

# CALIFORNIA LAW REVISION COMMISSION

## TENTATIVE RECOMMENDATION

### Municipal Bankruptcy

September 2001

This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be a part of the public record and will be considered at a public meeting when the Commission determines the provisions it will include in legislation the Commission plans to recommend to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made in the tentative recommendation.

**COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN November 1, 2001.**

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

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## SUMMARY OF TENTATIVE RECOMMENDATION

The Law Revision Commission recommends a number of revisions to update California statutes authorizing bankruptcy filings by local public entities under Chapter 9 of the federal Bankruptcy Code. Consistent with the approach historically taken in California, the general statute would authorize municipal bankruptcy filings to the full extent permissible under federal law, subject to any special statutory rules applicable to particular entities.

The Commission studied broader substantive reforms, including proposals to require pre-filing approval by the Governor or a governmental committee, and to provide for post-filing review by appropriate state authorities. However, there does not appear to be any general agreement on the best approach to reform, or even as to the need for additional protections or controls. Accordingly, the Commission is not recommending any broader substantive reforms at this time.

This recommendation was prepared pursuant to Resolution Chapter 78 of the Statutes of 2001.

## MUNICIPAL BANKRUPTCY

### BACKGROUND

1 Municipal bankruptcy law is covered by Chapter 9 of the federal Bankruptcy  
2 Code and related provisions.<sup>1</sup> The fundamental purpose is to give municipal  
3 debtors a breathing spell through the automatic stay of creditors' collection efforts  
4 and to restructure municipal debt through formulation of a repayment plan.  
5 Forcing a repayment plan on nonconsenting creditors requires resort to the federal  
6 power to impair contractual obligations under the Contract Clause.<sup>2</sup> Unlike private  
7 bankruptcy law, however, municipal bankruptcy law must respect the sovereign  
8 power of the states over their subdivisions pursuant to the Tenth Amendment.  
9 Consequently, states have the power to control municipal access to bankruptcy and  
10 the bankruptcy courts have little power to intervene or direct the affairs of a  
11 municipal debtor that has filed for bankruptcy.<sup>3</sup>

#### 12 California Law

13 The federal municipal bankruptcy procedure dates from May 1934.<sup>4</sup> The Cali-  
14 fornia Legislature responded quickly by enacting an uncodified statute authorizing  
15 taxing districts, as defined in federal law, to file for bankruptcy protection, which  
16 became operative on September 20, 1934.<sup>5</sup> This act also purported to validate any

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1. See 11 U.S.C. § 101 *et seq.*, commonly referred to as the Bankruptcy Code. Chapter 9 (11 U.S.C. §§ 901-946) is entitled "Adjustment of Debts of a Municipality" and comprises the bulk of municipal bankruptcy statutes, but other definitions and provisions in the Bankruptcy Code are also relevant. See, e.g., 11 U.S.C. § 901 (applicability of other sections of title).

Much of the discussion in this recommendation is drawn from a background study prepared by the Commission's consultant, Professor Frederick Tung, University of San Francisco School of Law. See Tung, *California Municipal Bankruptcy Legislation* (March 2000) (attached to Commission Staff Memorandum 2000-38 (April 29, 2000)). The background study is available at the Commission's website at the following URL: <<http://clrc.ca.gov/pub/Printed-Reports/BKST-811-TungMuniBk.pdf>>.

2. U.S. Const. art. I, § 10. See Tung, *supra* note 1, at 4.

3. See Tung, *supra* note 1, at 4-5. The full extent of judicial authority in these cases, and the appropriate policies, are matters of debate, but are beyond the scope of the Commission's study, since they largely involve federal constitutional issues and the intricacies of the Bankruptcy Code. See, e.g., McConnell & Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. Chi. L. Rev. 425 (1993); Kordana, *Tax Increases in Municipal Bankruptcies*, 83 Va. L. Rev. 1035 (1997).

4. Municipal bankruptcy law grew out of the financial crises of the 1930s. The original Chapter IX was created by an Act of May 24, 1934. After being held unconstitutional, Chapter IX was revised in 1938 and passed constitutional challenge. It was made a permanent part of the Bankruptcy Act in 1946. The revised law was little used until the mid-70s. In 1976, further revisions were made in response to New York City's fiscal difficulties. Substantive revisions concerning state authorization of municipal bankruptcies were made in 1994.

5. See 1934 Cal. Stat. ch 4 (1st Ex. Sess.). At least one municipal bankruptcy authorization for refunding bonded indebtedness was enacted *before* Chapter IX was added to the federal Bankruptcy Act of 1898 in 1934. See 1933 Cal. Stat. ch. 596, § 2 (authorization to "file a petition under any bankruptcy law of the United States now or hereafter enacted"). This provision is the antecedent of Government Code Section 43739, which is proposed to be repealed. See proposed repeal of Gov't Code § 43739 Comment *infra*.

1 municipal bankruptcy filings that occurred before it became operative.<sup>6</sup> The 1934  
2 California act was replaced in 1939 with a more general authorization for any  
3 “taxing agency or instrumentality of this State” as defined in federal law to file a  
4 bankruptcy petition.<sup>7</sup>

5 The general state statutes authorizing bankruptcy filings by local government  
6 were codified in 1949 and have never been amended. Government Code Sections  
7 53760 and 53761 provide as follows:

8       53760. Any taxing agency or instrumentality of this State, as defined in Section  
9       81 of the act of Congress entitled “An act to establish a uniform system of  
10       bankruptcy throughout the United States,” approved July 1, 1898, as amended,  
11       may file the petition mentioned in Section 83 of the act and prosecute to  
12       completion all proceedings permitted by Sections 81, 82, 83, and 84 of the act.<sup>8</sup>

13       53761. The State consents to the adoption of Sections 81, 82, 83, and 84 by  
14       Congress and consents to their application to the taxing agencies and  
15       instrumentalities of this State.<sup>9</sup>

16 The statutory references have been obsolete since enactment of the federal  
17 Bankruptcy Code in 1978.<sup>10</sup> Nor has the terminology been revised for compliance  
18 with 1994 amendments to federal law requiring that a “municipality” be  
19 “specifically authorized” by state law to petition for debt adjustment under Chap-  
20 ter 9. Section 109(c) of the Bankruptcy Code provides, in relevant part:<sup>11</sup>

21       (c) An entity may be a debtor under chapter 9 of this title if and only if such  
22       entity —  
23       (1) is a municipality; [and]

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6. 1934 Cal. Stat. ch 4, § 7a (1st Ex. Sess.).

7. See 1939 Cal. Stat. ch. 72 (operative April 21, 1939).

8. References are to 11 U.S.C.A. § 401 (repealed); 11 U.S.C.A. § 403 (repealed; see now 11 U.S.C.A. § 903); 11 U.S.C.A. §§ 401-403 (repealed; see now 11 U.S.C.A. §§ 101 *et seq.*, 901, 902 *et seq.*, 903, 904, 921(b)).

9. References are to 11 U.S.C.A. §§ 401-403 (repealed; see now 11 U.S.C.A. §§ 101 *et seq.*, 901, 902 *et seq.*, 903, 904, 921(b)).

10. Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549.

11. The remaining subparagraphs of 11 U.S.C. Section 107(c) provide the following additional prerequisites to municipal bankruptcy:

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; *and*

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

[Emphasis added.]

1 (2) is specifically authorized, in its capacity as a municipality or by name, to be  
2 a debtor under such chapter by State law, or by a governmental officer or  
3 organization empowered by State law to authorize such entity to be a debtor under  
4 such chapter ....

5 Bankruptcy Code Section 101(40) defines “municipality” as a “political subdivi-  
6 sion or public agency or instrumentality of a State.” The effect of this definition is  
7 that the federal courts will determine whether a local governmental entity is a  
8 “municipality.” This was one of the issues faced by the court in the Orange County  
9 Investment Pool case — perhaps the determinative issue. In *In re County of*  
10 *Orange*,<sup>12</sup> the court decided that OCIP’s Chapter 9 petition could not be sustained  
11 because OCIP was not a “municipality” or an “instrumentality of a State,” nor was  
12 it otherwise “specifically authorized” by the language of Government Code Sec-  
13 tion 53760 and the incorporated parts of the old Bankruptcy Act.<sup>13</sup>

#### 14 **Recent Reform Attempts**

15 Although the general authorization in Section 53760 has remained unaltered  
16 since 1949, there was a flurry of proposed revisions arising out of the Orange  
17 County financial collapse. Four bills during the 1995-96 session would have  
18 modernized Section 53760 in the course of enacting broader substantive reforms:

- 19 • Two bills granted the broadest authority permissible under federal law by  
20 adopting the federal definition of “municipality” in Section 101(40) — SB 1274  
21 (Killea) and AB 2xx (Caldera). Neither bill made it out of committee.
- 22 • A third bill — AB 29xx (Archie-Hudson) — provided authority for a munici-  
23 pality as defined by federal law to file “with specific statutory approval of the  
24 Legislature” and required the plan for adjustment of debts under Bankruptcy  
25 Code Section 941 to be “submitted to the appropriate policy committees of the  
26 Legislature prior to being submitted to the United States Bankruptcy Code.”  
27 This bill also died.
- 28 • A fourth bill — SB 349 (Kopp) — passed the Legislature, but was vetoed. Like  
29 the other bills, SB 349 modernized the obsolete references and adopted the  
30 “municipality” language of the federal statute. The bill would have established a  
31 “Local Agency Bankruptcy Committee,” consisting of the Controller, Treasurer,  
32 and Director of Finance, to determine whether to permit a municipality to file a  
33 Chapter 9 petition. It also contained provisions concerning appointment of a  
34 trustee by the Governor and time periods for various actions. Governor Wilson’s  
35 veto message (Sept. 30, 1996) stated that the bill “would inappropriately vest  
36 responsibility for local fiscal affairs at the state level, creating an instrument of

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12. 183 B.R. 594 (Bankr. C.D. Cal. 1995).

13. See *id.* at 600-06. The court did not discuss the issue of whether Government Code Section 53760 was obsolete or imposed additional restrictions that might prevent OCIP’s filing, but instead concluded that OCIP did not meet the requisite standards of old or new law. It is unknown whether the incongruity between the obsolete state authorization language and the new terms of the Bankruptcy Code might have any effect on the ability to file under Chapter 9. The OCIP court assumed that the municipality and state instrumentality language of the Bankruptcy Code could be applied, but found that OCIP did not qualify.

1 state government to usurp the authority of local officials to decide the wisdom  
2 of a bankruptcy filing” and “could raise questions of the liability of the state to  
3 creditors of the public agency if eligibility for bankruptcy is denied.”

4 No bills have been introduced to amend Section 53760 since the 1995-96 legisla-  
5 tive session.<sup>14</sup>

#### 6 **Revision of General Authorization**

7 With the proliferation of local government agencies — as many of 7,000 of them  
8 who might claim municipality or instrumentality status<sup>15</sup> — it is important to give

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14. A number of special statutes addressing the problems raised by the Orange County Investment Pool failure were enacted, even though the general bankruptcy authorization rules remained unamended. For provisions specific to Orange County, see, e.g., Educ. Code §§ 42238.21, 84753; Gov’t Code §§ 20487, 29141.1, 29530.5, 30400-30406, 53584.1, 53585.1; Health & Safety Code § 33670.9; Rev. & Tax. Code § 96.16; Sts. & Hy. Code § 2128. The Commission has not reviewed these provisions.

15. See Cal. Const. Revision Comm’n, *Final Report and Recommendations to the Governor and the Legislature 71-72* (1996). The Constitution Revision Commission reports that there are 470 cities, 1,062 school districts and county offices of education, and 5,000 special districts. “There are about 55 types of activities performed by special districts ranging from operating airports to managing zoos. Approximately 2,200 are ‘independent’ districts. That is, they have elected or appointed boards and are independent of the cities or counties in which they provide services.” *Id.* at 72.

The scope of activities carried on by special districts can be estimated by the following list of entities from the 1st Validating Act of 2001 (2001 Cal. Stat. ch. 10, § 2 (SB 161)):

Air pollution control districts of any kind, air quality management districts, airport districts, assessment districts, benefit assessment districts, and special assessment districts of any public body, bridge and highway districts, California water districts, citrus pest control districts, city maintenance districts, community college districts, community development commissions, community facilities districts, community redevelopment agencies, community rehabilitation districts, community services districts, conservancy districts, cotton pest abatement districts, county boards of education, county drainage districts, county flood control and water districts, county free library systems, county maintenance districts, county sanitation districts, county service areas, county transportation commissions, county water agencies, county water authorities, county water districts, county waterworks districts, ... agencies acting pursuant to Part 3 (commencing with Section 11100) of Division 6 of the Water Code, distribution districts of any public body, drainage districts, fire protection districts, flood control and water conservation districts, flood control districts, garbage and refuse disposal districts, garbage disposal districts, geologic hazard abatement districts, harbor districts, harbor improvement districts, harbor, recreation, and conservation districts, health care authorities, highway districts, highway interchange districts, highway lighting districts, housing authorities, improvement districts or improvement areas of any public body, industrial development authorities, infrastructure financing districts, integrated financing districts, irrigation districts, joint highway districts, levee districts, library districts, library districts in unincorporated towns and villages, local agency formation commissions, local health care districts, local health districts, local hospital districts, local transportation authorities or commissions, maintenance districts, memorial districts, metropolitan transportation commissions, metropolitan water districts, mosquito abatement or vector control districts, municipal improvement districts, municipal utility districts, municipal water districts, nonprofit corporations, nonprofit public benefit corporations, open-space maintenance districts, parking authorities, parking districts, permanent road divisions, pest abatement districts, police protection districts, port districts, project areas of community redevelopment agencies, protection districts, public cemetery districts, public utility districts, rapid transit districts, reclamation districts, recreation and park districts, regional justice facility financing agencies, regional park and open-space districts, regional planning districts, regional transportation commissions, resort improvement districts, resource conservation districts, river port districts, road maintenance districts, sanitary districts, school districts of any kind or class, school facilities improvement districts, separation of grade districts, service authorities for freeway emergencies, sewer districts, sewer maintenance districts, small craft harbor

1 some consideration to providing limitations on the authority to file for debt  
2 adjustment. One commentator asks: “Should a ‘citrus pest control district’ or a  
3 ‘storm drainage district’ be permitted to seek Chapter 9 relief?”<sup>16</sup> Conditions have  
4 changed dramatically since 1934 — there are significantly more special districts  
5 now than existed 65 years ago, although the number of counties remains the same  
6 and the number of cities presumably has not grown significantly. Historically,  
7 special districts have comprised the bulk of the Chapter 9 filers.<sup>17</sup>

8 If the goal is to preserve California’s historically broad grant of municipal  
9 bankruptcy authority,<sup>18</sup> the simplest approach is to use the word “municipality” as  
10 used in federal law and thereby incorporate the broadest possible class of permis-  
11 sible filers. Any exceptions can be made by statute as the Legislature and Gover-  
12 nor agree is appropriate under the circumstances, as was done in the Orange  
13 County situation.

14 Another option would be for the state to take control of the definitional issue by  
15 defining which public entities can file under Chapter 9, rather than leaving the  
16 issue potentially to the case-by-case determination by bankruptcy courts.<sup>19</sup> State  
17 law cannot expand the scope of federal bankruptcy law, but even if the purpose of  
18 listing types of entities is not to restrict access, a state catalog could be “a persua-  
19 sive starting point for defining the scope of [“municipality”] in California. More-  
20 over, the use of a state law definition would reduce the risk that certain entities  
21 might be permitted or precluded from filing based on shifting federal interpreta-  
22 tions of the term ‘municipality.’”<sup>20</sup>

23 Professor Tung notes that this approach “has some promise but also some limita-  
24 tions,”<sup>21</sup> and he reminds that “only the federal definition matters. That definition

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districts, stone and pome fruit pest control districts, storm drain maintenance districts, storm drainage districts, storm drainage maintenance districts, storm water districts, toll tunnel authorities, traffic authorities, transit development boards, transit districts, unified and union school districts’ public libraries, vehicle parking districts, water agencies, water authorities, water conservation districts, water districts, water replenishment districts, water storage districts, wine grape pest and disease control districts, zones, improvement zones, or service zones of any public body.

16. Memorandum from Henry C. Kevane to Randall Henry, Office of Senator Quentin L. Kopp 2 (May 31, 1996) (attached to Commission Staff Memorandum 97-19 (March 22, 1997)) [hereinafter Kevane Memorandum].

17. See Tung, *supra* note 1, at 22.

18. California is classed as one of the specific authorization states, even with its obsolete statutory language, and is generally considered as meeting the requirement of 11 U.S.C. Section 109(c)(2). See, e.g., Kordana, *Tax Increases in Municipal Bankruptcies*, 83 Va. L. Rev. 1035, 1044 (1997); Kupetz, *Municipal Debt Adjustment Under the Bankruptcy Code*, 27 Urb. Law. 531, 539-40 & n.24 (1995); Young, *Keeping a Municipal Foot in the Chapter 9 Door: Eligibility Requirements for Municipal Bankruptcies*, 23 Cal. Bankr. J. 309, 314-16 (1997); Comment (Freyberg), *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, 1008 n.66 (1997).

19. See Kevane Memorandum, *supra* note 16, at 3-5.

20. *Id.* at 5.

21. See Tung Study, *supra* note 1, at. 31-32.

1 cannot be expanded by state legislation, any more than any federal statute is sub-  
2 ject to modification by a state legislature.” He suggests:

3       A list approach may be more effective. It would not redefine terms contained in  
4 the federal statute, but would merely provide a reference for the bankruptcy judge  
5 in her attempts to construe the terms “political subdivision” and “public agency or  
6 instrumentality” from federal law and decide whether a particular state-created  
7 entity qualifies. For example, some manifestation by the state that it considers a  
8 county-created investment pool to be a state agency or instrumentality might be  
9 persuasive.<sup>22</sup>

10       The Commission has decided to favor simplicity in amendments to preserve the  
11 broad grant of authority, and to avoid additional detail or complications in imple-  
12 menting this goal. Municipal bankruptcies are relatively rare in recent years and  
13 most candidates for bankruptcy fall within well-understood categories. An attempt  
14 to list local public entities in a statute might just state the obvious without helping  
15 resolve issues such as those faced by the court in the Orange County Investment  
16 Pool case.<sup>23</sup>

#### 17 **Substantive Reform Options**

18       A variety of approaches is illustrated in the laws of other states. The largest  
19 group, over 20 states, have no enabling statutes at all.<sup>24</sup> Twelve or more states  
20 have granted generally unfettered authority to some or all local entities.<sup>25</sup> Georgia  
21 forbids resort to Chapter 9.<sup>26</sup> A number of other states provide restrictions on  
22 bankruptcy filings by way of preliminary review or other conditions, including  
23 state prebankruptcy insolvency procedures.<sup>27</sup>

24       Professor Tung gives a strong argument in favor of discretionary access to  
25 bankruptcy protection through use of a gatekeeper. Fundamental to his analysis is  
26 the potential effect that one municipality’s bankruptcy may have on the borrowing  
27 power of other municipalities, supporting the conclusion that a city or county  
28 should not have sole authority to take advantage of Chapter 9 in disregard of the  
29 fallout for other public entities. Professor Tung concludes that discretion to  
30 approve municipal bankruptcy filings should be vested in the Governor, as the  
31 authority best situated to decide whether and under what conditions a municipality

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22. *Id.* at 32.

23. The Commission takes no position on whether that case was correctly decided or whether the OCIP would be covered by the proposed incorporation of the “municipality” definition in federal law.

24. Freyberg, *supra* note 18, at 1009, 1016.

25. Tung, *supra* note 1, at 21-23; Freyberg, *supra* note 18, at 1009-10.

26. Tung, *supra* note 1, at 23.

27. See Tung, *supra* note 1, at 23-25; Freyberg, *supra* note 18, at 1010-14.

1 may file for bankruptcy.<sup>28</sup> Other possibilities exist, such as a committee of offi-  
2 cials, like the procedure passed by the Legislature but vetoed in 1996.<sup>29</sup>

3 Another well-argued proposal for reform has been presented to the Commission  
4 by Henry C. Kevane,<sup>30</sup> who agrees with Prof. Tung's reasons for early state  
5 involvement in the municipal bankruptcy process, but believes quick access to  
6 bankruptcy protection from creditors is essential to local public entities. A trustee  
7 could be appointed by the Governor when a public entity had filed a Chapter 9  
8 case and would have all the powers of the entity, including powers under Chapter  
9 9. He would limit the state government's function to helping formulate the adjust-  
10 ment plan and other post-filing issues, and argues that the correct focus is on shap-  
11 ing the adjustment plan and other fiscal matters (or dismissing the petition) once  
12 the factors can be better known.

### 13 CONCLUSION

14 The Commission has not found any consensus in favor of substantive reforms,  
15 whether providing for a gatekeeper or post-filing management. The Commission  
16 did learn informally that the Governor's Office is not particularly interested in  
17 having the gatekeeper function.<sup>31</sup> The Commission's study has engendered little  
18 interest from representatives of local public entities. The only written comment  
19 was received from the California County Counsels' Association, which expressed  
20 the view that substantive reform was not needed, particularly if it imposed a  
21 prefiling gatekeeper.<sup>32</sup>

22 Although it has been nearly five years since Senator Kopp's SB 349 establishing  
23 the Local Agency Bankruptcy Committee was vetoed by Governor Wilson, the  
24 Commission has concluded that a gatekeeper or other substantive restrictions on  
25 local agency filings are not acceptable to the state and local officials. Weighing the  
26 factors discussed by Prof. Tung and Mr. Kevane is largely a political exercise:  
27 what is the state's interest in controlling access as a gatekeeper, what is the risk to  
28 the fiscal soundness of the state and its subdivisions by unrestricted access to  
29 Chapter 9, who can and should step in to remedy insolvency and when should they  
30 do it.

31 As we have seen in the Orange County crisis, the state can respond legislatively  
32 in serious cases. In other situations, such as school district insolvency, there are  
33 mechanisms in place for the state to use a trustee mechanism. Generally speaking,

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28. See Tung, *supra* note 1, at 24-31.

29. See discussion of SB 349 under "Recent Reform Attempts" *supra*.

30. See Kevane Memorandum, *supra* note 18; Letter from Henry C. Kevane to California Law Revision Commission (June 21, 2000) (attached to First Supplement to Commission Staff Memorandum 2000-38 (June 21, 2000)).

31. See Commission Staff Memorandum 2000-66 (Sept. 29, 2000), at 1-2.

32. See Letter from Robert A. Ryan, Jr., to California Law Revision Commission (March 26, 2001) (attached to First Supplement to Commission Staff Memorandum 2001-32 (March 28, 2001)).

1 bankruptcy is not the only remedy, since there are a host of statutes governing  
2 municipal finance that also serve to avoid insolvency and promote sound credit.

3 In light of the political factors and the lack of a consensus, the Commission rec-  
4ommends only a technical statutory cleanup at this time. Conditions may change in  
5 the future, at which time the background study and other materials should be of  
6 significant assistance in fashioning an appropriate recommendation.

## 7 RECOMMEND REVISIONS

8 The Commission recommends revision of Government Code Section 53760 with  
9 the goal of making the general authority of local public entities to file for Chapter  
10 9 bankruptcy protection consistent with the scope and language of the federal  
11 Bankruptcy Code. The proposed statute authorizes local public entities to file a  
12 bankruptcy petition and exercise powers to the extent permitted municipalities  
13 under federal bankruptcy law. As revised, this section is intended to provide the  
14 specific state law authorization for municipal bankruptcy filing required under  
15 federal law.<sup>33</sup>

16 The proposed revision will update the intent of the statute to meet the specific  
17 authorization requirement of current federal law and will reaffirm the likely origi-  
18 nal intent of the statute to provide the broadest possible access to municipal debt  
19 relief.

20 In addition, the Commission recommends a number of conforming amendments  
21 and repeals to modernize language and eliminate duplicative authority.<sup>34</sup> These  
22 revisions would be technical, nonsubstantive changes in the statutes. Overlapping  
23 provisions, such as Government Code Section 53761, should be repealed as  
24 unnecessary and redundant.<sup>35</sup>

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33. 11 U.S.C. § 109(c)(2) (Westlaw 2001). In discussing the specificity requirement, the court in the Orange County Investment Pool case opined: “For example that statute could authorize all ‘municipalities’ as defined in the Code to file bankruptcy.” *In re County of Orange*, 183 B.R. 594, 605 (1995). This conclusion follows from the language in Section 109(c)(2) requiring authorization “in its capacity as a municipality or by name.” Granting state authorization for “municipalities” as a class satisfies the Bankruptcy Code standard.

34. See proposed amendments and repeals concerning Educ. Code § 41325 (school districts); Gov’t Code §§ 43739 (cities), 53761 (general consent to bankruptcy), 59125 (Special Assessment and Bond Refunding Law of 1939); Water Code §§ 24767 (irrigation districts), 25115 (irrigation districts), *infra*. There are a number of other provisions relating to bankruptcy that are not in need of revision. See, e.g., Gov’t Code §§ 59472, 59110, 59125, 59598; Ins. Code § 10089.21; Sts. & Hy. Code §§ 9011, 9075.

35. See proposed repeal of Gov’t Code § 53761 *infra*. See also Kevane Memorandum, *supra* note 18, at 2 n.2.

PROPOSED LEGISLATION

1 **Educ. Code § 41325 (technical amendment). Legislative intent concerning school district**  
2 **insolvency**

3 SEC. 1. Section 41325 of the Education Code is amended to read:

4 41325. (a) The Legislature finds and declares that when a school district  
5 becomes insolvent and requires an emergency apportionment from the state in the  
6 amount designated in this article, it is necessary that the Superintendent of Public  
7 Instruction assume control of the district in order to ensure the district's return to  
8 fiscal solvency.

9 (b) It is the intent of the Legislature that the Superintendent of Public Instruction,  
10 operating through an appointed administrator, do all of the following:

11 (1) Implement substantial changes in the district's fiscal policies and practices,  
12 including, if necessary, the filing of a petition under Chapter 9 of the federal  
13 Bankruptcy Act Code for the adjustment of indebtedness.

14 (2) Revise the district's educational program to reflect realistic income  
15 projections, in response to the dramatic effect of the changes in fiscal policies and  
16 practices upon educational program quality and the potential for the success of all  
17 pupils.

18 (3) Encourage all members of the school community to accept a fair share of the  
19 burden of the district's fiscal recovery.

20 (4) Consult, for the purposes described in this subdivision, with the school  
21 district governing board, the exclusive representatives of the employees of the  
22 district, parents, and the community.

23 (5) Consult with and seek recommendations from the county superintendent of  
24 schools for the purposes described in this subdivision.

25 **Comment.** Subdivision (b)(1) of Section 41325 is amended to reflect the repeal of the former  
26 Bankruptcy Act and enactment of the Bankruptcy Code in 1978.

27 **Gov't Code § 43739 (repealed). Authorization for municipal bankruptcy**

28 SEC. 2. Section 43739 of the Government Code is repealed.

29 ~~43739. Any city authorized to refund its indebtedness pursuant to this article~~  
30 ~~may file a petition under any bankruptcy law of the United States. If the refunding~~  
31 ~~of the city indebtedness is authorized in the bankruptcy proceeding, the city may~~  
32 ~~refund its indebtedness pursuant to this article.~~

33 **Comment.** Former Section 43739 is superseded by Section 53760. The substance of the grant  
34 of authority to file for municipal bankruptcy provided in the first sentence of this section is  
35 continued in new Section 53760. The reference to the ability of a city to refund indebtedness is  
36 not continued because it is unnecessary. Section 53760 provides the broadest possible state  
37 authorization for municipal bankruptcy filings. See Section 53760 Comment.

38 The second sentence is not continued because it is unnecessary. Section 43720 provides the  
39 scope of this article and does not exclude its application in bankruptcy proceedings. Whether or  
40 not debt is refunded pursuant to this article should be determined in the bankruptcy proceedings.

1 **Gov't Code § 53760 (repealed). Authorization for municipal bankruptcy**

2 SEC. 3. Section 53760 of the Government Code is repealed.  
3 ~~53760. Any taxing agency or instrumentality of this State, as defined in Section~~  
4 ~~81 of the act of Congress entitled "An act to establish a uniform system of~~  
5 ~~bankruptcy throughout the United States," approved July 1, 1898, as amended,~~  
6 ~~may file the petition mentioned in Section 83 of the act and prosecute to~~  
7 ~~completion all proceedings permitted by Sections 81, 82, 83, and 84 of the act.~~

8 **Comment.** Former Section 53760 is superseded by a new Section 53760. The substance of the  
9 grant of authority to file for municipal bankruptcy provided in this section is continued in new  
10 Section 53760, which modernizes references to federal bankruptcy law. The Bankruptcy Act  
11 sections listed in former Section 53760 were repealed in 1978. See Bankruptcy Reform Act of  
12 1978, Pub. L. No. 95-598. The "taxing agency or instrumentality" phrase was drawn from the  
13 predecessor Bankruptcy Act of 1898, as amended in 1937. This language has been replaced by  
14 the more general term "municipality" in the Bankruptcy Code. See 11 U.S.C. § 101(40) (Westlaw  
15 2001), as amended by the Bankruptcy Reform Act of 1994. To the extent that former Section  
16 53760 could be interpreted in a more limited fashion (*cf. In re County of Orange*, 183 B.R. 594,  
17 605 (Bankr. C.D. Cal. 1995)), that limitation is not continued in new Section 53760.

18 **Gov't Code § 53760 (added). Authorization for municipal bankruptcy**

19 SEC. 4. Section 53760 is added to the Government Code, to read:  
20 53760. (a) Except as otherwise provided by statute, a local public entity in this  
21 state may file a petition and exercise powers pursuant to applicable federal  
22 bankruptcy law.  
23 (b) As used in this section, "local public entity" means any entity, without  
24 limitation, that is a "municipality," as defined in paragraph (40) of Section 101 of  
25 Title 11 of the United States Code (Bankruptcy), or that qualifies under any other  
26 federal bankruptcy law applicable to political subdivisions of the state.

27 **Comment.** Section 53760 supersedes former Sections 43739 (city bankruptcy), 53760 (taxing  
28 agency or instrumentality bankruptcy), and 53761 (state consent). The former sections contained  
29 obsolete references to repealed federal bankruptcy law. This section is intended to provide the  
30 broadest possible state authorization for municipal bankruptcy proceedings, and thus provides the  
31 specific state law authorization for municipal bankruptcy filing required under federal law. See 11  
32 U.S.C. § 109(c)(2) (Westlaw 2001).

33 As recognized in the introductory clause of subdivision (a), this broad grant of authority is  
34 subject to specific limitations provided by statute. See, e.g., Ins. Code § 10089.21 (California  
35 Earthquake Authority precluded from resort to bankruptcy); Sts. & Hy. Code § 9011  
36 (prerequisites to bankruptcy filing under Improvement Bond Act of 1915). See also Educ. Code §  
37 41325 (control of insolvent school district by Superintendent of Public Instruction); Health &  
38 Safety Code § 129173 (health care district trusteeship).

39 **Gov't Code § 53761 (repealed). Consent to bankruptcy**

40 SEC. 5. Section 53761 of the Government Code is repealed.  
41 ~~53761. The State consents to the adoption of Sections 81, 82, 83, and 84 by~~  
42 ~~Congress and consents to their application to the taxing agencies and~~  
43 ~~instrumentalities of this State.~~

44 **Comment.** Former Section 53761 is superseded by Section 53760. The substance of the  
45 consent to file for municipal bankruptcy provided in this section is continued in new Section

1 53760, which modernizes references to federal bankruptcy law. The Bankruptcy Act sections  
2 listed in former Section 53760 were repealed in 1978. See Bankruptcy Reform Act of 1978, Pub.  
3 L. No. 95-598. To the extent that former Section 53761 could be interpreted to provide a more  
4 limited scope than federal law, that limitation is not continued.

5 **Gov't Code § 59125 (amended). Special Assessment and Bond Refunding Law of 1939**

6 SEC. 6. Section 59125 of the Government Code is amended to read:

7 59125. A legislative body authorized to conduct a proceeding pursuant to this  
8 chapter may file a petition and ~~take all actions required by any exercise powers~~  
9 under applicable federal bankruptcy law ~~for a district formed under any~~  
10 ~~improvement or acquisition law which provides for the payment of the~~  
11 ~~improvement or acquisition by special assessment upon the property benefited as~~  
12 provided by Section 53760.

13 **Comment.** Section 59125 is amended for consistency with the general authorization for  
14 municipal bankruptcy provided in Section 53760. See Section 53760 Comment. This is a  
15 technical, nonsubstantive revision.

16 **Water Code § 24767 (amended). Irrigation districts, condition of modification plan**

17 SEC. 7. Section 24767 of the Water Code is amended to read:

18 24767. An agreement or plan may not be carried out pursuant to this article until  
19 a proposal therefor is approved by the voters, and a plan may not be carried out  
20 until it is either:

21 (a) Agreed to in writing by all of the holders of bonds and warrants affected.

22 (b) ~~Confirmed by a decree of any United States District Court in accordance~~  
23 ~~with the provision of the National Bankruptcy Act, as amended~~ federal bankruptcy  
24 law.

25 **Comment.** Subdivision (b) of Section 24767 is amended to generalize the reference to federal  
26 bankruptcy law, in recognition of the repeal of the former Bankruptcy Act and enactment of the  
27 Bankruptcy Code. The limitation on the effectiveness of a bankruptcy court decree — requiring  
28 that it be made by a district court — is deleted.

29 **Water Code § 25115 (amended). Irrigation districts, approval of bondholders**

30 SEC. 8. Section 25115 of the Water Code is amended to read:

31 25115. The approval of the holders of outstanding refunding bonds affected by  
32 the modification shall be evidenced by either of the following:

33 (a) The written consent of all of the owners and holders of the bonds.

34 (b) ~~A decree of any United States District Court in accordance with the~~  
35 ~~provisions of the National Bankruptcy Act, as amended~~ under federal bankruptcy  
36 law, which decree provides that the modification is binding upon the holders and  
37 owners of all of the outstanding refunding bonds affected.

38 **Comment.** Subdivision (b) of Section 25115 is amended to generalize the reference to federal  
39 bankruptcy law, in recognition of the repeal of the former Bankruptcy Act and enactment of the  
40 Bankruptcy Code. The limitations on the effectiveness of a bankruptcy court decree — requiring  
41 that it be made by a district court and that it provide that it is binding on affected persons — are  
42 deleted. The content and effect of a decree in bankruptcy is determined by federal law.