“There is hereby . . . declared to exist a national emergency caused by increasing financial difficulties of many local governmental units”); see also Gillette & Skeel, *supra* note 7, at 1167 (describing circumstances under which 1934 Act was passed).

164. Act of May 24, 1934 § 80(k).

165. *Id.* § 80(c)(11). Identical provisions remain part of Chapter 9 today. See 11 U.S.C. § 903 (2012) (mandating that chapter 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”); *id.* § 904(1) (forbidding courts from interfering with “any of the political or governmental powers of the debtor”).

could not be forced into federal bankruptcy proceedings against their will.¹⁶⁶ Underscoring the intended effect of these provisions, one of the sections of the Judiciary Committee's report on the bill was headed, "The Bill Does Not Extend the Federal Jurisdiction over the States or Any of Their Subdivisions."¹⁶⁷

These provisions were not enough for the Supreme Court. In *Ashton v. Cameron County Water Improvement District No. 1*,¹⁶⁸ the Supreme Court invalidated the 1934 Act. The reasoning of *Ashton* rested squarely on the "dual federalism" theory, specifically holding that Congress may not legislate on inherently local matters.¹⁶⁹

One might argue that the 1934 Act did not restrict municipal or state control over local affairs because participation was voluntary.¹⁷⁰ Indeed, Justice Cardozo stressed this point in his dissent.¹⁷¹ For its part, the majority dismissed any notion that the voluntary nature of the statute mattered. Preserving the separation between the spheres of authority of federal and state government was paramount. The majority wrote, "The sovereignty of the state essential to its proper functioning under the Federal Constitution *cannot be surrendered*; it cannot be taken away by any form of legislation."¹⁷² The *Ashton* majority saw no difference between voluntary and involuntary bankruptcy: "[i]f voluntary proceedings may be permitted, so may involuntary ones"¹⁷³

Congress enacted a new municipal bankruptcy statute ("the 1937 Act") the next year.¹⁷⁴ Despite the Supreme Court's ruling in *Ashton*, the new statute was extremely similar to the old one and did little more to protect state sovereignty. The committee report on the 1937 Act listed several provisions of the statute that were supposed to protect it from constitutional challenge, all of which had been included in the 1934 Act.¹⁷⁵ Other provisions that enhanced

166. Act of May 24, 1934 § 80(a). Another provision provided that if state law gave fiscal control over a municipality to a special agency, that agency's permission was required for the municipality's bankruptcy petition. *Id.* § 80(k).

167. H.R. REP. NO. 73-207, at 2 (1934).

168. 298 U.S. 513 (1936).

169. *See id.* at 529 (appealing to "the independence of the national and state governments within their respective spheres" and to "the provisions of the Constitution which look to the maintenance of the dual system").

170. *Id.* at 530 (noting that municipal bankruptcy "might materially restrict [the municipality's] control over its fiscal affairs").

171. *Id.* at 538-40 (Cardozo, J., dissenting) (stressing consensual nature of municipal bankruptcy under the 1934 Act observing that the states may tax federal instrumentalities with consent, and arguing that the federal government may tax states with consent).

172. *Id.* at 531 (emphasis added).

173. *Id.* at 530.

174. Act of Aug. 16, 1937, Pub. L. No. 75-302, 50 Stat. 653.

175. The report cited the following provisions, each of which was contained in the 1934 Act: (1) "No interference with the fiscal or governmental powers of a subdivision is permitted," H.R. REP. NO. 75-517, at 2 (1937); Act of May 24, 1934 § 80(c)(11)(a), (2) "The taxing agency itself is the only instrumentality which can seek the benefits of the proposed legislation," H.R. REP. NO. 75-517, at 2; Act of May 24, 1934 § 80(a)); and "[N]o control or jurisdiction over that property and those

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protection of state power were modest.¹⁷⁶ Indeed, one of the changes Congress made in 1937 actually cut back on state authority: The 1937 Act removed the 1934 Act's explicit provision that states had the power to require state permission to file.¹⁷⁷ In short, the 1934 Act, already respectful of state sovereignty in many ways, did not undergo significant state-autonomy-enhancing change in 1937.

Despite the resemblance between the 1934 and 1937 Acts, the Supreme Court upheld the new statute against a Tenth Amendment challenge in *United States v. Bekins*.¹⁷⁸ Reversing course from *Ashton*, the Court made state consent the centerpiece of its analysis. The Court began by finding that California had given its consent for the debtor, a California irrigation district, to seek bankruptcy protection.¹⁷⁹ Then, drawing on the examples of international treaties, interstate compacts, and contracts between states and individuals,¹⁸⁰ the Court held that “[i]t is of the essence of sovereignty to be able to make contracts and give consents bearing upon the exertion of governmental power.”¹⁸¹ The Court observed that consent to municipal bankruptcy enabled federal-state cooperation to solve the problem of municipal insolvency and found that the state could not solve the problem on its own because the federal Constitution prohibited states from impairing contracts.¹⁸² It concluded that when the state cooperates with the federal government in this way, it “acts in aid, and not in derogation, of its sovereign powers.”¹⁸³ The fact of state consent to municipal bankruptcy, rather than the substantive protections of state power in the municipal bankruptcy statute, were at the core of the Court's analysis.

Bekins appears to be a stop along the way to the eventual abandonment of the dual-federalism's bar against federal invasion of state sovereignty, even with the state's consent. As Dean Erwin Chemerinsky puts it, from the New Deal era until 1976, the Court “expressly rejected the view that the Tenth Amendment is an independent limit on the legislative power and instead viewed it simply as a reminder that Congress may legislate only if there is

revenues of the petitioning agency necessary for essential governmental purposes is conferred by the bill,” H.R. REP. NO. 75-517, at 2; Act of May 24, 1934 § 80(c)(11)(b)).

176. Congress changed the eligibility provision so that only specific listed types of state agencies or instrumentalities, such as cities, drainage districts, and local improvement districts, could file. Act of Aug. 16, 1937, § 81(1)-(6). The 1934 Act had allowed “[a]ny municipality or other political subdivision of any State” to seek federal bankruptcy protection. Act of May 24, 1934 § 80(a). The change apparently was intended to reduce the risk that a filing entity would be held to be a “political subdivision[] [of the state] exercising sovereign powers.” H.R. REP. NO. 75-517, at 3.

177. Compare Act of May 24, 1934 § 83(i), with Act of Aug. 16, 1937 § 80(k). This change may not have made much difference because the 1937 Act still required that the municipality be authorized by law to take any actions needed to carry out the reorganization plan. Act of Aug. 16, 1937 § 80(e)(6).

178. 304 U.S. 27 (1938).

179. *Id.* at 47.

180. *Id.* at 52.

181. *Id.* at 51-52.

182. *Id.* at 53-54.

183. *Id.* at 54.

authority in the Constitution.”¹⁸⁴ Characteristic of this period was *United States v. Darby*, in which the Court famously stated that the Tenth Amendment “states but a truism that all is retained which has not been surrendered.”¹⁸⁵ This statement can be understood as rejecting the notion that the Tenth Amendment is an independent limit on federal power.

2. The Tenth Amendment’s Two Revivals: *National League of Cities* and the Supreme Court’s “New Federalism” Cases of the 1990s

Since the *Darby* era, the Supreme Court has twice reinvigorated the Tenth Amendment and associated notions of federalism. The first effort lasted from 1976 to 1985, when the Court prohibited the use of enumerated powers to regulate the states in the performance of their “traditional governmental functions.” The second effort started in 1992 and continues to this day: the Court now prohibits Congress from conscripting the state governments to carry out federal programs, including conscription through “coerced” consent.

The Supreme Court temporarily revived the idea that the federal government may not use its enumerated powers to regulate certain inherently local matters between 1976 and 1985. In *National League of Cities v. Usery*, the Court found that a federal statute requiring state and local governments to pay minimum wages was unconstitutional.¹⁸⁶ The four-justice plurality opinion stated that because the law “operate[d] to directly displace the States’ freedom to structure integral operations in areas of traditional governmental functions,” Congress had no power under the Commerce Clause to enact it.¹⁸⁷ The attempt to regulate the states as states “transgress[ed] an affirmative limitation” contained in the Tenth Amendment that applied “even when [Congress] exercise[d] its otherwise plenary power[] . . . to regulate commerce.”¹⁸⁸

The Court declined several times to extend the holding of *National League of Cities v. Usery* beyond its facts,¹⁸⁹ and explicitly overruled the

184. CHEMERINSKY, *supra* note 158, at 332.

185. 312 U.S. 100, 123-24 (1941).

186. 426 U.S. 833 (1976).

187. *Id.* at 852.

188. *Id.* at 842.

189. *See* EEOC v. Wyoming, 460 U.S. 226, 238-39 (1983) (holding that it was permissible for Congress to apply the Age Discrimination in Employment Act to state and local governments because the Act does not “directly impair the State’s ability to structure integral operations in areas of traditional governmental functions” (internal citation omitted)); FERC v. Mississippi, 456 U.S. 742, 759-60, 764 (1982) (holding that it is not a violation of the Tenth Amendment for a federal statute to require state utility commissions to consider adopting federal proposals and to resolve disputes under the portion of the statute that preempted state law); United Transp. Union v. Long Island R.R. Co., 455 U.S. 678, 685 (1982) (holding that the Tenth Amendment did not prohibit application of Railway Labor Act to state-owned railroad because the “operation of a railroad engaged in interstate commerce is not an integral part of traditional state activities”); Hodel v. Va. Surface Mining & Reclamation Ass’n, 452 U.S. 264, 293 (1981) (holding that *National League of Cities* does not apply to federal regulation of individual business); *see also* CHEMERINSKY, *supra* note 158, at 333-36.

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decision in 1985 in *Garcia v. San Antonio Metropolitan Transit Authority*.¹⁹⁰ The Court found that “the attempt to draw the boundaries of state regulatory immunity in terms of ‘traditional governmental function’ is not only unworkable but is also inconsistent with established principles of federalism.”¹⁹¹ *Garcia* seems to indicate that Congress is not barred from acting in the area of municipal taxation, assuming the action is within the bankruptcy power, simply because municipal taxation is a traditional governmental function. Indeed, *Garcia*’s rejection of the traditional-governmental-function limit on Congress’s power survives to this day. The Supreme Court’s subsequent revitalization of the Tenth Amendment proceeded along a different line.

The Court’s second revival of the Tenth Amendment began in 1992, when it decided *New York v. United States*.¹⁹² The Court did not return to the notion that Congress cannot regulate certain inherently local subjects.¹⁹³ Instead, the Court started with the proposition that Congress may not order states to carry out a federal regulatory program,¹⁹⁴ and rejected the statute at issue on the ground that it did what was prohibited: the statute “commandeer[ed]” the states to carry out a federal program.¹⁹⁵ Importantly, the Court reached this conclusion even though the statute gave states a choice whether to carry out the program or not. The statute “crossed the line distinguishing encouragement from coercion.”¹⁹⁶

Specifically, the statute forced the states to choose between two alternatives, and Congress lacked the power to compel the state to carry out either one of them. It required each state either to provide for the disposal of low-level radioactive waste generated within its borders or to take title to the waste.¹⁹⁷ The Court found that Congress lacked the power to order the states to take title. Requiring the states to carry out Congress’s regulatory scheme in this way would unconstitutionally “commandeer” state governments into the service of federal regulatory purposes.”¹⁹⁸ Nor could Congress order the states to provide for disposal of the waste, because Congress may not “present a

190. 469 U.S. 528 (1985) (holding that it was constitutional for Congress to apply Fair Labor Standards Act to a metropolitan transit authority).

191. *Id.* at 531.

192. 505 U.S. 144 (1992).

193. The Court wrote that it did not matter whether the inquiry was characterized as finding the outer limits on the power delegated to Congress or as determining whether the “core of sovereignty retained by the States under the Tenth Amendment” was invaded. *Id.* at 159. It stated that the two inquiries were “mirror images” of one another, *id.* at 156, and that “just as a cup may be half empty or half full, it makes no difference” how the question before it was characterized, *id.* at 159. The Court did not, however, state that there was a sphere of activity in which the states could regulate and Congress cannot.

194. *Id.* at 161.

195. *Id.* at 175-76.

196. *Id.*

197. *Id.* at 151.

198. *Id.* at 175.

simple command to state governments to implement legislation enacted by Congress.”¹⁹⁹ Accordingly, Congress could not require states to choose one of the alternatives: “A choice between two unconstitutionally coercive regulatory techniques is no choice at all.”²⁰⁰ Even though the states could choose not to carry out Congress’s program (providing for disposal) by deciding to take title instead, that was a false choice because Congress lacked the power to order either alternative. The absence of valid consent to the regulatory program was the touchstone of *New York*.²⁰¹

Five years after *New York*, in *Printz v. United States*,²⁰² the Supreme Court applied the anti-commandeering principle to a federal command to state executive officers, holding that the “Federal Government may . . . [not] command the States’ officers, or those of their political subdivisions, to administer or enforce a federal regulatory program.”²⁰³ Accordingly, the Court held that a statute requiring local law enforcement officials to perform background checks on gun purchasers was unconstitutional.²⁰⁴ The Court expressly noted that it was deciding that the federal government could not *require* participation in the program, leaving open the possibility that a purely voluntary background-check program would be permissible.²⁰⁵

The Court picked up where *New York* left off and further elaborated on its views on coercion recently in *National Federation of Independent Business v. Sebelius* (“*NFIB*”).²⁰⁶ In that case, the Court considered the Patient Protection and Affordable Care Act, which, among other things, put states to a choice between expanding Medicaid eligibility and losing all Medicaid funds. Many states objected, and the Court agreed that Congress had “crossed the line distinguishing encouragement from coercion.”²⁰⁷ The Court found that the Medicaid expansion was a new program,²⁰⁸ and characterized the funds that

199. *Id.* at 175-76.

200. *Id.* at 176.

201. It is also noteworthy that the state officials’ alleged consent in *New York v. United States* did not consist of the kind of official state and local government acts typically involved in authorizing and seeking municipal bankruptcy. Instead, New York’s officials’ “consent” took the form of congressional testimony by a deputy commissioner of the state’s Energy Office and a speech by one of the state’s senators in favor of the act in question. *Id.* at 181. By contrast, municipal bankruptcy typically involves a state statute authorizing the municipality to file, followed by a formal decision of the municipality’s governing body to make the filing, with the filing potentially subject to review by another state body.

202. 521 U.S. 898 (1997).

203. *Id.* at 935.

204. *Id.* at 902-04.

205. *See id.* at 910-11 (stating that the “critical point here” is whether Congress “could impose these responsibilities *without the consent of the States*”) (emphasis added); *id.* at 934 (discussing possibility that some local officials have “chosen, voluntarily, to participate in administration of the federal scheme”).

206. 132 S. Ct. 2566 (2012).

207. *Id.* at 2603 (quoting *New York v. United States*, 505 U.S. 144, 175 (1992)).

208. *Id.* at 2605-06 (holding that the Medicaid expansion “accomplishes a shift in kind, not merely degree,” because after the Affordable Care Act, Medicaid “is no longer a program to

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states stood to lose if they did not adopt this “new program” as “over 10 percent” of the states’ overall budgets.²⁰⁹ The pre-ACA Medicaid spending was an “independent grant[],”²¹⁰ and Congress’s threat to take away that independent grant was “a means of pressuring the State to accept policy changes.”²¹¹ Because the pressure was too intense—a “gun to the head” in the Court’s view²¹²—the states could not “voluntarily and knowingly accept[] the terms of the contract” Congress offered.²¹³

Thus, the focus of current Tenth Amendment analysis is on whether the state is forced to carry out a federal regulatory program. If the state has a choice about whether to carry out the program, as it does in the case of municipal bankruptcy, then the question is whether that choice is “coerced.” After *Garcia*, the focus is not on the subject of the federal statute.²¹⁴ In *New York*, the Court did not ask whether nuclear waste disposal policy was central to state sovereignty. In *Printz*, the Court did not ask whether law enforcement, or gun-control policy, was central to state sovereignty.²¹⁵ In *NFIB*, the court did not ask whether Medicare policy was central to state sovereignty. Under current law, the question raised by federal preemption of state tax limits in municipal bankruptcy is not whether taxation is central to state sovereignty, but whether the choice presented to state governments by the municipal bankruptcy statute is unduly coercive.

As applied to preemption of state tax limits in municipal bankruptcy, the Court’s Tenth Amendment cases suggest that the Court would not invalidate the preemption simply because it involves state taxation. Under its recent precedents, the Court might not permit Congress to force the states to

care for the neediest among us, but rather an element of a comprehensive national plan to provide universal health care insurance”).

209. *Id.* at 2605.

210. *Id.* at 2604.

211. *Id.*

212. *Id.*

213. *Id.* at 2602 (quoting *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981)).

214. The Court has relied on the idea of the “usual constitutional balance of federal and state powers” in the context of statutory interpretation; it has given statutes a narrow reading to avoid “upset[ting]” that balance. *Gregory v. Ashcroft*, 501 U.S. 452, 460 (1991); *see also id.* at 464-67 (invoking the plain statement rule to resolve ambiguity and find that state judges are “appointee[s] on the policymaking level” and therefore not protected by Age Discrimination in Employment Act); *Bond v. United States*, 134 S Ct. 2077, 2089-90 (2014) (citing and quoting *Gregory* in finding that a federal statute making it a criminal offense to possess or use chemical weapons did not reach “purely local crimes”). Any revision to the Bankruptcy Code to preempt state tax limits should be drafted plainly with these precedents in mind. The proposal described in Section I.B, *supra*, is intended to meet that standard.

215. *Printz* does state, “[i]t is an essential attribute of the States’ retained sovereignty that they remain independent and autonomous within their proper sphere of autonomy.” *Printz v. United States*, 521 U.S. 898, 928 (1997). However, the Court found that Congress violated this “independence and autonomy” when it “‘dragooned’” local officials into national service. *Id.* The Court did not focus on the nature of the service into which the local officials were “dragooned.” What was important, at least according to the Court, was that the local officials were pressed into federal service, not that they were pressed into the federal service of background checks.

participate in its municipal bankruptcy scheme.²¹⁶ However, states are not forced. They can choose whether to authorize bankruptcy for their municipalities. The next Section argues that states can give valid consent to a municipal bankruptcy regime that includes preemption of state tax limits.

B. State Consent and State Constraints

Municipal bankruptcy is voluntary. States have a choice about whether to participate and many decline to do so. Thus, as shown in the preceding Section, the Tenth Amendment would not bar preemption of state tax limits in municipal bankruptcy as long as a state gives valid consent to participation in a municipal bankruptcy regime that includes such preemption. This Section argues that a state may give valid consent to a municipal bankruptcy system that authorizes municipalities to propose plans that would otherwise violate state law, including the state constitution.

State consent to municipal bankruptcy empowers a municipality to propose a plan of adjustment that contains provisions that would otherwise violate the state constitution. Although this conclusion may seem surprising when stated so plainly, it is implicit in *Bekins* and has been made explicit in later decisions, most recently the high-profile bankruptcies of Detroit and Stockton.

In *Bekins*, the Court found that municipal bankruptcy “relie[ves]” debtors by allowing them to propose plans in which contracts are impaired, even though state or municipal impairment of contracts would otherwise be forbidden by the Federal Constitution.²¹⁷ When Congress acts within the bankruptcy power, it can authorize municipal acts that would otherwise violate the federal constitution. Implicit in *Bekins*’s holding that municipalities may propose plans that impair contracts is a finding that they can propose plans that would violate the *state* constitution. That is because state constitutions, no less

216. The Court might permit nonconsensual municipal bankruptcy if it were to find that there is something special about the bankruptcy power that trumps the Tenth Amendment, as suggested by *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006). In *Katz*, the Court rejected claim of several Virginia colleges that their sovereign immunity barred a liquidating supervisor in bankruptcy from recovering certain pre-bankruptcy transfers from them. *Id.* at 360. The Court relied on the “unique history” of the bankruptcy power, *id.* at 369 n.9, holding that at the time of the Framing, “the power to enact bankruptcy legislation was understood to carry with it the power to subordinate state sovereignty, albeit within a limited sphere,” *id.* at 377, and that the states “agreed in the plan of the [Constitutional] Convention not to assert” sovereign immunity, *id.* at 373. Although the specific doctrine at issue in *Katz* was sovereign immunity, the decision’s logic would appear to apply to the Tenth Amendment as well, as Jonathan Lipson has suggested. *See* Lipson, *supra* note 103, at 643. Although a recent decision finds that sovereign immunity does apply in municipal bankruptcy, the decision relies heavily on a policy of avoiding “the sort of interference with the State’s control of its fiscal affairs that the Supreme Court sought to avoid” in *Bekins*. *In re City of San Bernardino*, No. ED CV 13-01797 SJO, 2014 WL 2511096, at *13 (C.D. Cal. June 4, 2014). In emphasizing the substantive reservations of state power in the 1937 Act, the Court does not grapple with the consent-based rationale of *Bekins*.

217. *United States v. Bekins*, 304 U.S. 27, 54 (1938) (noting that in municipal bankruptcy, Congress uses the bankruptcy power to overcome “the restriction imposed by the Federal Constitution upon the impairment of contracts by state legislation”).

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than the federal one, contain impairment of contracts clauses.²¹⁸ California’s constitution contained such a clause when *Bekins* was litigated and decided,²¹⁹ yet the Court held that the California irrigation district in *Bekins* could propose a plan that impaired contracts. Impairment of contracts is ordinarily forbidden by both federal and state constitutions, but is permitted in the context of a municipal bankruptcy plan. That is, municipal bankruptcy plans, proposed under a municipal bankruptcy statute that is a legitimate exercise of the bankruptcy power, can contain provisions that would otherwise violate state constitutions.

What was implicit in *Bekins* became explicit in *Mission Independent School District v. Texas*.²²⁰ There, the Texas Constitution expressly forbade the legislature from authorizing the release of any indebtedness to the state. Yet the Fifth Circuit held that the district court should have confirmed a plan proposed by the debtor school district even though the plan released the school district’s debt to the state.²²¹ The state constitutional provision could not “stand in the way of the operation of the Bankruptcy Act” if the prerequisites for plan confirmation were met.²²² The municipality was allowed to do in bankruptcy that which the state constitution forbade it to do outside bankruptcy.

The recent *Detroit*²²³ and *Stockton*²²⁴ decisions provide further explicit confirmation of the principle that state constitutional constraints give way in bankruptcy. In these cases, objecting parties argued that what the municipalities proposed to do in bankruptcy impaired or could impair obligations in violation of the state constitution. The courts turned back these challenges. In so doing, they relied on the proposition that when a state authorizes municipal bankruptcy, it accedes to all provisions of Chapter 9 of the Bankruptcy Code—even if those provisions authorize actions otherwise prohibited by the state constitution.

In *Stockton*, retirees asked the bankruptcy court to enjoin the city not to reduce retiree health benefits, arguing that the planned reduction violated the contracts clauses of the federal and California constitutions.²²⁵ The court

218. Currently, it appears that impairment of contracts clauses appear in thirty-nine state constitutions. Impairment of Contracts: 50-State Survey, July 21, 2016 (on file with author). Cf. GEORGE D. BRADEN ET AL., THE CONSTITUTION OF THE STATE OF TEXAS: AN ANNOTATED AND COMPARATIVE ANALYSIS 62 (1977) (reporting that thirty-eight state constitutions contained impairment-of-contracts clauses).

219. The irrigation district in *Bekins* presented its petition for confirmation of its plan of composition on September 21, 1937. *Bekins*, 304 U.S. at 46. Both the 1937 and 1939 versions of the California Constitution contain clauses forbidding impairment of contracts. See CAL. CONST. of 1937 art. I, § 16 (“No bill of attainder, ex post facto law, or law impairing the obligation of contracts, shall ever be passed.”); CAL. CONST. of 1939 art. I, § 16 (same). The provision dates back to the Constitution of 1849. See CAL. CONST. of 1849 art. I, § 16 (same).

220. 116 F.2d 175 (5th Cir. 1940).

221. *Id.* at 179.

222. *Id.*

223. *In re City of Detroit*, 504 B.R. 97 (Bankr. E.D. Mich. 2013).

224. *In re City of Stockton*, 478 B.R. 8 (Bankr. E.D. Cal. 2012).

225. *Id.* at 14, 16.

rejected the challenges.²²⁶ It held that the Bankruptcy Clause authorized contract impairment that would otherwise violate the federal Contracts Clause.²²⁷ In so doing it held that “[t]he federal bankruptcy power also, by operation of the Supremacy Clause, trumps the similar contracts clause in the California state constitution.”²²⁸ Because the bankruptcy power embraces the impairment of contracts, wrote the court, the state’s contracts clause gave way.²²⁹

The *Detroit* court reached the same result. It rejected contentions that the state constitution’s clauses protecting contracts and pensions constrained the municipality’s bankruptcy plan. In a section of the opinion headed “When the State Consents to a Chapter 9 Bankruptcy, the Tenth Amendment Does Not Prohibit the Impairment of Contract Rights That Are Otherwise Protected by the State Constitution,”²³⁰ the court found that “[t]he state constitutional provisions prohibiting the impairment of contracts and pensions impose no constraint on the bankruptcy process.”²³¹ The court implicitly dismissed the argument that a state cannot consent to an arrangement that allows its instrumentality, the municipality, to violate the state constitution. Specifically, the court held that “with state consent, the adjustment of municipal debts does not impermissibly intrude on state sovereignty.”²³² The separate provision of the Michigan Constitution that expressly protects pensions from being “diminished or impaired”²³³ also gave way in municipal bankruptcy. The court held that pensions stood on the same footing as any other contract right and thus could be impaired.²³⁴

Nor could objecting parties argue that state constitutional impairments clauses are preserved by § 903 of the Bankruptcy Code, which reserves state control over municipalities. The *Stockton* court observed that the reservation in § 903 “is limited by the Supremacy Clause. A state cannot rely on the § 903 reservation of power to condition or to qualify, i.e., to ‘cherry pick,’ the application of the Bankruptcy Code provisions that apply in chapter 9 cases after such a case has been filed.”²³⁵ A state may not use its law to “revise

226. *Id.* at 30.

227. *Id.*

228. *Id.* at 16.

229. *Id.* at 15-16.

230. *In re City of Detroit*, 504 B.R. 97, 150 (Bankr. E.D. Mich. 2013).

231. *Id.*

232. *Id.*

233. MICH. CONST. art. 9, § 24 (2016).

234. *See Detroit*, 504 B.R. at 150-54. The discussion fell under the heading “Under the Michigan Constitution, Pension Rights Are Contractual Rights.”

235. *In re City of Stockton*, 478 B.R. 8, 16 (Bankr. E.D. Cal. 2012); *see also* *Mission Indep. Sch. Dist. v. Texas*, 116 F.2d 175, 176-78 (5th Cir. 1940) (holding that Texas could not exclude its own bonds from impairment in municipal bankruptcy); *In re City of Vallejo*, 403 B.R. 72, 75-76 (E.D. Cal. 2010) (“[B]y authorizing the use of chapter 9 by its municipalities, California must accept chapter 9 in its entirety; it cannot cherry pick what it likes while disregarding the rest.”); *In re City of Stockton*, 475 B.R. 720, 727-29 (Bankr. E.D. Cal. 2012) (“The state is the chapter 9 gatekeeper by virtue

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chapter 9.”²³⁶ Similarly, the *Detroit* court stated, “[i]f the state consents to a municipal bankruptcy, it consents to the application of chapter 9 of the bankruptcy code.”²³⁷

It might be argued that if municipal bankruptcy authorization permits the municipality to violate the state constitution’s impairment of contracts clause, that makes the authorization itself a violation of the state constitution. A recent student note makes this argument, asserting that “state constitutional contract impairment clauses prohibit state authorization of chapter 9 bankruptcy filings, except in the very rare cases of municipalities with absolutely no contractual obligations.”²³⁸ The *Detroit* court expressly rejected such an argument, finding that “if a state consents to a municipal bankruptcy, no state law can protect contractual pension rights from impairment in bankruptcy, just as no law could protect any other types of contract rights.”²³⁹ The court relied on the implicit proposition that it is constitutional for a state to authorize municipal bankruptcy, even if municipal bankruptcy permits municipalities to take actions that otherwise would violate the state constitution.

Although the *Detroit* court did not analyze the issue in depth, a contrary conclusion would undermine municipal bankruptcy itself. Every municipal bankruptcy case in which the municipality received a discharge of debt despite a state constitutional impairment contracts clause can be seen as an implicit endorsement of the proposition that a state may constitutionally empower its municipalities to take actions in bankruptcy that would otherwise violate the state constitution.

As long as Congress is acting within the bankruptcy power and the state consents to municipal bankruptcy, Congress can authorize municipalities to take actions in municipal bankruptcy that would otherwise violate state constitutional provisions. The very existence of municipal bankruptcy suggests that this proposition is correct as to state constitutions’ impairment of contracts clauses. Further, the *Detroit* court held that Detroit could use bankruptcy to get around the state constitution’s impairment-of-pensions clause. Nor should Congress’s power in this regard be understood as limited to state laws

of § 109(c)(2). But that gatekeeping function ends once the gate is opened and a chapter 9 case is filed.”); *In re Cty. of Orange*, 191 B.R. 1005, 1021 (Bankr. C.D. Cal. 1996) (“By authorizing the use of chapter 9 by its municipalities, California must accept chapter 9 in its entirety; it cannot cherry pick what it likes while disregarding the rest.”). At least one bankruptcy judge has taken a critical view of this proposition. See Thomas B. Bennett, *Consent: Its Scope, Blips, Blemishes, and a Bekins Extrapolation Too Far*, 37 CAMPBELL L. REV. 3, 22 (2015) (“The espousal of some that a state’s authorization of its subdivisions to file a municipal bankruptcy case equates to it and others not being able to avoid application of all sections of the Bankruptcy Code that are part of Chapter 9 is an overstatement of what *Bekins* viewed as consent by a state in aid of its sovereign powers.”).

236. *Stockton*, 478 B.R. at 17.

237. *Detroit*, 504 B.R. at 161.

238. Bradley Hull, Note, *State Contract Impairment Clauses and the Validity of Chapter 9 Authorization*, 32 EMORY BANKR. DEV. J. 87, 90 (2015).

239. *Detroit*, 504 B.R. at 161.

prohibiting impairment of contracts; as noted in Section II.A, Congress's power to preempt state law is not so limited.

The principle explained in this section applies with as much force to preemption of state tax limits in municipal bankruptcy: Congress can authorize municipalities to take actions in municipal bankruptcy that would otherwise violate constitutional state tax limits, as long as Congress is acting within the bankruptcy power and the state consents.²⁴⁰ The next Section addresses the validity of state consent to a municipal bankruptcy system that preempts state tax limits.

C. Consent to State Tax Limit Preemption

This Section argues that states' consent to a revised municipal bankruptcy statute that preempts state tax limits would probably be found not to be impermissibly coerced. First, preemption would likely be seen as aiding the state's authority, not derogating from it. Second, even if preemption is viewed as a string attached to the benefit of access to municipal bankruptcy, rather than as a part of that benefit, it is probably permissible. State tax limit preemption probably passes the test set forth in *NFIB* for permissible conditions on federal benefits provided to states.

As discussed, state consent lay at the heart of *Bekins*,²⁴¹ and the *Detroit* and *Stockton* decisions also stressed the importance of consent.²⁴² Indeed, the *Detroit* court went so far as to state, "[t]he Tenth Amendment to the United States Constitution is violated only when the state does not consent."²⁴³ This Section assumes that that statement is probably too broad. Under current Tenth Amendment jurisprudence, courts would probably look to the quality of consent, not just the fact of consent.²⁴⁴

It is not clear that preemption of state tax limits in municipal bankruptcy even raises questions about the quality of state consent. Questions about unconstitutional conditions come into play when the federal government proposes that the state give up something in exchange for a federal benefit,²⁴⁵

240. See discussion *supra* Part II.

241. See discussion *supra* Section III.A.1.

242. See *Detroit*, 504 B.R. at 144 ("At its core, *Bekins* rests on state consent."); *Stockton*, 478 B.R. at 20 (stating that the "foundation" of federal-state relationship in municipal bankruptcy contains "multiple levels of consent," including the state's consent to the municipality's filing and the municipality's consent, evidenced by the facts that only voluntary filings are permitted and that only the municipality can propose a plan of adjustment).

243. *Detroit*, 504 B.R. at 147.

244. See discussion *supra* Section III.A.2.

245. See *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2602 (2012) ("We have repeatedly characterized . . . Spending Clause legislation as 'much in the nature of a contract'" (quoting *Barnes v. Gorman*, 536 U.S. 181, 186 (2002)); *id.* at 2602-03 (noting that the issue in unconstitutional-condition analysis of spending programs is whether "a State has a legitimate choice to accept the federal conditions *in exchange for* federal funds" (emphasis added)); *Pennhurst St. Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981) (noting that in a conditional spending program, "*in return for* federal funds, the States agree to comply with federally imposed conditions" (emphasis added)).

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but municipal freedom from state constitutional limitations is something states *get*, not something they give up. The proposal here is for the federal government to give states and their instrumentalities more freedom from state constitutional constraints. If increased taxes are needed for municipal financial rehabilitation, freedom to raise them helps the state “save its agency which the State itself is powerless to rescue.”²⁴⁶ The state is no more coerced by preemption of its state tax limits in municipal bankruptcy than it is by preemption of its impairment of contracts clause.

Similarly, the Court has described unconstitutional conditions as an impermissible way of inducing the states to “act in accordance with *federal* policies.”²⁴⁷ But the preemption of state tax limits can be described as lifting a constraint on implementation of *municipal* policies. The proposed legislation would free the municipality from state constitutional constraints that prevent it from implementing its preferred tax policies, just as municipal bankruptcy currently frees a municipality to implement its preferred debt adjustments.

Even if lifting state limits on municipal tax in bankruptcy is described as constraining state discretion rather than as freeing it, the proposal probably does not impose an unconstitutional condition. Signing onto the revised municipal bankruptcy statute and thus signing on to preemption of state tax limits increases local discretion, but the arrangement could potentially be seen as limiting state authority because state constitutional provisions are abrogated.

If the proposed municipal bankruptcy statute is so viewed, *NFIB* provides a useful framework for analysis. This is so even though *NFIB* was a case about conditional spending, not bankruptcy. Professors Clayton Gillette and David Skeel have argued that municipal bankruptcy with strings attached functions similarly to a conditional block grant of money. In return for accepting the federal government’s conditions, the municipality gets access to money it would not otherwise have.²⁴⁸ If Gillette and Skeel are right, *NFIB* is controlling precedent. But in any event, attention to *NFIB* is appropriate because the case is the Supreme Court’s latest word on unconstitutional conditions.

Professor Samuel Bagenstos has identified three criteria that must be met before a congressional conditional-spending program fails the test of *NFIB*: “When Congress takes an (1) entrenched federal program (2) that provides large sums to the states and (3) tells states that they can continue to participate

246. *United States v. Bekins*, 304 U.S. 27, 54 (1938); *see also In re City of Stockton*, 478 B.R. 8, 20 (Bankr. E.D. Cal. 2012) (“Chapter 9 passed constitutional muster on the basis that the federal bankruptcy power be exercised at the request of, but not at the expense of, the sovereign state in an exercise of cooperation . . .”).

247. *NFIB*, 132 S. Ct. at 2602 (emphasis added); *see also New York v. United States*, 505 U.S. 144, 166 (1992) (holding that Congress may use conditional spending to “urge a State to adopt a legislative program consistent with federal interests”).

248. Gillette & Skeel, *supra* note 7, at 1210.

in that program only if they *also* agree to participate in a separate and independent program, the condition is unconstitutionally coercive.”²⁴⁹

Applying this framework to the proposed revised municipal bankruptcy law, the condition is that the state must give up its constitutional limits on municipal tax increases in return for use of the federal bankruptcy power to adjust municipal debts. So viewed, the proposal probably passes *NFIB*, as interpreted by Bagenstos.²⁵⁰

With respect to the first of Bagenstos’s questions, the proposal might affect an “entrenched federal program,” particularly as to those states that have already authorized their municipalities to file for bankruptcy.²⁵¹ But with respect to the second question, municipal bankruptcy arguably is not like a program that provides large sums to the states because municipal bankruptcy has provided only a small amount of money relative to state budgets²⁵² and because the program is not too attractive to turn down.²⁵³ As for the third question, lifting state tax limits in municipal bankruptcy should not be seen as a separate and independent program from the rest of municipal bankruptcy. Creditor recovery is a central function of bankruptcy, and municipal bankruptcy in particular has always been concerned with municipalities’ repayment of their debt through taxes.²⁵⁴

D. Arguments That State Consent Is Insufficient

This Article has argued that state consent is the touchstone in analyzing the constitutionality of municipal bankruptcy, and therefore of analyzing the constitutionality of preempting state tax limits. This Section addresses two arguments that might be leveled against the Article’s contentions.

249. Samuel R. Bagenstos, *The Anti-Leveraging Principle and the Spending Clause After NFIB*, 101 GEO. L.J. 861, 866 (2013) (emphasis and numbering added); see also Samuel R. Bagenstos, *Viva Conditional Federal Spending*, 37 HARV. J.L. & PUB. POL’Y 93, 95 (2014) (expressing a similar view). The *NFIB* framework is formalistic and does not focus on the substantive fairness of the exchange between the federal government and the states. *Bekins* suggested in passing an inquiry that does focus on substance. See *Bekins*, 304 U.S. at 53 (noting that the Constitution permits the state to agree to conditions “that will assure a fair and just requital for benefits received” (quoting *Charles C. Steward Mach. Co. v. Davis*, 501 U.S. 548, 595-96 (1937))). It seems likely that preemption of state tax limits is a “fair and just requital” for the benefit of a federal discharge, but further development of the *Bekins* test would be needed to say anything with confidence.

250. Cf. Hunt, *supra* note 25, at 556-68 (applying Bagenstos’s framework to question whether judicial requirement to raise taxes in bankruptcy is an unconstitutional condition).

251. See H. SLAYTON DABNEY, JR. ET AL., *MUNICIPALITIES IN PERIL: THE ABI GUIDE TO CHAPTER 9 11* (2d ed. 2012) (“Approximately half of the states do not permit municipalities to file at all.”).

252. See Hunt, *supra* note 25, at 567 n.297 (observing that Detroit, the largest municipal bankruptcy in history, involved total debt (not debt reduction) of one third of Detroit’s budget for *one* year, while the Medicaid expansion analyzed in *NFIB* involved ten percent of the *average* affected state’s budget *every* year).

253. See DABNEY, *supra* note 251, at 11.

254. See *supra* Section II.B.1.

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First, this Section answers the argument that there is something special about municipal taxes *qua* taxes—as distinct from their status as traditionally local matters—that would make the proposal unconstitutional. Despite many statements that taxes are central to sovereignty, courts have not established rules governing state tax laws’ possible immunity from preemption. At the same time, Congress has preempted state tax laws in many areas. The consensus view of scholars seems to be that Congress has wide discretion to preempt state tax laws. Moreover, the main concern expressed about preemption of state tax laws is the need to protect state and local fiscal health, and the proposal here would tend to enhance local finances.

Second, this Section confronts the argument that state consent to federal programs is insufficient because federalism protects individuals as well as states. This principle might, in certain applications, undermine the state-consent-based framework that currently prevails in municipal bankruptcy. However, the Court simply has not explored the implications of the proposition that federalism protects individuals in enough depth to permit an informed assessment of the proposition’s impact.

1. State Taxation as a Reserved State Domain

Although Tenth Amendment analysis has moved away from asking whether the specific activity in question is fundamental or central to sovereignty, it is worth discussing whether state taxation is special. Both scholars and the Supreme Court have stated that taxation is fundamental to state sovereignty.²⁵⁵ In the words of Professor Michael McConnell, “The power of taxation is as much at the core of sovereignty as anything could possibly be: The American Revolution was fought over the proposition of no taxation without representation.”²⁵⁶ Emily Johnson and Professor Ernest Young have argued that it would be “an extraordinary exercise of federal power” to “empower the bankruptcy court to enjoin the operation of state laws that *prevent* necessary taxing or spending, while leaving the actual execution of the tax to state authorities.”²⁵⁷

Such an argument could find some support in language used in *Bekins*. Although the main focus of *Bekins* was consent, the opinion does reflect some concern with what precisely the states consented to. In particular, the Court mentioned the sovereignty-preserving provisions of the 1937 Act, such as the requirement that “the action of the taxing agency in carrying out a plan of

255. See, e.g., *Dep’t of Revenue v. ACF Indus.*, 510 U.S. 332, 345 (1994) (holding that the taxation authority of state government is “central to state sovereignty”). Michael Fatale has collected additional cases in this vein. See Michael T. Fatale, *Common Sense: Implicit Constitutional Limitations on Congressional Preemptions of State Tax*, 2012 MICH. ST. L. REV. 41, 42 n.3.

256. McConnell, *supra* note 7, at 234.

257. Emily D. Johnson & Ernest A. Young, *The Constitutional Law of State Debt*, 7 DUKE J. CONST. L. & PUB. POL’Y, 117, 161 n.226 (2012) (emphasis added). Johnson and Young made this assertion in the course of evaluating a proposal for a mandatory bankruptcy regime for states.

composition . . . [be] authorized by state law.”²⁵⁸ The Court also held that state consent protects a cooperative federal-state program against a Tenth Amendment challenge “if the essence of . . . statehood is maintained without impairment.”²⁵⁹ These observations were made in passing and not integrated into the analysis, but they might have some bite if taxation truly is special. For example, one might argue that a municipal bankruptcy statute that includes federal preemption of state tax limits fails to “maintain[]” the “essence of statehood.”²⁶⁰

Despite frequent references to the importance of the states’ power to tax to state sovereignty, commentators have found that there are “no established applicable judicial limitations” on Congress’s power to preempt state tax measures.²⁶¹ Johnson and Young cite nothing indicating that the exercise of federal power they deem “extraordinary” would actually be prohibited. In the words of Professors David Gamage and Darien Shanske, the consensus view, although one not universally shared,²⁶² seems to be that “the federal government almost certainly can impose significant restrictions on state taxing power, though within limits.”²⁶³ Indeed, the federal government already has preempted state taxation in many areas.²⁶⁴

It might be argued that state tax *limits* are entitled to greater protection than state taxes themselves, particularly for limits that were adopted by popular vote. Such an argument may be answered by observing, again, that state governments consent to municipal bankruptcy.²⁶⁵ Moreover, when the Supreme Court upheld Proposition 13 against constitutional challenge, it did not rely on any proposition that initiatives are entitled to greater deference than laws

258. *United States v. Bekins*, 304 U.S. 27, 51 (1938). Among the sovereignty-preserving provisions mentioned by the Court were voluntariness of proceedings, state-law authorization to carry out the reorganization plan, noninterference with municipal fiscal or governmental affairs, and the absence of judicial control or jurisdiction over property and revenues necessary for essential governmental purposes. *Id.* at 50-51.

259. *Id.* at 53.

260. *Id.*

261. Fatale, *supra* note 255, at 43; see also David Gamage & Darien Shanske, *The Federal Government’s Power to Restrict State Taxation*, 81 ST. TAX NOTES 547, 547 (2016) (stating that there is “no clear guidance from the U.S. Supreme Court” on the extent of Congress’s power to preempt state taxes).

262. See Fatale, *supra* note 255, at 45 (arguing that Congress’s state-tax preemption authority under Commerce Clause is limiting to preempting state taxes that amount to “state-based economic protectionism”).

263. Gamage & Shanske, *supra* note 261, at 553.

264. *Id.* at 551 (noting federal preemption of direct state taxation of the Internet, of individuals “traveling in air commerce,” of interstate travel by motor carrier, of the retirement income of non-residents, and of the purchase of food with Supplemental Nutrition Assistance Program benefits, as well as prohibition on state taxation that discriminates against railroads and on state taxation of interstate motor fuels unless the state is a member of the International Fuel Tax Agreement). Gamage and Shanske also call attention to the facts that ERISA broadly preempts state taxes and that the federal government has capped the amount of franchise fees a cable company can be required to pay a state or local government. *Id.* at 552.

265. See discussion *supra* Section III.B.

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adopted by legislatures; instead, it relied on precedents dealing with legislative enactments in upholding the statute.²⁶⁶

Even if the Court were inclined to protect state taxation as such, there are reasons to think the state tax limit preemption would pass muster. First, as discussed, courts have embraced a notion of consent in the municipal bankruptcy context under which state autonomy would be enhanced, not limited, by preempting state tax limits.²⁶⁷ Second, the leading commentator advancing the view that Congress's power to preempt state law is sharply limited emphasizes the original understanding and current reality that states need taxes to fund their governments.²⁶⁸ Under the proposal here, Congress is making it easier, not harder, for local governments to fund themselves. Finally, even if the proposal is viewed as an intrusion on state taxing authority, the intrusion is sharply limited. It applies only in the comparatively rare case of municipal bankruptcy and preserves the ultimate decision about whether to raise taxes to the local or state authorities in charge of the bankrupt municipality.

2. Federalism as an Individual Protection

The view that federalism limits federal power to protect individual rights, as well as to “preserve[] the integrity, dignity, and residual sovereignty of the States,”²⁶⁹ has been described as “increasingly dominant.”²⁷⁰ The Court has found that because “[s]tates are not the sole intended beneficiaries of federalism,”²⁷¹ state consent to a federal program may not in itself be enough to validate the program,²⁷² at least if the arrangement amounts to “tyranny [or] abuse.”²⁷³

266. See *Nordlinger v. Hahn*, 505 U.S. 1, 12 (1992) (citing the discretion of legislatures to design tax laws in evaluating the constitutionality of Proposition 13); *id.* at 15-16 (equating “legislatures” and “other governmental decisionmakers” (in context, state electorates) for purposes of constitutional analysis).

267. See discussion *supra* Section III.A.

268. See *Fatale*, *supra* note 255, at 44-45; see also *Gamage & Shanske*, *supra* note 261, at 551 n.35 (collecting cases in which the Supreme Court has expressed solicitude for the states' ability to raise revenue).

269. *Bond v. United States*, 564 U.S. 211, 221 (2011).

270. *McConnell*, *supra* note 7, at 235.

271. *Bond*, 564 U.S. at 222; see also *id.* (“[T]he individual liberty secured by federalism is not simply derivative of the rights of the States.”).

272. See *New York v. United States*, 505 U.S. 144, 182 (1992) (“Where Congress exceeds its authority relative to the States, therefore, the departure from the constitutional plan cannot be ratified by the ‘consent’ of state officials.”); see also *Bond*, 564 U.S. at 222 (“Fidelity to principles of federalism is not for the States alone to vindicate.”).

273. *New York*, 505 U.S. at 181-82 (quoting *Gregory v. Ashcroft*, 501 U.S. 452, 458 (1991) (“[A] healthy balance of power between the States and the Federal Government will reduce the risk of tyranny and abuse from either front.”)).

Although the Court has been emphatic in stating that federalism protects individual rights,²⁷⁴ it has not actually found any federal statute unconstitutional despite otherwise valid state consent because the statute tyrannized or abused individuals.²⁷⁵ Thus, we have little guidance about the scope or operation of the principle that federalism protects individual rights.

Consider *New York v. United States*, the first of the recent cases to assert that federalism protects individual rights. The observation seems unnecessary to the outcome. The Court found that Congress offered New York an unconstitutionally coercive choice between regulating as Congress desired or taking title to nuclear waste.²⁷⁶ It then went on to observe, based on the premise that federalism protects individuals,²⁷⁷ that “[s]tate officials . . . cannot consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution.”²⁷⁸ In context, this statement seems to mean simply that if the choice is impermissibly coercive, states (or their officials)²⁷⁹ cannot consent to being bound to make the impermissible choice that Congress has devised.²⁸⁰ The Court’s observation about federalism and individuals does not seem to have any particular import when the state’s choice is not impermissibly coerced.

Broad application of this principle—that state consent does not matter because federalism also protects individuals—threatens to upend municipal bankruptcy, at least as it is currently conceived. Not just *Detroit* and *Stockton*, but also *Bekins* rests on the proposition that state consent is what matters. For this reason, we might expect the Court to hesitate before applying the idea that federalism protects individuals in this context. Indeed, the Court might find the proposal to preempt state tax limits salutary, rather than “abusive” or “tyrannical.” It might be influenced by arguments such as those presented in

274. See *Bond*, 564 U.S. at 221 (quoting *Gregory*, 501 U.S. at 458) (“Federalism secures the freedom of the individual.”); *New York*, 505 U.S. at 181 (noting that federalism protects against “tyranny and abuse”).

275. In cases where the Court has mentioned the principle that federalism protects individuals, it has applied the plain statement rule to the challenged statute to avoid constitutional doubt. See *Gregory*, 501 U.S. at 464-67 (invoking the plain statement rule to resolve ambiguity and find that state judges are “appointee[s] on the policymaking level” and therefore not protected by the Age Discrimination in Employment Act). The Court likewise used the plain statement rule when it considered the merits of *Bond*. See *Bond v. United States*, 134 S. Ct. 2077, 2089-90 (2014) (citing and quoting *Gregory* in finding that the federal statute making it a criminal offense to possess or use chemical weapons did not reach “purely local crimes”).

276. *New York*, 505 U.S. at 175-76.

277. *Id.* at 181-82.

278. *Id.* at 182.

279. The only act by a state official asserted to constitute consent to the federal statute was a deputy commissioner’s congressional testimony in support of the statute. *Id.* at 181. It seems unlikely that this act bound the state government.

280. See *In re City of Detroit*, 504 B.R. 97, 149 (Bankr. E.D. Mich. 2013) (“The Court can only conclude that Justice O’Connor meant . . . that a state cannot consent to be compelled . . . [O]ne cannot consent to have a gun held to one’s head. The idea of ‘consent’ in such a scenario is meaningless.”).

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this Article,²⁸¹ or perhaps by a more fundamental notion that the tax revolt movement reflects an impulse to get “something for nothing.”²⁸² Without further development of the principle that federalism protects individuals, we are left to speculate about its implications for preemption of state tax limits.

IV. Possible State Circumvention of Tax Limit Preemption

If Congress were to preempt state tax limits in municipal bankruptcy, the states also would retain control over the conditions under which municipalities enter bankruptcy. Municipal bankruptcy is permitted only if the state authorizes the filing.²⁸³ That retention of control opens up the possibility that states could circumvent federal preemption of tax limits. There is at least some suggestion in case law that state governments can use their control over *whether* a municipality files a bankruptcy petition to dictate to the municipality *how* it must conduct the ensuing bankruptcy.²⁸⁴ Thus, it is arguably permissible for a state to require that a municipality abide by state-law limits on tax increases as a condition of filing, just as it is arguably permissible for a state to require that a municipality abide by state-law limits on pension cuts as a condition of filing.

If states can simply amend the law authorizing municipal bankruptcy to require that bankrupt municipalities abide by state tax limits, what good is the preemption of state tax limits? Won't states simply make the necessary amendments to their state laws and return to the status quo ante? There are several answers.

First, although it is *possible* that states may control the conduct of municipal bankruptcy through their authorization requirements, it is not clear that they may do so.²⁸⁵ Second, state tax limits often do not originate with state legislatures, but instead with anti-tax activists who make use of the initiative

281. See discussion *supra* Section I.A.

282. See, e.g., DAVID O. SEARS & JACK CITRIN, *TAX REVOLT: SOMETHING FOR NOTHING IN CALIFORNIA* 70 (1982); see also *id.* at 1 (“People are understandably readier to demand services from government than to pay for them.”).

283. See 11 U.S.C. § 109(e)(2) (2012) (“An entity may be a debtor under chapter 9 of this title if and only if such entity . . . is specifically authorized . . . 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.”).

284. See *Int'l Bhd. of Elec. Workers v. City of Vallejo* (*In re City of Vallejo*), 432 B.R. 262, 270 (E.D. Cal. 2010), *aff'g*, 403 B.R. 72, 76-77 (Bankr. E.D. Cal. 2009) (“If California had desired to restrict the ability of its municipalities to reject public employee contracts in light of state labor law, it could have done so as a pre-condition to seeking relief under Chapter 9.”); *In re City of Stockton*, 478 B.R. 8, 17 (Bankr. E.D. Cal. 2012) (“While a state may control prerequisites for consenting to permit one of its municipalities . . . to file a chapter 9 case, it cannot revise chapter 9.”); see also Moringiello, *supra* note 23, at 458 (2014) (“By granting the states [a] gatekeeper role, Congress . . . provided a mechanism for state participation in the federal bankruptcy process.”). *But see In re City of Detroit*, 504 B.R. 97, 153 (Bankr. E.D. Mich. 2013) (listing ways Michigan could have protected pensions from impairment in bankruptcy and not including conditions on authorization to file).

285. See, e.g., *Detroit*, 504 B.R. at 153 (not including conditions on authorization to file in a list of ways Michigan could have protected pensions from impairment in bankruptcy).

process.²⁸⁶ State legislative majorities may dislike the limits and be in no hurry to reenact them.²⁸⁷ Reimposing the limits might require new initiatives with all the accompanying difficulties of such efforts. Third, even if some legislators do want to reimpose the tax limits in municipal bankruptcy, there is the substantive argument that bankruptcy is a special case. Even if one concedes that tax limits are desirable in general, there is a special interest in rehabilitating insolvent municipalities, whose travails may affect the credit standing of “neighboring jurisdictions, the state, and even the nation.”²⁸⁸ State tax limits can interfere with achieving the goal of rehabilitation.

Moreover, residents of municipalities that are not in distress may perceive little threat that they will endure the tax increases made possible by the proposal. The new local taxes will be paid, by and large, by the residents of the insolvent municipality. Indeed, tax limit preemption in bankruptcy may be in the financial interest of residents of non-distressed cities, because if distressed cities cannot right themselves they may receive bailouts from the state government.²⁸⁹ If the choice is between selectively lifting tax limits and bailing out insolvent municipalities, citizens who are concerned with their own tax bills and who do not expect their own municipality²⁹⁰ to go bankrupt may favor the preemption of state tax limits.

Finally, Congress may be able to insist on state abandonment of any effort to circumvent preemption of tax limits as a condition of access to municipal bankruptcy. Congress could condition access to municipal bankruptcy on state acceptance of tax limit preemption. As discussed below, such a condition should withstand constitutional scrutiny as long as it is within the federal bankruptcy power and does impermissibly coerce the states.

Conclusion

This Article advances and defends a proposal for federal preemption of state tax limits and electoral requirements, such as those imposed by California’s Proposition 13, in municipal bankruptcy. Such limits apparently contribute to municipal financial distress and restrict municipalities’ flexibility

286. See, e.g., MARTIN, *supra* note 33, at 100-08 (describing passage of California’s Proposition 13 by initiative); Mark Henkels, *Measure 5 (Property Taxes)*, OR. ENCYCLOPEDIA, https://oregonencyclopedia.org/articles/measure_5_property_taxes (reporting that Oregon’s Measure 5, limiting local taxes, was a ballot initiative).

287. See MARTIN, *supra* note 33, at 104 (recounting California legislature’s attempt to defeat Proposition 13 by proposing alternative measure to voters).

288. Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 281, 302 (2012). Gillette also presents evidence for the plausibility of such an outcome. See *id.* at 302-06.

289. See, e.g., *id.* at 308-09 (discussing state bailouts of distressed municipalities).

290. A “municipality” under the Bankruptcy Code can be a special district such as a water or sewer district, and in fact most municipal bankruptcies over the life of the statute have been of such special districts. See Moringiello, *supra* note 23, at 406. The point in the text holds nevertheless.

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in responding to distress.²⁹¹ The proposal would amend Chapter 9 of the Bankruptcy Code to provide that a plan may be confirmed if it provides for tax levels or increases in excess of limits provided by state law and if it provides for tax increases notwithstanding any requirement of state law that such increases are subject to electoral approval.²⁹²

The Article argues that such preemption is a permissible exercise of Congress's power under the Bankruptcy Clause. The Supreme Court has recognized that the Clause confers broad power on Congress to legislate "on the subject of any person's general inability to pay [its] debts,"²⁹³ and the Court's conception of this power has expanded over time to meet new conditions.²⁹⁴ In only one case has the Court found that Congress exceeded its authority under the Bankruptcy Clause, but only because the statute concerned was not "uniform" because it affected only one named railroad.²⁹⁵ The proposal to preempt state tax limits presents no such issue: it affects all states with tax limits. Moreover, preemption of state tax limits advances both the creditor-recovery and debtor-rehabilitation goals of bankruptcy law.²⁹⁶

Specific limits on the bankruptcy power that scholars or courts have embraced do not preclude adoption of the proposal advanced in this Article. For example, it has been argued that the bankruptcy power extends only to adjustment of the affairs of an insolvent debtor.²⁹⁷ This limit does not affect the proposal because only insolvent municipal debtors may seek bankruptcy relief.

Alternatively, some decisions that speak to the bankruptcy power generally may appear to restrict it to proceedings that liquidate property. However, the Supreme Court has recognized in its municipal bankruptcy decisions and in earlier decisions relating to compositions and railroad reorganizations that bankruptcy proceedings need not liquidate property.²⁹⁸

It has been asserted in scholarly literature that bankruptcy may not impair the rights of noncreditors.²⁹⁹ Even assuming that state tax limits confer "rights" on taxpayers within the meaning of this assertion, this proposition faces several issues. In *Wright v. Central Union Fire Insurance Co.*, the Supreme Court upheld a bankruptcy statute that impaired a noncreditor's rights.³⁰⁰ Moreover, existing provisions of the Bankruptcy Code call for the impairment of these rights. Finally, the principal academic defense of the no-impairment-of-

291. See discussion *supra* Section I.A.

292. See discussion *supra* Section I.B.

293. See *Cont'l Ill. Bank & Tr. Co. v. Chi., Rock Island, & Pac. Ry. Co.*, 294 U.S. 648, 670 (1935) (quoting *Kunzler v. Kohaus*, 5 Hill 317, 321 (N.Y. 1843)).

294. See *supra* Section II.A.2.

295. See *supra* Section II.A.2.

296. See *supra* Section II.A.1.

297. See *supra* Section II.B.1.

298. See *supra* Section III.B.1.

299. See discussion Section III.B.2.

300. 304 U.S. 502 (1938).

noncreditors proposition relies on an originalist reading of the Constitution that the Supreme Court has rejected in the municipal bankruptcy context.

The Article defends the proposal for state tax limit preemption against the objection that such preemption would violate the Tenth Amendment. The Supreme Court has recognized, ever since it first approved municipal bankruptcy in *United States v. Bekins*, that valid state consent to municipal bankruptcy cures the Tenth Amendment issue.³⁰¹ As *Bekins* suggests, later decisions confirm, and the recent *Detroit* and *Stockton* decisions reaffirm, states may give valid consent to a municipal bankruptcy statute that authorizes municipal bankruptcy plans that would otherwise violate state constitutional provisions, such as clauses forbidding the impairment of contracts.³⁰² Municipal bankruptcy plans that would violate tax limits found in state constitutions should stand on the same footing.

Under modern Tenth Amendment jurisprudence, courts would scrutinize whether a state's consent to municipal bankruptcy is valid, as opposed to being impermissibly coerced.³⁰³ State tax limit preemption grants states and their instrumentalities freedom of action rather than taking it away, because municipalities are able to take measures to right their finances that would otherwise be impermissible. Even if state tax limit preemption is seen as restricting state power, it should pass muster under *NFIB*, the Supreme Court's most recent decision in the area. Unlike Medicaid, the program at issue in *NFIB*, municipal bankruptcy is not too attractive for states to turn down. Moreover, it was critical to the Court's analysis in *NFIB* that the Affordable Care Act provisions at issue were separate and independent from the existing Medicaid program. State tax preemption in municipal bankruptcy cannot be described as separate and independent from municipal bankruptcy.

Congress can authorize the municipalities of consenting states to propose bankruptcy plans that would otherwise violate state constitutional constraints. To date, this power to preempt has been used against creditors. Most recently and dramatically, retirees felt its force in the Detroit and Stockton bankruptcies. This use of Congress's power is unduly one-sided. Municipal financial distress arises not just from the presence of liabilities, but also from the absence of assets. Municipal insolvency can be addressed by increasing available revenues as well as by adjusting debts. Preemption of state tax limits in bankruptcy can help municipalities raise funds and thereby cope with financial distress. Congress's use of its preemptive power to help cities raise revenues would bring greater balance and fairness to municipal bankruptcy.

301. See discussion *supra* Section III.A.1.

302. See discussion *supra* Section III.B.

303. See discussion *supra* Section III.C.