

1-1-2016

# *Ashton, Bekins, and Necessity: Why Chapter 9 is Constitutional, But Not the Only Way for Municipalities to Adjust Their Debts*

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## Recommended Citation

Aaron Michael Dmiszewicki, *Ashton, Bekins, and Necessity: Why Chapter 9 is Constitutional, But Not the Only Way for Municipalities to Adjust Their Debts*, 24 U. Miami Bus. L. Rev. 59 (2016)

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# *Ashton, Bekins, and Necessity: Why Chapter 9 Is Constitutional, But Not the Only Way for Municipalities to Adjust Their Debts*

Aaron Michael Dmiszewicki\*

*The 1930s saw the nation in crisis, steeped in the worst of the Great Depression. In 1936, over 2,000 municipalities, counties, and other governmental units, in 41 of the 48 states, were known to be in default. In response to this crisis, Congress amended the Bankruptcy Act in 1934 and passed the first municipal bankruptcy statute. Shortly thereafter, the Supreme Court struck it down. Undeterred, Congress passed another municipal bankruptcy statute in 1937, which was almost identical to the previously invalidated law. In 1938, the Supreme Court, now stocked with Roosevelt-appointed New Deal sympathizers, upheld the law.*

*However, the latter case, while perhaps correctly decided, was woefully lacking in analysis. Since that time, no court has engaged in the appropriate legwork to make a case for both the need and constitutionality of a municipal bankruptcy statute. This paper aims to connect the dots between Chapter 9, the Contract Clause, and the Tenth Amendment to establish that, while Chapter 9 is undoubtedly constitutional, the Supreme Court overstated its necessity, and its necessity remains overstated today.*

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## PART I. INTRODUCTION

Although municipal bankruptcy has existed since the 1930s, never did it get so much attention as when the City of Detroit filed the largest municipal bankruptcy in history in the middle of 2013. The filing caused an uproar, as thousands of state pensioners fought to prevent the City from modifying their retirement benefits in the bankruptcy.<sup>1</sup> Various creditors and citizens filed roughly twelve objections, each with various sub-objections, to the Detroit filing, of which one was to the very constitutionality of Chapter 9.<sup>2</sup> On December 5, 2013, Bankruptcy Judge Steven Rhodes issued a ruling on each of those objections, holding that Chapter 9 did not violate the uniformity requirement of the Bankruptcy Clause, the Contract Clause, or the Tenth Amendment.<sup>3</sup>

This paper, however, focuses not on the Detroit bankruptcy in and of itself, but rather addresses the concern that states cannot adjust their debts outside of the bankruptcy regime, as well as the specific objection

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<sup>1</sup> Matt Helms, Nancy Kaffer & Stephen Henderson, *Detroit Files for Chapter 9 Bankruptcy Amid Staggering Debts*, Detroit Free Press, July 19, 2013, at A1; *see also* MICH. CONST. art. IX, § 24 (“The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.”).

<sup>2</sup> *See In re City of Detroit*, 504 B.R. 97 (Bankr. E.D. Mich. 2013) (analyzing and ruling on each of the objections).

<sup>3</sup> *Id.* at 136–54.

that Chapter 9 violates the Tenth Amendment. Indeed, at this point, a discussion of the objections themselves is largely moot, as the Detroit bankruptcy was confirmed in late 2014.<sup>4</sup> In his opinion overruling the objections, Judge Rhodes hung his hat<sup>5</sup> on a Supreme Court case from 1938, in which the Supreme Court, recognizing the necessity of a municipal bankruptcy option during the height of the Great Depression, found that municipal bankruptcy was constitutional, only two years after striking down a similar law.<sup>6</sup> *Bekins* adopted the logic, common in the bankruptcy context, that bankruptcy—and only bankruptcy—can fix these problems, so “get out of the way” and “let us do our job.”<sup>7</sup> *Bekins* further suggested that, because the State of California consented to the bankruptcy, the Tenth Amendment had been effectively waived, and there was no federalism issue.<sup>8</sup>

*Bekins*, however, focused on the wrong issue. Even prior to the decision in *Bekins*, the Contract Clause—the traditional impediment to state insolvency solutions—had been under fire to the point where a state remedy really was a possibility.<sup>9</sup> Today, however, the Contract Clause has been all but written out of the Constitution.<sup>10</sup> Accordingly, were municipal bankruptcy to go before the Supreme Court for the first time today, the Court would likely have to rest its decision on something other than the states’ inability to act otherwise. This is largely because the modern trend in Tenth Amendment jurisprudence is to focus on whether or not the federal government is coercing states to adopt a federal scheme. Plainly, by both the language of Chapter 9 and the presence of

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<sup>4</sup> See Oral Opinion on the Record, *In re City of Detroit*, No. 13–53846 (Bankr. E.D. Mich. Nov. 7, 2014), available at <http://www.mieb.uscourts.gov/news/oral-opinion-record-re-city-detroit-bankruptcy-judge-steven-rhodes-november-7-2014>.

<sup>5</sup> *In re City of Detroit*, 504 B.R. at 141–44.

<sup>6</sup> Compare *United States v. Bekins*, 304 U.S. 27 (1938) (finding the new municipal bankruptcy law, as enacted in 1937, constitutional), with *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513 (1936) (finding the old municipal bankruptcy law, as enacted in 1934, unconstitutional).

<sup>7</sup> *Bekins*, 304 U.S. at 54 (“We see no ground for the conclusion that the Federal Constitution, in the interest of state sovereignty, has reduced both sovereigns to helplessness in such a case.”); see also Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 660 (2008) (“We need to get bankruptcy work done somewhere, and the system we have—for all its conceptual anomalies—is as good as any.”).

<sup>8</sup> *Bekins*, 304 U.S. at 47–48; *contra Ashton*, 298 U.S. at 531 (“Neither consent nor submission by the states can enlarge the powers of Congress; none can exist except those which are granted.”).

<sup>9</sup> See *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398 (1934) [hereinafter *Blaisdell IV*].

<sup>10</sup> See *infra* Part III.

real alternatives for the states, that is not the case in the context of municipal bankruptcy.<sup>11</sup>

In Part II of this paper, I will attempt to set *Ashton* and *Bekins* in their historical context in order to explore how we got to the conclusion that state consent is sufficient to meet any Tenth Amendment challenges. In Part III, I will explore the purported necessity of a municipal bankruptcy statute by exploring the relationship between the Bankruptcy Clause and the Contracts Clause, and show that municipal bankruptcy was not a necessary remedy at the time either *Ashton* or *Bekins* were decided, and remains unneeded. In Part IV, I will address the Tenth Amendment concern that still exists in Chapter 9, notwithstanding the lack of necessity for such a law. Finally, in Part V, I will conclude.

## PART II. THE HISTORICAL CONTEXT OF *ASHTON* AND *BEKINS*

### A. *The First Municipal Bankruptcy Statute*

To truly consider the requirements and constitutionality of Chapter 9, we must go back to the last great economic downturn in American history, the Great Depression. Prior to 1934, there was no municipal bankruptcy statute,<sup>12</sup> leaving thousands of municipal units floundering during the height of financial catastrophe as the tax base crumbled beneath them.<sup>13</sup> Congress, under immense pressure to act,<sup>14</sup> passed the first municipal bankruptcy statute in 1934, which I shall call the 1934 Act.<sup>15</sup> In relevant part, it provided:

Nothing contained in this chapter shall 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,

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<sup>11</sup> Georgia, for example, specifically disallows municipal units from filing for bankruptcy. How, then, could Chapter 9 be coercive? See GA. CODE ANN. § 36-80-5 (2013).

<sup>12</sup> Michael W. McConnell & Randall C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 427 (1993).

<sup>13</sup> *Ashton*, 298 U.S. at 533–34 (Cardozo, J., dissenting) (noting that 2,019 municipalities, counties, and other governmental units, in 41 of the 48 states, were known to be in default).

<sup>14</sup> See S. REP. NO. 73-407, at 1–2 (1934) (recognizing that only Congress could act, as the Contracts Clause bars the states from impairing the obligation of contracts).

<sup>15</sup> Act of May 24, 1934, Pub. L. No. 73-251, 48 Stat. 798 (codified as 11 U.S.C. § 301–03) (1934) (amending the Bankruptcy Act of 1898 to include “Provisions for the Emergency Temporary Aid of Insolvent Public Debtors and to Preserve the Assets Thereof and for Other Related Purposes”).

including expenditures therefor, and *including the power to require the approval by any governmental agency of the State of the filing of any petition hereunder and of any plan of readjustment*, and whenever there shall exist or shall hereafter be created under the law of any State any agency of such State authorized to exercise supervision or control over the fiscal affairs of all or any political subdivisions thereof, and whenever such agency has assumed such supervision or control over any political subdivision, then no petition of such political subdivision may be received hereunder unless accompanied by the written approval of such agency, and no plan of readjustment shall be put into temporary effect or finally confirmed without the written approval of such agency of such plans.<sup>16</sup> (emphasis added)

In short, Congress, cognizant of the potential Tenth Amendment pitfalls of a municipal bankruptcy statute,<sup>17</sup> explicitly provided in the 1934 Act that the states retained the power to determine whether a municipality was eligible to file for bankruptcy.<sup>18</sup>

#### *B. Ashton v. Cameron County Water Improvement District No. 1*

The 1934 Act received its first test on July 17, 1934, when a water district in Cameron County, Texas, unable to meet its bond obligations, presented a petition to the United States District Court.<sup>19</sup> After the District Court dismissed for lack of jurisdiction and the Fifth Circuit reversed and remanded, the dissenting bondholders filed a petition for certiorari, which was subsequently granted.<sup>20</sup>

Before discussing exactly what the Supreme Court did, it is important to note the makeup of the Court in 1936. The Hughes Court of the 1930s and early 1940s was something of a watershed moment in the history of the Court, as slowly but surely President Roosevelt replaced the four conservatives on the Court—Justices Butler, McReynolds,

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<sup>16</sup> 11 U.S.C. § 301(k) (1934), *invalidated by Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513 (1936).

<sup>17</sup> S. REP. NO. 73-407, at 2.

<sup>18</sup> See Nicholas B. Malito, *Municipal Bankruptcy: An Overview of Chapter 9 and a Critique of the “Specifically Authorized” and “Insolvent” Eligibility Requirements of 11 U.S.C.A. § 109(c)*, 17 NORTON J. BANKR. L. & PRAC. 517, 520 (2008).

<sup>19</sup> *In re Cameron Cnty. Water Improvement Dist. No. 1*, 9 F. Supp. 103, 103 (S.D. Tex. 1934).

<sup>20</sup> *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 524 (1936).

Sutherland, and van Devanter (collectively known as the “Four Horsemen”)—with pro-New Deal Justices Black and Reed.<sup>21</sup> Bitterly opposed to almost all New Deal legislation, the Four Horsemen had fought tooth and nail to maintain a strict line between the powers of the states and the federal government and to limit the federal government’s power to regulate commerce.<sup>22</sup>

In a 5–4 decision written by Justice McReynolds and joined by Justices Butler, Sutherland, van Devanter, and Roberts, the majority cited three reasons for finding the municipal bankruptcy statute unconstitutional.<sup>23</sup> First, the Court held that because the water improvement district was a political subdivision of the state chartered for local benefit, its fiscal affairs were purely local and not subject to oversight by the federal government.<sup>24</sup> If the obligations of the states were so subject to federal intrusion, then state sovereignty would not really exist.<sup>25</sup> Secondly, the Court, invoking the Contract Clause,<sup>26</sup> found that a state entity invoking the bankruptcy clause was an impermissible means of sidestepping the constitutional prohibition of states impairing contracts.<sup>27</sup> Finally, the Court held that Congress did not possess the ability to increase its own power vis-à-vis the states, even with the states’ consent.<sup>28</sup> *Ashton* has been criticized as “[motivated more by] judicial ideology than sound legal reasoning”<sup>29</sup> and “unnecessary and misguided”<sup>30</sup> by modern scholars; however, as I will soon point out, *Bekins*, the case that overruled *Ashton*, fails to engage in any meaningful constitutional analysis at all.

### C. The Second Municipal Bankruptcy Statute

Undeterred by the Supreme Court’s ruling in *Ashton*, and still recognizing a dire need for municipal bankruptcy, and reiterating the argument that “relief must come from Congress, if at all,”<sup>31</sup> Congress

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<sup>21</sup> See WILLIAM E. LEUCHTENBURG, *THE SUPREME COURT REBORN: THE CONSTITUTIONAL REVOLUTION IN THE AGE OF ROOSEVELT* 213–36 (1995) (describing the “Constitutional Revolution of 1937”).

<sup>22</sup> See *id.* at 132–33.

<sup>23</sup> *Ashton*, 298 U.S. at 527–28, 531.

<sup>24</sup> *Id.* at 527–28.

<sup>25</sup> *Id.* at 531 (citing *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 430 (1819)).

<sup>26</sup> U.S. CONST. art. I, § 10, cl. 1 (“No State shall . . . pass any . . . Law impairing the Obligation of Contracts.”).

<sup>27</sup> See *Ashton*, 298 U.S. at 531.

<sup>28</sup> *Id.*

<sup>29</sup> Malito, *supra* note 18, at 521.

<sup>30</sup> McConnell & Picker, *supra* note 12, at 452.

<sup>31</sup> H.R. REP. NO. 75-517, at 3 (1937). The Senate adopted the House Report verbatim in voting for passage. S. REP. NO. 75-911, at 1 (1937).

went back to the drawing board and enacted the second municipal bankruptcy statute in 1937 (which I shall call the 1937 Act).<sup>32</sup> In relevant part, the 1937 Act provided:

**State powers unaffected.** Nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any municipality or any political subdivision of or in such State in the exercise of its political or governmental powers, including expenditures therefor.<sup>33</sup>

Despite considerably *less* sweeping language than the heretofore-invalidated 1934 Act (note that the 1937 Act has no requirement that the state consents to a municipality's petition), Congress strongly believed that the 1934 Act passed constitutional muster.<sup>34</sup> However, Congress changed very little structurally in amending the statute; their argument essentially was that the Court in *Ashton* was wrong, not that the amendments addressed the Court's concerns.<sup>35</sup>

#### D. *United States v. Bekins*

Unsurprisingly, given the ongoing solvency concerns in municipalities nationwide, the Supreme Court was soon given an opportunity to rule on the 1937 Act.<sup>36</sup> In the two years since *Ashton*, however, the Court's makeup had changed substantially. Justices Sutherland and van Devanter, two of the "Four Horsemen", retired.<sup>37</sup> President Roosevelt replaced them with Hugo Black and Stanley Reed, both of whom were supporters of the New Deal and much more flexible in their understanding of dual sovereignty.<sup>38</sup> Additionally, Justice Roberts, fresh off his "switch in time that saved nine" in *West Coast*

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<sup>32</sup> Act of August 16, 1937, Pub. L. No. 75-302, 50 Stat. 653 (subsequently codified at 11 U.S.C. §§ 401-04).

<sup>33</sup> 11 U.S.C. § 403(i) (Supp. 1939).

<sup>34</sup> H.R. REP. NO. 75-517, at 2 (1937) ("The bill here recommended for passage expressly avoids any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties. No interference with the fiscal or governmental affairs of a political subdivision is permitted. The taxing agency itself is the only instrumentality which can seek the benefits of the proposed legislation. No involuntary proceedings are allowable, and no control or jurisdiction over that property and those revenues of the petitioning agency necessary for essential governmental services is conferred by the bill.").

<sup>35</sup> *Id.* at 2-3.

<sup>36</sup> *See* *United States v. Bekins*, 304 U.S. 27 (1938).

<sup>37</sup> *See* LEUCHTENBURG, *supra* note 21, at 155-56, 220.

<sup>38</sup> *See id.* at 211-12, 226.

*Hotel Co. v. Parrish*,<sup>39</sup> seemed to have become more amendable to the New Deal. In a 6–2 opinion,<sup>40</sup> in another case involving an insolvent water district strangely enough, the Supreme Court upheld the 1937 Act.<sup>41</sup> However, in light of the holding in *Ashton*, the Court’s justification for changing its mind was startlingly weak, and it is just as likely that the Court’s change of heart was based on its composition than any legal argument.<sup>42</sup>

The Court justified its decision based on three distinctions between the 1937 Act and the 1934 Act.<sup>43</sup> First, the 1937 Act was limited to voluntary proceedings, as the 1937 Act makes it much more clear that only a taxing entity can be a petitioner.<sup>44</sup> Secondly, the 1937 Act was, according to the Court, drawn so as not to infringe upon state sovereignty.<sup>45</sup> Finally, the Court found no grounds for the conclusion that state sovereignty was so unshakeable that both the states and Congress would be reduced to helplessness in cases of municipal insolvency.<sup>46</sup>

The Court’s second justification, that because California consented to the bankruptcy the Tenth Amendment concerns were assuaged, lacks any constitutional analysis. The Court began with the shocking declaration that, “It is unnecessary to consider the question whether Chapter 10 would be valid as applied to the irrigation district in the absence of the consent of the State which created it, for the State has given its consent.”<sup>47</sup> This argument completely ignores the concern presented in *Ashton*, that “[n]either consent nor submission by the states

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<sup>39</sup> 300 U.S. 379 (1937).

<sup>40</sup> *Bekins*, 304 U.S. at 54 (Justice Cardozo, who authored the dissent in *Ashton*, strangely did not participate).

<sup>41</sup> *Id.* at 51.

<sup>42</sup> 6 COLLIER ON BANKRUPTCY ¶ 900.LH[3] (16th ed., 2013); *see also* David Fellman, *Ten Years of the Supreme Court: 1937–1947, I. Federalism*, 41 AM. POL. SCI. REV. 1142, 1148 n.28 (1947) (“Since the [1934 Act and the 1937 Act] were practically identical, a curious feature of the *Bekins* case was that instead of overruling the earlier decision, the Court made a feeble effort at distinguishing them.”).

<sup>43</sup> The bondholders also posited an argument that Chapter X, as it was then called, violated the Fifth Amendment. The Court dismissed this argument, citing *In re Reiman*, 20 F. Cas. 490 (S.D.N.Y. 1874) (finding composition in bankruptcy constitutional).

<sup>44</sup> *Bekins*, 304 U.S. at 47; *see also* 11 U.S.C. § 402 (Supp. 1939) (defining a petitioner as “any taxing agency or instrumentality referred to in section 401 of this chapter”), and § 403 (“Any *petitioner* may file a petition hereunder . . .”) (emphasis added). Nevertheless, even *Ashton* seemed to suggest that the 1934 Act only allowed for voluntary petitions. *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 530 (1936) (“If voluntary proceedings may be permitted, so may involuntary ones, subject, of course, to any inhibition of the Eleventh Amendment.”).

<sup>45</sup> *Bekins*, 304 U.S. at 51.

<sup>46</sup> *Id.* at 54.

<sup>47</sup> *Id.* at 47.

can enlarge the powers of Congress; none can exist except those which are granted.”<sup>48</sup> What makes this even more perplexing is that, unlike the unconstitutional 1934 Act, the 1937 Act does not explicitly require state authorization.<sup>49</sup> The Court “attach[ed] no importance to this omission,” without any meaningful explanation.<sup>50</sup> This is not to say that the Court in *Ashton* was correct, but neither the Court in *Bekins* nor any subsequent court has done the appropriate constitutional legwork to explain how consent satisfies the Tenth Amendment in the bankruptcy context.

Where the majority in *Bekins* really seems to ground its ruling, however, is in Congress’s assertion that a municipal bankruptcy statute was truly needed, and that absent congressional action, the states would be powerless to act.<sup>51</sup> Unfortunately, mere exigency is not—and arguably should not be—enough to overcome the constitutional framework.<sup>52</sup> Only a year prior to *Bekins*, Justice Sutherland, in arguing that the states did not have the authority to enact minimum wage laws, wrote, “If the Constitution, intelligently and reasonably construed in the light of these principles, stands in the way of desirable legislation, the blame must rest upon that instrument, and not upon the court for enforcing it according to its terms.”<sup>53</sup> Ultimately, whether or not the Constitution allows for exigencies such as this is a matter of ideology; however, even still, the *Bekins* majority failed to engage in the constitutional legwork. Instead, the Court was “of the opinion that the [House Committee on the Judiciary]’s points are well taken and that chapter 10 is a valid enactment.”<sup>54</sup> Rather than challenging or engaging with the Committee’s argument—which, as I already discussed, was fairly weak—the Court simply accepts that the 1937 Act fixes all of the problems of the 1934 Act.<sup>55</sup>

### PART III. THE NECESSITY OF A MUNICIPAL BANKRUPTCY STATUTE

As Congress noted in passing both the 1934 Act and the 1937 Act, the general understanding of the Contract Clause at the time was that states were held essentially powerless in adjusting municipal debt,

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<sup>48</sup> *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 531 (1936).

<sup>49</sup> Compare 11 U.S.C. § 303(k) (1934), with 11 U.S.C. § 403(i) (Supp. 1939).

<sup>50</sup> *Bekins*, 304 U.S. at 49.

<sup>51</sup> *Id.* at 51.

<sup>52</sup> Though, as I shall explain in Part III *infra* the Contract Clause had already been subject to the same result, thereby obviating the need for municipal bankruptcy at all.

<sup>53</sup> *W. Coast Hotel Co. v. Parrish*, 300 U.S. 379, 404 (1937) (Sutherland, J., dissenting).

<sup>54</sup> *Bekins*, 304 U.S. at 51.

<sup>55</sup> *Id.* at 51–53.

leaving only Congress able to act, pursuant to the Bankruptcy Clause.<sup>56</sup> Although that may have been true at the time—and it is not entirely clear that it was—it is almost certainly no longer true. Roughly three-quarters of a century of jurisprudence has largely eroded the original basis for passing municipal bankruptcy statutes and for deeming them constitutional by necessity. In short, Chapter 9 is constitutional today because the Court said so in *Bekins*. However, the reasoning behind it—that Congressional action was necessary because the Contract Clause precluded the states from acting—was untrue then and is certainly untrue now. Were a court to see municipal bankruptcy today, without precedent, it is unlikely that it would declare it as violating the Tenth Amendment, as Chapter 9 lacks any meaningfully coercive elements. Rather, the “necessity” argument would focus not on federalism concerns but whether the exigency is sufficient to avoid the Contract Clause altogether.

#### *A. Was Municipal Bankruptcy Necessary in 1934?*

The Contract Clause, on its face, would seem to preclude states from passing any legislation that would impair the obligations of contracts.<sup>57</sup> Although there was very little discussion of the Contract Clause during the Constitutional Convention, there is some evidence that the Framers intended a broad reading of the clause, applying it to both private and public contracts.<sup>58</sup> Prior to passing the 1934 Act, municipalities that were in danger of not being able to service their bond obligations could remain solvent essentially only by raising their taxes, a move that in the financial ruin of the 1930s would have been as politically unpopular as it would be ineffective.<sup>59</sup> Although there was likewise very little discussion of the Bankruptcy Clause during the drafting of the constitution,<sup>60</sup> the Framers

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<sup>56</sup> See S. REP. NO. 73-407, at 1–2 (1934); H.R. REP. NO. 75-517, at 3 (1937); see also U.S. CONST. art. I, § 8, cl. 4 (“The Congress shall have the Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . .”).

<sup>57</sup> See U.S. CONST. art. I, § 10, cl. 1 (“No State shall . . . pass any . . . Law impairing the Obligation of Contracts.”).

<sup>58</sup> JAMES W. ELY, *THE GUARDIAN OF EVERY OTHER RIGHT: A CONSTITUTIONAL HISTORY OF PROPERTY RIGHTS* 45–46 (2007).

<sup>59</sup> See Jeff B. Fordham, *Methods of Enforcing Satisfaction of Obligations of Public Corporations*, 33 COLUM. L. REV. 28, 44–53 (1933) (discussing the existence of and requirements for a writ of mandamus to compel taxation); *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 533–34 (1936) (Cardozo, J., dissenting) (“In such circumstances the only remedy was a mandamus whereby the debtor was commanded to tax and tax again. The command was mere futility when tax values were exhausted.”) (citations omitted).

<sup>60</sup> THE FEDERALIST NO. 42, at 267 (James Madison) (Clinton Rossiter ed., Signet Classic 2003) (providing the sole mention of bankruptcy in the Federalist Papers).

probably would have understood it broadly to encompass both private and public bankruptcies.<sup>61</sup> It was with that backdrop that Congress passed the 1934 Act.

However, it is not readily apparent that, even by the time of the passage of the 1934 Act, the states were powerless to act. About four months prior, the Supreme Court rendered its decision in *Home Building & Loan Ass'n v. Blaisdell*,<sup>62</sup> in which the Court held that “[t]he economic interests of the state may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts.”<sup>63</sup> At issue in *Blaisdell* was the wonderfully alliterative Minnesota Mortgage Moratorium Law, which provided that, during the housing emergency brought on by the Great Depression, foreclosures and execution sales could be postponed via judicial proceedings.<sup>64</sup> The economic situation in Minnesota was startlingly bleak, as farmers were forced to cope with the lowest agricultural prices in a generation.<sup>65</sup> Governor Floyd B. Olson, cognizant of other mortgage moratoria in the neighboring states of South Dakota, Wisconsin, and Nebraska, and under enormous public pressure, directed the state sheriffs to refrain from continuing any foreclosure action until further order, invoking the state’s traditional “police power” to protect the health, safety, and welfare of its citizens.<sup>66</sup> The order was so popular that the Minnesota legislature codified it less than a month later.<sup>67</sup>

The Home Building and Loan Association foreclosed on the Blaisdells’ home on May 2, 1932.<sup>68</sup> Under Minnesota law at the time, the couple had one year to redeem the property, at a cost of about \$3,700, exclusive of taxes and interest.<sup>69</sup> Unable to redeem the property in time,

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<sup>61</sup> See *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 370 (2006) (“The power granted to Congress by that Clause is a unitary concept rather than an amalgam of discrete segments.”).

<sup>62</sup> *Blaisdell IV*, 290 U.S. 398 (1934).

<sup>63</sup> *Id.* at 437.

<sup>64</sup> *Id.* at 416; see also MINN. STAT. §§ 9633-1 to -21 (1934 Supp.).

<sup>65</sup> JOHN A. FLITER & DEREK S. HOFF, *FIGHTING FORECLOSURE: THE BLAISDELL CASE, THE CONTRACT CLAUSE, AND THE GREAT DEPRESSION* 68 (2012).

<sup>66</sup> *Id.* at 70.

<sup>67</sup> *Id.* at 71.

<sup>68</sup> *Id.* at 89.

<sup>69</sup> *Blaisdell v. Home Bldg. & Loan Ass'n*, 249 N.W. 334, 334–35 (Minn. 1933) [hereinafter *Blaisdell II*]. As an aside, such redemption laws are ancient, dating back at least to biblical times. See *Leviticus* 25:29–30 (JPS Tanakh) (“And if a man sell a dwelling-house in a walled city, then he may redeem it within a whole year after it is sold; for a full year shall he have the right of redemption. And if it be not redeemed within the space of a full year, then the house that is in the walled city shall be made sure in perpetuity to him that bought it, throughout his generations; it shall not go out in the jubilee.”).

the Blaisdells found themselves extremely lucky when Governor Olson signed the Mortgage Moratorium Law mere weeks before the sale was to be finalized.<sup>70</sup> The Blaisdells filed suit under the Mortgage Moratorium Law seeking to extend their redemption period, but the trial judge immediately dismissed the case, reasoning that the law violated the Contract Clause and was an improper use of state police power because it served only private interests.<sup>71</sup>

On appeal, the Minnesota Supreme Court acknowledged that the law did indeed impair the obligation of contracts.<sup>72</sup> However, the majority disagreed with the trial judge, saying that, although normally it does not matter in whom the title to lands rest, the sheer number of families in danger of losing their homes was indeed a public concern, bringing it within the police power of the state to regulate.<sup>73</sup> Additionally, the majority noted the narrow breadth of the law, which limited foreclosure by advertisement not by action, limited the time, and required a hearing before the redemption period could be extended.<sup>74</sup> In other words, the Minnesota Supreme Court took a very narrow view of what it means to impair a contract and concluded that the moratorium did not meet that standard.<sup>75</sup> After the Blaisdells won in the state trial court on remand, the Association appealed again and lost in the Minnesota Supreme Court, for the reasons they stated in the first appeal.<sup>76</sup>

After having lost three times in the Minnesota courts, the Association appealed to the United States Supreme Court, which affirmed the Minnesota Supreme Court by a 5–4 vote.<sup>77</sup> In a bizarre twist, after warning that “[e]mergency does not create power,”<sup>78</sup> the Court sanctioned just the opposite and concluded that the Contract Clause was meant to “inspire a general prudence and industry,” not to prevent the

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<sup>70</sup> FLITER & HOFF, *supra* note 65, at 90.

<sup>71</sup> *Id.* at 91–92; *see also* *Blaisdell II*, 249 N.W. at 335.

<sup>72</sup> *Blaisdell II*, 249 N.W. at 335.

<sup>73</sup> *Id.* at 337; *cf.* *Wickard v. Filburn*, 317 U.S. 111, 128–29 (1942) (holding approximately a decade later that an aggregate effect on the price of wheat allowed Congress to regulate purely intrastate wheat growth under the Commerce Clause).

<sup>74</sup> *Blaisdell II*, 249 N.W. at 338.

<sup>75</sup> *Id.* at 336, 338 (concluding that where the impairment is only temporary and narrowly tailored, the states’ general police power trumps the Contract Clause.).

<sup>76</sup> *Blaisdell v. Home Bldg. & Loan Ass’n*, 249 N.W. 893, 894 (Minn. 1933) [hereinafter *Blaisdell III*] (per curiam).

<sup>77</sup> *Blaisdell IV*, 290 U.S. 398, 448 (1934).

<sup>78</sup> *Id.* at 425. This mirrors language from the Minnesota Supreme Court, which read, “Although emergency cannot become the source of power, and although the Constitution cannot be suspended in any complication of peace or war, an emergency may afford a reason for putting forth a latent governmental power already enjoyed but not previously exercised.” *Blaisdell II*, 249 N.W. at 336.

state legislature from acting in a declared emergency.<sup>79</sup> Although *Blaisdell* did not completely neuter the Contract Clause, it severely limited its force, as was demonstrated in subsequent cases.<sup>80</sup>

Interestingly, as a matter of vote counting, the majority in *Blaisdell* was comprised of Justices Hughes, Brandeis, Stone, Cardozo, and Roberts, with the Four Horsemen dissenting.<sup>81</sup> Justice Sutherland, in blistering dissent, reasoned that “[The Contract Clause] was framed and adopted with the specific and studied purpose of preventing legislation designed to relieve debtors *especially* in time of financial distress.”<sup>82</sup> Justice Roberts, the obvious swing vote in *Blaisdell*, then perplexingly joined the majority in *Ashton*, which posited that municipal bankruptcy was simply a way to skirt the Contract Clause, by delegating the power to Congress, and otherwise adhered to the philosophy that emergency can enlarge neither enumerated powers nor explicit prohibitions.<sup>83</sup> We may never know what caused this switch, as Roberts had his personal papers burned after his death.<sup>84</sup> It does, however, continue to affect the credibility of the Court with respect to all of these decisions.

What all of this serves to do is undermine the reasoning both of the dissent in *Ashton* and the majority in *Bekins*. The dissent in *Ashton* argued that, “[t]he Constitution prohibits the states from passing any law that will impair the obligation of existing contracts . . . . Relief must come from Congress if it is to come from any one.”<sup>85</sup> The majority in *Bekins* opined that “[t]here is no hope for relief through statutes enacted by the States, because the Constitution forbids the passing of State laws impairing the obligations of existing contracts. Therefore, relief must come from Congress, if at all.”<sup>86</sup> It is clear that neither of those statements were true. Like the Minnesota Mortgage Moratorium Law, the 1934 Act was time-limited.<sup>87</sup> Like the Minnesota law, the 1934 Act

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<sup>79</sup> *Blaisdell IV*, 290 U.S. at 427–28 (citing THE FEDERALIST NO. 44 (James Madison)).

<sup>80</sup> See FLITER & HOFF, *supra* note 65, at 157; see also *infra* Parts III.C–D.

<sup>81</sup> See *Blaisdell IV*, 290 U.S. at 398, 448.

<sup>82</sup> *Id.* at 453–54 (Sutherland, J., dissenting) (emphasis added); cf. *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 531 (1936) (“The Constitution was careful to provide that ‘no State shall pass any Law impairing the Obligation of Contracts.’ This she may not do under the form of a bankruptcy act or otherwise.”) (citations omitted).

<sup>83</sup> See *Ashton*, 298 U.S. at 530–31.

<sup>84</sup> FLITER & HOFF, *supra* note 65, at 165–66 (positing Roosevelt’s court packing plan, Roosevelt’s landslide reelection in 1936, as well as a simple legal technicality).

<sup>85</sup> *Ashton*, 298 U.S. at 534. (Cardozo, J., dissenting).

<sup>86</sup> *United States v. Bekins*, 304 U.S. 27, 51 (1938).

<sup>87</sup> See 11 U.S.C. § 302 (1934) (“Until the expiration of two years from May 24, 1934 . . . courts of bankruptcy shall exercise original jurisdiction in proceedings for the relief of debtors, as provided in this chapter of this title.”); see also MINN. STAT. § 9633-

was tailored for a very specific emergency in the depths of the Great Depression.<sup>88</sup> And yet *Blaisdell* was cited in neither *Ashton* nor *Bekins*, in neither majority nor dissent. In reality, there was at least some evidence that the states *could* act in a way that impaired contracts, as long as they did not impair them beyond what was necessary to counter the emergency.<sup>89</sup> Although the 1934 Act may still have violated the Tenth Amendment, the alarmism of Justice Cardozo and the majority in *Bekins* was wholly unfounded.

### *B. Had the Contract Clause Been Effectively Written Out of the Constitution by 1936?*

States have always been able to create their own bankruptcy statutes, with the caveat that such statutes can only govern contracts that do not yet exist and cannot be retroactively applied.<sup>90</sup> But for the Contract Clause, municipal bankruptcy would be largely unnecessary, as states would clearly be free to adjust their municipalities' debts on their own.<sup>91</sup> The Contract Clause took a big hit when the United States Supreme Court affirmed the ruling of the Minnesota Supreme Court in *Blaisdell IV*, a ruling that should have been a strong factor in deciding *Ashton* and *Bekins*. Although *Blaisdell* was not even mentioned in either *Ashton* or *Bekins*, it is still widely believed that the Contract Clause precludes states from enacting their own bankruptcy statutes.<sup>92</sup> In fact, the Contract Clause is all but dead, leaving modern legal justification for the necessity of municipal bankruptcy without a leg to stand on.<sup>93</sup>

In the cases immediately following *Blaisdell*, the Court seemed determined to limit its applicability. In fact, less than six months after deciding *Blaisdell*, the Court struck down an Arkansas statute that

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20 (1934 Supp.) ("This Act shall remain in effect only during the continuance of the emergency and in no event beyond May 1, 1935.").

<sup>88</sup> See 11 U.S.C. § 301 (1934) ("There is hereby found, determined, and declared to exist a national emergency caused by increasing financial difficulties of many local governmental unities, which renders imperative the further exercise of the bankruptcy powers of the Congress of the United States."); see also MINN. STAT. § 9633-2 (1934 Supp.) ("In view of the situation hereinbefore set forth, the Legislature of the State of Minnesota hereby declares that a public economic emergency does exist in the State of Minnesota.").

<sup>89</sup> See *Blaisdell IV*, 290 U.S. at 431 ("The obligations of a contract are impaired by a law which renders them invalid, or releases or extinguishes them.") (citations omitted).

<sup>90</sup> See *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 197-200 (1819).

<sup>91</sup> See *Bekins*, 304 U.S. at 51.

<sup>92</sup> See, e.g., *In re City of Detroit*, 504 B.R. 97, 143-44 (Bankr. E.D. Mich. 2013) (finding that, save one case ostensibly limited to its facts, courts have always found that the Contract Clause prohibits municipal bankruptcy legislation).

<sup>93</sup> See FLITER & HOFF, *supra* note 65, at 174.

exempted life insurance proceeds from creditors' garnishment.<sup>94</sup> Although the majority based its decision on the fact that, unlike *Blaisdell*, the Arkansas statute lacked the "temporary and conditional relief,"<sup>95</sup> the concurrence, written by Justice Sutherland and signed by the other three Horsemen, used *Thomas* as an opportunity to fight back against *Blaisdell*, claiming

[w]e are unable to agree with the view set forth in the opinion that the differences between the Arkansas statute and the Minnesota mortgage moratorium law . . . are substantial. . . . We were unable then, as we are now, to concur in the view that an emergency can ever justify . . . a nullification of the constitutional restriction upon state upon state power in respect of the impairment of contractual obligations.<sup>96</sup>

In 1935, about a year after *Thomas*, the Court was confronted with a series of statutes, also from Arkansas, that tremendously warped the repayment options for defaulting debtors.<sup>97</sup> Among other things, the laws increased the time for payment after notice of default from thirty days to ninety,<sup>98</sup> reduced the late penalty from twenty percent to three percent,<sup>99</sup> and increased the amount of time a delinquent mortgagor could remain on the property from a minimum of sixty-five days to a minimum of six and a half years.<sup>100</sup> Noting that none of the restrictions in the Minnesota law<sup>101</sup> were present in this case, Justice Cardozo concluded for a unanimous court that "[t]here has been not even an attempt to assimilate what was done by this decree to the discretionary action of a chancellor in subjecting an equitable remedy to an equitable condition. Not *Blaisdell's Case*, but [*Thomas's*], supplies the applicable rule."<sup>102</sup>

Finally, in *Treigle v. Acme Homestead Ass'n*,<sup>103</sup> just under four months before deciding *Ashton*, the Court unanimously invalidated a Louisiana law that removed a building association's obligation to

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<sup>94</sup> See *W.B. Worthen Co. v. Thomas*, 292 U.S. 426, 434 (1934) (unanimous).

<sup>95</sup> *Id.* at 433–34.

<sup>96</sup> *Id.* at 434–35 (Sutherland, J., concurring).

<sup>97</sup> See, e.g., *W.B. Worthen Co. ex rel. Bd. of Comm'rs of St. Improvement Dist. No. 513 v. Kavanaugh*, 295 U.S. 56 (1935) (unanimous).

<sup>98</sup> *Id.* at 58–59.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 61.

<sup>101</sup> The Minnesota statute was limited to two years, only during the scope of the declared emergency, and creditors were still given the opportunity to be heard by a judge. *Blaisdell IV*, 290 U.S. 398, 416–18 (1934).

<sup>102</sup> *Kavanaugh*, 295 U.S. at 63.

<sup>103</sup> 297 U.S. 189 (1936) (unanimous).

maintain a fund to pay shareholders. *Treigle* was not in the context of a moratorium; instead, the legislature simply revised the law governing building and loan associations and abrogated contracts between members and associations that were lawful at the time into which they were entered.<sup>104</sup> Justice Roberts, writing for the Court, reasoned,

[the statute] does not purport to deal with any existing emergency and the provisions respecting the rights of withdrawing members are neither temporary nor conditiona . . . .Such an interference with the right of contract cannot be justified by saying that in the public interest the operations of building associations may be controlled and regulated, or that in the same interest their charters may be amended.<sup>105</sup>

In light of these cases exploring the scope of *Blaisdell* prior to *Ashton*, a trend seems to have emerged. *Blaisdell* clearly did not initially signal “open season” on pre-existing contracts. Although the Court never spelled out a test for what crossed the line into unconstitutional impairment of contracts,<sup>106</sup> it is apparent that by the time *Ashton* was decided, a state needed to show both economic emergency and that there were substantial safeguards in place to protect creditors’ rights.<sup>107</sup> The argument, therefore, that states could not act themselves, was somewhat tenuous. In his dissent in *Ashton*, in which he argued that municipal bankruptcy was necessary because the states were forbidden from impairing contracts, Justice Cardozo completely ignored the Contract Clause jurisprudence of the previous three years.<sup>108</sup> There were no Contract Clause cases decided by the Supreme Court between *Ashton* and *Bekins*, and, in *Bekins*, the Court did not bother to offer a citation at all to support its contention that the states’ hands were tied.<sup>109</sup> Although there is certainly a difference between a moratorium and an actual discharge of debt, as long as a state had declared an emergency and provided creditors with an opportunity to be heard, there would seem to

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<sup>104</sup> See *id.* at 195.

<sup>105</sup> *Id.* at 195–96.

<sup>106</sup> The Court would not actually establish a test until 1977, which I shall address *infra*. See *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977).

<sup>107</sup> See generally Samuel R. Olken, CHARLES EVAN HUGHES AND THE BLAISDELL DECISION: A HISTORICAL STUDY OF CONTRACT CLAUSE JURISPRUDENCE, 72 OR. L. REV. 513 (1993).

<sup>108</sup> See *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 534 (1936) (Cardozo, J., dissenting) (citing instead to *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819) for the proposition that states cannot impair preexisting contracts).

<sup>109</sup> See *United States v. Bekins*, 304 U.S. 27, 51 (1938).

be no reason why, under contemporary Contract Clause jurisprudence, the states would not be able to handle municipal debts sans federal involvement.

### *C. State Composition Plans for Municipalities Post-Bekins*

In fact, states could—and did—implement their own municipal composition plans outside the federal bankruptcy scheme. In 1931, New Jersey adopted the Municipal Finance Act that authorized state control over insolvent municipalities.<sup>110</sup> Like other such acts in the 1930s, New Jersey passed the statute “to meet the public emergency arising from a default in the payment of municipal obligations and the resulting impairment of public credit . . . in such a way as to cause the least embarrassment to property owners as taxpayers.”<sup>111</sup> This adjustment of debt could be made binding on all creditors, whether or not they consented,<sup>112</sup> though the law did nominally provide for the protection against the impairment of contracts.<sup>113</sup> In the meantime, the erosion of the Contract Clause had continued after the Constitutional Revolution of 1937, to the point where it was not clear it would still be enforced at all.<sup>114</sup>

During the height of the Great Depression, years of “optimistic and extravagant” municipal expansion had brought the seashore resort town of Asbury Park, New Jersey to its knees.<sup>115</sup> In short, the city had expanded and when the tax base crumbled and property values plummeted, the city was left holding municipal bonds it could no longer afford to service.<sup>116</sup> Eventually, the creditors applied to the Supreme Court of New Jersey to have the Municipal Finance Commission put in charge of the city’s finances.<sup>117</sup> Citing *Bekins*’ assurances that the federal

<sup>110</sup> See Act of Apr. 28, 1931, ch. 340, 1931 N.J. Laws 830 (supplemented by Act of June 27, 1933, ch. 331, 1933 N.J. Laws 866).

<sup>111</sup> § 405, 1931 N.J. Laws at 835.

<sup>112</sup> See Act of June 27, 1933, ch. 331, 1933 N.J. Laws 866, ¶ 3.

<sup>113</sup> § 406, 1931 N.J. Laws at 835 (“[N]othing contained in this act shall be construed to impair in any way the obligations of any contract, or the existing remedies of any creditor of any municipality.”).

<sup>114</sup> See *Veix v. Sixth Ward Bldg. & Loan Ass’n*, 310 U.S. 32, 39 (1940) (“We are here considering a permanent piece of legislation. So far as the contract clause is concerned, is this significant? We think not . . . . If the legislature could enact the legislation as to withdrawals to protect the associations in that emergency, we see no reason why the new status should not continue.”); see also *Gelfert v. Nat’l City Bank*, 313 U.S. 221, 235 (1941) (“The fact that an emergency was not declared to exist when this statute was passed does not bring within the protective scope of the contract clause rights which were denied such protection in *Honeyman v. Jacobs*.”) (citation omitted).

<sup>115</sup> *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 503 (1942).

<sup>116</sup> *Id.* at 503–07.

<sup>117</sup> *Id.* at 503.

municipal bankruptcy statute was narrowly and painstakingly tailored so as not to impinge on the sovereignty of the states, the Court concluded that it was impossible that the power to enact a federal municipal bankruptcy statute, which specifically reserved state sovereignty, and which had not been recognized until 1938, had preempted the states' rights to manage their finances outside of bankruptcy.<sup>118</sup> The Court thereby rejected a sort of "dormant bankruptcy clause," where only federal debt relief schemes would be permitted.<sup>119</sup> Rather, the Court found that, "[t]he intervention of the state in the fiscal affairs of its cities is plainly an exercise of its essential reserve power to protect the vital interests of its people by sustaining the public credit and maintaining local government."<sup>120</sup>

As for the Contract Clause, the Court continued digging its grave. First, the Court seemed to suggest that, because the municipal bonds in question were practically worthless anyway, New Jersey was not actually impairing anything.<sup>121</sup> In upholding the New Jersey statutes, Justice Frankfurter continued:

From time to time, ever since *Sturges v. Crowninshield*, it has been stated that a state insolvency act is limited by the Contract Clause of the Constitution in authorizing composition of preexisting debts. So it is, but it all depends on what is affected by such a composition and what state power it brings into play. The dictum from *Sturges v. Crowninshield* is one of those inaccurate generalizations that has gained momentum from uncritical repetition.<sup>122</sup>

Thus, because the bonds were practically worthless, and because mandamus was simply an "empty right to litigate,"<sup>123</sup> the Court determined that, far from impairing the obligations of contracts, the Municipal Finance Act was actually beneficial to creditors, and that the

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<sup>118</sup> See *id.* at 508–09.

<sup>119</sup> See Lipson, *supra* note 7, at 631 (arguing that the Bankruptcy Clause may have been meant more to deter a race to the bottom between states, and that the Framers may have actually intended state law bankruptcies to be the norm, judgments under which would be protected by the Full Faith and Credit Clause).

<sup>120</sup> *Faitoute*, 316 U.S. at 512.

<sup>121</sup> See *id.* at 513 ("[I]n view of the slump of the credit of the City of Asbury Park before the adoption of the plan now assailed, appellants' bonds had little value; the new bonds issued under the plan, however, are not in default and there is a very substantial market for them.").

<sup>122</sup> *Id.* (citations omitted).

<sup>123</sup> *Id.* at 510.

bondholders were foolish to insist upon standing on mere “paper rights.”<sup>124</sup> In short, the Municipal Finance Act accomplished one of the primary goals of bankruptcy—protecting the rights of both the debtor and the creditors.<sup>125</sup>

*Faitoute* was ostensibly limited to its facts.<sup>126</sup> However, from a constitutional standpoint, it appears to still be good law.<sup>127</sup> From a statutory standpoint, in 1946, Congress stepped in to limit *Faitoute*’s applicability when it amended section 403(i) of the Bankruptcy Act to provide that no state law composition mechanism could be binding on any creditor who did not consent.<sup>128</sup> This remains, in slightly different language, the law today.<sup>129</sup> In any case, it was suggested not long after *Faitoute* that the Contract Clause no longer served a purpose, as the analysis of whether or not the deprivation of a property right is “reasonable” essentially mirrors the analysis for any other property right under the Fifth or Fourteenth Amendments, and would likely turn out the same way under a Due Process challenge.<sup>130</sup>

#### D. “Necessity” and the Contract Clause Today

After *Faitoute*, Contract Clause jurisprudence remained virtually dormant for over twenty years.<sup>131</sup> In 1965, the Supreme Court in *City of El Paso v. Simmons* reaffirmed the malleability of the Contract Clause with a Texas law regarding the sale of public lands.<sup>132</sup> The modern approach for Contract Clause interpretation, however, was laid out in 1977 in *United States Trust Co. v. New Jersey*.<sup>133</sup> In *United States Trust*, New York and New Jersey financed improvements to the Port Authority with public bonds on the condition that they not use the money to subsidize rail transit.<sup>134</sup> New York and New Jersey, crunched by the

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<sup>124</sup> *Id.* at 516.

<sup>125</sup> See Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 785–789 (1987).

<sup>126</sup> See *Faitoute*, 316 U.S. at 516.

<sup>127</sup> See McConnell & Picker, *supra* note 12, at 479–80.

<sup>128</sup> Act of July 1, 1946, Pub. L. No. 79-481, 60 Stat. 409.

<sup>129</sup> See 11 U.S.C. § 903 (2012) (“[A] state law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition . . .”).

<sup>130</sup> See Robert L. Hale, *The Supreme Court and the Contract Clause: III*, 57 HARV. L. REV. 852, 890–91 (1944).

<sup>131</sup> See FLITER & HOFF, *supra* note 65, at 169–70.

<sup>132</sup> 379 U.S. 497, 508 (1965) (“The decisions put it beyond question that the prohibition [against the impairment of contracts] is not an absolute one and is not to be read with literal exactness like a mathematical formula.”) (quotations omitted).

<sup>133</sup> 431 U.S. 1 (1977).

<sup>134</sup> *Id.* at 10–11.

energy crisis of the 1970s, then repealed the promise in their respective legislatures and subsidized rail transit anyway.<sup>135</sup>

The Court, for the first time, applied an actual test to determine whether a Contract Clause violation had occurred.<sup>136</sup> The test has four parts: 1) whether a contract with the state exists;<sup>137</sup> 2) whether that contract is substantially impaired;<sup>138</sup> 3) whether that impairment serves a significant and legitimate public purpose;<sup>139</sup> and 4) whether that impairment was reasonable and necessary to satisfy that public purpose.<sup>140</sup> The conservative Court of the 1970s<sup>141</sup> actually struck down the legislation in question, on the grounds that concerns of environmental protection and energy conservation were known at the time the bonds were issued, and so the repeal failed under the fourth prong.<sup>142</sup> The next year, a divided Court “dust[ed] off the Contract Clause”<sup>143</sup> again in *Allied Structural Steel Co. v. Spannaus*, where the Court once again struck down a state law under the Contract Clause, in which a Minnesota company that closed within the state would be fined to the extent that workers who had been employed for at least ten years did not receive a full pension.<sup>144</sup> Justice Potter Stewart, writing for the majority, reminded the world that “[t]he Contract Clause remains part of the Constitution. It is not a dead letter.”<sup>145</sup> In a scathing dissent, Justice Brennan once again argued that the majority was rewriting a half-century worth of Contract Clause jurisprudence.<sup>146</sup> He argued that imposing additional obligations on parties—as the Minnesota statute did—was not the same thing as

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<sup>135</sup> *Id.* at 13–14.

<sup>136</sup> See generally Debra Brubaker Burns, Note, *Too Big to Fail and Too Big to Pay: States, Their Public-Pension Bills, and the Constitution*, 39 HASTINGS CONST. L.Q. 253, 261–69 (2011) (discussing in more depth the ins and outs of *United States Trust* and the test applied therein).

<sup>137</sup> *U.S. Trust Co.*, 431 U.S. at 17–18 (“The trial court found, and appellees do not deny, that the 1962 covenant constituted a contract between the two States and the holders of the Consolidated Bonds issued between 1962 and the 1972 prospective repeal.”).

<sup>138</sup> *Id.* at 21 (“[A] finding that there has been a technical impairment is merely a preliminary step in resolving the more difficult question whether that impairment is permitted under the Constitution.”).

<sup>139</sup> *Id.* at 22 (“[L]aws intended to regulate existing relationships must serve a legitimate public purpose.”).

<sup>140</sup> *Id.* at 25 (“[A]n impairment may be constitutional if it is reasonable and necessary to serve an important public purpose.”).

<sup>141</sup> See FLITER & HOFF, *supra* note 65, at 170–71.

<sup>142</sup> See *U.S. Trust Co.*, 431 U.S. at 32.

<sup>143</sup> *Id.* at 44 (Brennan, J., dissenting).

<sup>144</sup> 438 U.S. 234, 238, 251 (1978) (5–3 decision).

<sup>145</sup> *Id.* at 241.

<sup>146</sup> See *id.* at 251 (Brennan, J., dissenting).

diminishing or nullifying obligations, and that such an imposition could only be challenged as a taking under the Due Process clause.<sup>147</sup>

Despite the momentary blip in the 1970s, however, the Court has since consistently upheld legislation against Contract Clause challenges, exhibiting a high level of deference to the legislature's reasonableness determination.<sup>148</sup> The Supreme Court has not taken a Contract Clause case since 1987.<sup>149</sup> As far as anyone can tell, then, *Blaisdell* is still good law, and the Contract Clause is, even today, virtually read out of the Constitution.<sup>150</sup> Accordingly, were the first federal municipal bankruptcy statute to be enacted today, neither Congress nor the Court could credibly argue that municipal bankruptcy was in any way necessary due to the strictures of the Contract Clause. Useful, perhaps, due to the expertise of the bankruptcy courts in handling complex restructuring matters, but not "necessary." This is especially true as the United States continues to recover from an economic downturn that has been consistently compared to the Great Depression.<sup>151</sup> For more than eighty years, even a narrow reading of the case law permits states to impair contracts in an emergency, so long as they take mitigating steps to protect the rights of the creditors whose contracts are being impaired. A broader rule, as in the more recent cases, gives the states even more power.

#### PART IV. THE TENTH AMENDMENT

In *Bekins*, the Court devoted very little time to the actual Tenth Amendment concerns, preferring to focus on the policy reasons for needing a federal municipal bankruptcy law.<sup>152</sup> Those policy reasons, as I have just addressed, were largely unfounded.<sup>153</sup> However, even though the policy reasons were unfounded, it does not change the fact there is still a municipal bankruptcy statute in effect today, and the statute is still

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<sup>147</sup> See *id.*; cf. Hale, *supra* note 130, at 890–91.

<sup>148</sup> See *Energy Reserves Grp., Inc. v. Kansas Power & Light Co.*, 459 U.S. 400 (1983) (unanimous) (holding that an energy pricing scheme that conflicted with existing contracts did not substantially impair the arrangement); see also *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987) (upholding a law pursuant to state police power that required mining companies to leave a certain amount of coal in the ground for structural support that was more than the amount the companies had contracted for with the landowners).

<sup>149</sup> See FLITER & HOFF, *supra* note 65, at 174.

<sup>150</sup> See *id.*

<sup>151</sup> See, e.g., Paul Krugman, *The Great Recession Versus the Great Depression*, N.Y. TIMES (Mar. 20, 2009, 4:35 PM), <http://krugman.blogs.nytimes.com/2009/03/20/the-great-recession-versus-the-great-depression/>.

<sup>152</sup> See *United States v. Bekins*, 304 U.S. 27, 47–54 (1938).

<sup>153</sup> See *supra* Part III.

subject to Tenth Amendment challenges.<sup>154</sup> In this section, I will dismiss the notion that Chapter 9 is unconstitutional, as least as of today.<sup>155</sup>

The modern scope of the Tenth Amendment has been largely set forth<sup>156</sup> in two Supreme Court cases, *New York v. United States*<sup>157</sup> and *Printz v. United States*.<sup>158</sup> Both of them suggest a definition of coercion that is fundamentally incompatible with the nature of a voluntary Chapter 9 filing.<sup>159</sup> In short, Congress may not “commandeer the legislative processes of the states” to force them to enact a federal program,<sup>160</sup> but as I shall discuss, Chapter 9 falls outside of that coercive framework.

The key provision in question in *New York* was the “Take Title” provision of the Low-Level Radioactive Waste Policy Amendments Act of 1985.<sup>161</sup> States that were unable to properly dispose of their low-level nuclear waste under the federal regulatory scheme would be required to take title to the waste and incur liability for any damages that occurred as a result.<sup>162</sup> Finding that the Take Title provision did not involve Congress threatening its use or disuse of its enumerated spending or commerce powers, but rather submitted the states to another federal instruction if the states did not comply, the Court struck down that provision of the Act.<sup>163</sup> Honing in on the coercive nature of the provision, Justice O’Connor wrote, “A choice between two unconstitutionally coercive regulatory techniques is no choice at all.”<sup>164</sup>

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<sup>154</sup> See, e.g., *In re City of Detroit*, 504 B.R. 97, 141–49 (Bankr. E.D. Mich. 2013).

<sup>155</sup> The Tenth Amendment was extremely underdeveloped in the case law at the time *Bekins* was decided. Indeed, *Ashton* largely rested on its violation. See *United States v. Darby Lumber Co.*, 312 U.S. 100, 124 (1941) (“The amendment states but a truism that all is retained which has not been surrendered.”); see also *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 530–32 (1936) (finding that the 1934 Act violated the Tenth Amendment).

<sup>156</sup> See Burns, *supra* note 136, at 281.

<sup>157</sup> 505 U.S. 144 (1992).

<sup>158</sup> 521 U.S. 898 (1997).

<sup>159</sup> This paper only deals with voluntary petitions, for two reasons. First, under the Bankruptcy Code, involuntary petitions against state entities are not permitted. Second, even if they were, such a filing would unquestionably violate the Eleventh Amendment, and very likely the Tenth as well.

<sup>160</sup> *New York*, 505 U.S. at 161 (quoting *Hodel v. Va. Surface Mining & Reclamation Ass’n, Inc.*, 452 U.S. 264, 288); see also *In re City of Detroit*, 504 B.R. 97, 149 (Bankr. E.D. Mich. 2013) (describing the holding of *New York* succinctly as, “[A] state cannot consent to be compelled.”).

<sup>161</sup> See *New York*, 505 U.S. at 151–53.

<sup>162</sup> See *id.* at 153–54.

<sup>163</sup> See *id.* at 176.

<sup>164</sup> *Id.*; see also *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2607 (2012) (holding that Congress could not penalize states that chose not to comply with new Medicaid requirements under the Affordable Care Act by taking away their existing Medicaid funding).

Several years later, as a result of Congress passing the Brady Handgun Violence Prevention Act, state chief law enforcement officers (CLEOs) were required to enforce certain background check provisions of the federal regulatory scheme.<sup>165</sup> Even though the enforcement provisions were only temporary, private firearms dealers were still required to forward background check forms to the CLEOs, who then needed to process them.<sup>166</sup> Once again, the Court struck down the Act as being coercive: “The Federal Government may neither issue directives requiring the States to address particular problems, nor command the States’ officers, or those of their political subdivisions, to administer or enforce a federal regulatory program.”<sup>167</sup> In concurrence, Justice O’Connor, the author of *New York*, noted that Congress was free to amend the statute such that the states contracted with the federal government to enforce the regulation, *à la* federal highway funds in return for a drinking age of twenty-one.<sup>168</sup>

The most recent case in which a federal law was struck down for being coercive was the first “Obamacare” decision.<sup>169</sup> In *Sebelius*, the Court held that Congress was not permitted to withhold *all* Medicaid funding to a state that refused to participate in the new Medicaid scheme under the Patient Protection and Affordable Care Act (“ACA”), noting that “Congress may not simply conscript states agencies into the national bureaucratic army.”<sup>170</sup> Once again, however, the Court explicitly refused to “fix the outermost line” between congressional persuasion and coercion.<sup>171</sup>

During oral argument of another case involving the ACA, *King v. Burwell*, the Court suggested that it might be revisiting the issue of coercion again.<sup>172</sup> Specifically, the question was whether the way the petitioners were interpreting the ACA—that only healthcare exchanges established by states, as opposed to those established by the federal government, entitled their users to tax subsidies—demonstrated an

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<sup>165</sup> *Printz v. United States*, 521 U.S. 898, 903–04 (1997).

<sup>166</sup> *See id.* at 904–05.

<sup>167</sup> *Id.* at 935.

<sup>168</sup> *See id.* at 936 (O’Connor, J., concurring).

<sup>169</sup> *Sebelius*, 132 S. Ct. at 2607. For a brief discussion of the term “Obamacare,” see Charlton C. Copeland, *Beyond Separation in Federalism Enforcement: Medicaid Expansion, Coercion, and the Norm of Engagement*, 15 U. PA. J. CONST. L. 91, 94 n.3 (2012).

<sup>170</sup> *Sebelius*, 132 S. Ct. at 2606–07 (internal quotations omitted).

<sup>171</sup> *Id.* at 2606 (“It is enough for today that wherever that line may be, this statute is surely beyond it.”).

<sup>172</sup> *See* Tom Miller, *Unfair Coercion, or Greater Deference? Two New Sides of King v. Burwell*, 23 U. MIAMI BUS. L. REV. 297, 299 (2015).

unconstitutional invasion of state sovereignty by Congress.<sup>173</sup> In short, threatening the states with the options of setting up their own healthcare exchanges or suffering insurance “death spirals” may have been an unconstitutionally coercive choice. However, the issue of coercion went unmentioned in both the majority and minority opinions.<sup>174</sup> The Court likewise denied an opportunity to review a decision out of the Third Circuit that held that the Professional and Amateur Sports Protection Act of 1992 (“PASPA”) did not violate the anti-commandeering principal underlying the Tenth Amendment.<sup>175</sup> Thus, it seems that, for the time being, our understanding of coercion is still constrained by *New York, Printz*, and *Sebelius*.

Irrespective of where the Supreme Court winds up on the issue of coercion, what should be immediately apparent between the provisions in *New York, Printz, Sebelius*, and Chapter 9 is that Chapter 9 is both implicitly and explicitly *non-coercive*. To begin with, only voluntary petitions are permitted, and no creditor or group of creditors can submit a state or its subdivisions to the power of a federal court.<sup>176</sup> Filing a voluntary petition is by definition a voluntary act. This is even more so the case where states have options outside the bankruptcy context, due to the frailty of the Contract Clause.<sup>177</sup> Rather than a regulatory scheme that the state is forced into,<sup>178</sup> Chapter 9 is simply another avenue for state subdivisions to adjust their debts. Furthermore, as an additional protection against federal intrusion into state financial affairs, the Bankruptcy Code explicitly provides that “[t]his 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, including expenditures for

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<sup>173</sup> See Transcript of Oral Argument at 15:18–19, *King v. Burwell*, No. 14–114 (U.S. Mar. 4, 2015) (Sotomayor, J.) (“Tell me how that is not coercive in an unconstitutional way?”). The issue in *King* was the statutory interpretation of the phrase “established by the state,” with respect to the healthcare exchanges set up under the ACA, and whether tax subsidies thereunder are available to individuals who obtained healthcare from the federal exchange. See Lyle Denniston, *Argument Preview: Now, the Third Leg of the Health-Care Stool*, SCOTUSBLOG (Mar. 1, 2015, 12:04 AM), <http://www.scotusblog.com/2015/03/argument-preview-now-the-third-leg-of-the-health-care-stool/>.

<sup>174</sup> See generally *King v. Burwell*, 135 S. Ct. 2480 (2015).

<sup>175</sup> See *NCAA v. Governor of New Jersey*, 730 F.3d 208 (3d Cir. 2013), *cert. denied*, 134 S. Ct. 2866 (2014).

<sup>176</sup> See 11 U.S.C. § 901(a) (2012), which does not incorporate section 303, the provision governing involuntary bankruptcies.

<sup>177</sup> See *supra* Part III.

<sup>178</sup> Indeed, Georgia has opted out of Chapter 9 entirely, and there has been no suggestion that this is somehow inappropriate. See GA. CODE ANN. § 36-80-5 (2013).

such exercise,”<sup>179</sup> and that unless the debtor consents, the court may not interfere with political powers of the debtor, property or revenues of the debtor, or the debtor’s use of any income-producing property.<sup>180</sup> And although there may be some concern about the sovereignty of a municipality post-petition and post-waiver, that is beyond the scope of this paper. On its face, Chapter 9 complies with the Tenth Amendment.

Congress, having been granted the power to write a uniform law on the subject of bankruptcies, is clearly within its right to enact a municipal bankruptcy statute, as long as it does so within the confines of its otherwise enumerated powers.<sup>181</sup> The strictures of Chapter 9 plainly contemplate a Tenth Amendment challenge and are sufficient to rebut the same. Note that, under this understanding, it would not appear to make a difference constitutionally whether Congress required general authorization or specific authorization from the state under section 109 in order to file.<sup>182</sup> As long as the state consents in some way to the filing—that is, it is not coerced by an *ultra vires* act of Congress—a Tenth Amendment challenge will fall flat. The ultimate conclusion in *Bekins* was therefore correct;<sup>183</sup> the Court simply needlessly focused on the supposed necessity of a municipal bankruptcy act and failed to pay adequate attention to the “real” issue of state sovereignty.

#### PART V. CONCLUSION

Although Chapter 9 had a rocky beginning in the Courts, there remains a relative dearth of case law, owing to the few number of cases filed and even fewer of number of actual cities filing.<sup>184</sup> The unfortunate result of this, at least for the time being, is that in large Chapter 9 cases in which billions of dollars are at stake, such as Detroit, the constitutionality of Chapter 9 will continue to be litigated. The irony is that, if states acted on their own, pursuant to contracted Contract Clause, the state would probably still have to litigate. Thus, in some ways, it does

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<sup>179</sup> 11 U.S.C. § 903 (2012).

<sup>180</sup> 11 U.S.C. § 904 (2012).

<sup>181</sup> See U.S. CONST. art. I, § 8, cl. 4.

<sup>182</sup> See generally Daniel J. Freyberg, Comment, *Municipal Bankruptcy and Express State Authorization to Be a Chapter 9 Debtor: Current State Approaches to Municipal Insolvency and What Will States Do Now?*, 23 OHIO N.U. L. REV. 1001 (1997) (describing the history and implications of the change from general to specific authorization under section 109(c)(2)).

<sup>183</sup> Focusing on the idea and ignoring the slight changes in the language and requirements Chapter 9 between 1937 and today.

<sup>184</sup> See David D. Bird, *Chapter 9 and 11 Case Processing: Same, Similar or Different?*, AM. BANKR. INST. J., Mar. 2014, at 50, 50 (noting that only 215 Chapter 9 cases have been filed since 1990, compared to over 28 million filings overall.).

not matter under which method a state proceeds—if the money is big enough, there are going to be objections from creditors. It is my hope, therefore, that this paper has adequately addressed both of these issues, making their resolution easier when they inevitably arise.

States have wide discretion to “impair” contracts, as long as they provide safeguards for the creditors who are taking a haircut. *Bekins*, still controlling law in the municipal bankruptcy context, was therefore correctly decided, but for the wrong reason. Likewise, the protections built into Chapter 9 allow Chapter 9 to survive any Tenth Amendment challenges. The modern Tenth Amendment is concerned with coercion, and, with the state either consenting or remaining in complete control every step of the way, it is difficult to compare Chapter 9 to either provision struck down in *New York* or *Printz*, or the withdrawal of Medicaid funding in *Sebelius*. Chapter 9 is here, and it’s here to stay.