

STATE OF CALIFORNIA

CALIFORNIA LAW REVISION COMMISSION

RECOMMENDATION

Municipal Bankruptcy

November 2001

California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

NOTE

This report includes an explanatory Comment to each section of the recommended legislation. The Comments are written as if the legislation were already operative, since their primary purpose is to explain the law as it will exist to those who will have occasion to use it after it is operative.

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CALIFORNIA LAW REVISION COMMISSION

4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739
650-494-1335

JOYCE G. COOK, Chairperson
ASSEMBLY MEMBER HOWARD WAYNE, Vice Chairperson
BION M. GREGORY
DAVID HUEBNER
SENATOR BILL MORROW
SANFORD M. SKAGGS

November 15, 2001

To: The Honorable Gray Davis
Governor of California, and
The Legislature of California

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.

Respectfully submitted,

Joyce G. Cook
Chairperson

MUNICIPAL BANKRUPTCY

BACKGROUND

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

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 from the Commission's website at <<http://clrc.ca.gov/pub/Printed-Reports/BKST-811-TungMuniBk.pdf>>. For a later version, see Tung, *After Orange County: Reforming California Municipal Bankruptcy Law*, 53 *Hastings L.J.* ____ (forthcoming 2002).

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 consti-

California Law

The federal municipal bankruptcy procedure dates from May 1934.⁴ The California Legislature responded quickly by enacting an uncodified statute (operative September 20, 1934) that authorized taxing districts, as defined in federal law, to file for bankruptcy protection.⁵ This act also purported to validate any municipal bankruptcy filings that occurred before it became operative.⁶ The 1934 California act was replaced in 1939 with a more general authorization for any “taxing agency or instrumentality of this State” as defined in federal law to file a bankruptcy petition.⁷

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

53760. Any taxing agency or instrumentality of this State, as defined in Section 81 of the act of Congress

tutional 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 survived constitutional challenge. It was made a permanent part of the Bankruptcy Act in 1946. The revised law was little used until the mid-1970s. In 1976, further statutory revisions were made in response to New York City’s fiscal difficulties. Finally, in 1994, additional substantive revisions were made concerning the requirement for state authorization of municipal resort to bankruptcy protection.

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*.

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

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

entitled “An act to establish a uniform system of bankruptcy throughout the United States,” approved July 1, 1898, as amended, may file the petition mentioned in Section 83 of the act and prosecute to completion all proceedings permitted by Sections 81, 82, 83, and 84 of the act.

53761. The State consents to the adoption of Sections 81, 82, 83, and 84 by Congress and consents to their application to the taxing agencies and instrumentalities of this State.

These references to sections in the federal Bankruptcy Act have been obsolete since enactment of the Bankruptcy Code in 1978.⁸

The Government Code terminology has also not been revised for compliance with the 1994 amendments to federal law requiring that a “municipality” be “specifically authorized” by state law to petition for debt adjustment under Chapter 9. Section 109(c) of the Bankruptcy Code provides, in relevant part:

- (c) An entity may be a debtor under chapter 9 of this title if and only if such entity —
 - (1) is a municipality; [and]
 - (2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter⁹

8. Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549. The superseded Bankruptcy Act provisions, referred to in Government Code Sections 53760 and 53761, were codified as follows: 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. The remaining subparagraphs of 11 U.S.C. Section 107(c) provide the following additional prerequisites to municipal bankruptcy:

- (3) is insolvent;

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

Recent Reform Attempts

Although the general authorization in Section 53760 has remained unaltered since 1949, a number of revisions were

(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.]

10. 183 B.R. 594 (Bankr. C.D. Cal. 1995).

11. 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.

proposed in the aftermath of the Orange County financial collapse. Four bills during the 1995-96 session would have modernized Section 53760 in the course of enacting broader substantive reforms:

- Two bills would have granted the broadest authority permissible under federal law by adopting the federal definition of “municipality” in Section 101(40) — SB 1274 (Killea) and AB 2xx (2d Extraordinary Session) (Caldera). Neither bill made it out of committee.
- A third bill — AB 29xx (2d Extraordinary Session) (Archie-Hudson) — provided authority for a municipality as defined by federal law to file “with specific statutory approval of the Legislature” and required the plan for adjustment of debts under Bankruptcy Code Section 941 to be “submitted to the appropriate policy committees of the Legislature prior to being submitted to the United States Bankruptcy Code.” This bill also died.
- A fourth bill — SB 349 (Kopp) — passed the Legislature, but was vetoed. Like the other bills, SB 349 modernized the obsolete references and adopted the “municipality” language of the federal statute. The bill would have established a “Local Agency Bankruptcy Committee,” consisting of the Controller, Treasurer, and Director of Finance, to determine whether to permit a municipality to file a Chapter 9 petition. It also contained provisions concerning appointment of a trustee by the Governor and time periods for taking various actions. Governor Wilson’s veto message (Sept. 30, 1996) stated that the bill “would inappropriately vest responsibility for local fiscal affairs at the state level, creating an instrument of state government to usurp the authority of local officials to decide the wisdom of a bankruptcy filing” and “could raise questions of the liability of the state to creditors of the public agency if eligibility for bankruptcy is denied.”

No bills have been introduced to amend Section 53760 since the 1995-96 legislative session.¹²

Revision of General Authorization

With the proliferation of local government agencies — as many as 7,000 of them who might claim municipality or instrumentality status¹³ — it is important to give some con-

12. 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.

13. 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

sideration to providing limitations on the authority to file for debt adjustment. One commentator asks: “Should a ‘citrus pest control district’ or a ‘storm drainage district’ be permitted to seek Chapter 9 relief?”¹⁴ Conditions have changed dramatically since 1934 — there are significantly more

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 districts, special municipal tax 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.

14. 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].

special districts now than existed 65 years ago, although the number of counties remains the same and the number of cities presumably has not grown significantly. Historically, special districts have comprised the bulk of the Chapter 9 filers.¹⁵

If the goal is to preserve California's historically broad grant of municipal bankruptcy authority,¹⁶ the simplest approach would be to incorporate the word "municipality" as used in federal law and thereby adopt the broadest possible class of permissible filers. Any exceptions can be made by statute as the Legislature and Governor agree is appropriate under the circumstances, as was done in the Orange County situation.

Another option would be for the state to take control of the definitional issue by defining which public entities can file under Chapter 9, rather than leaving the issue to case-by-case determination by bankruptcy courts.¹⁷ State law cannot expand the scope of federal bankruptcy law, but even if the purpose of listing types of entities is not to restrict access, a state catalog could be "a persuasive starting point for defining the scope of ["municipality"] in California. Moreover, the use of a state law definition would reduce the risk that certain

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

16. 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 & n.49 (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).

17. See Kevane Memorandum, *supra* note 14, at 3-5.

entities might be permitted or precluded from filing based on shifting federal interpretations of the term ‘municipality.’”¹⁸

Professor Tung notes that this approach “has some promise but also some limitations,”¹⁹ and he cautions that “only the federal definition matters. That definition cannot be expanded by state legislation, any more than any federal statute is subject to modification by a state legislature.” He suggests:

A list approach may be more effective. It would not redefine terms contained in the federal statute, but would merely provide a reference for the bankruptcy judge in her attempts to construe the terms “political subdivision” and “public agency or instrumentality” from federal law and decide whether a particular state-created entity qualifies. For example, some manifestation by the state that it considers a county-created investment pool to be a state agency or instrumentality might be persuasive.²⁰

In drafting amendments to preserve the broadest grant of authority for municipal bankruptcy, the Commission has decided to favor simplicity and to avoid additional detail that might detract from implementing this goal. Municipal bankruptcies are relatively rare in recent years and most candidates for bankruptcy fall within well-understood categories. An attempt to list all local public entities in a statute might simply state the obvious without helping resolve issues such as those faced by the court in the Orange County Investment Pool case.²¹

18. *Id.* at 5.

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

20. *Id.* at 32.

21. 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.

Substantive Reform Options

A variety of approaches is illustrated in the laws of other states. Over 20 states have no enabling statutes at all.²² Twelve or more states have granted generally unfettered authority to some or all local entities.²³ Georgia forbids resort to Chapter 9.²⁴ A number of other states provide restrictions on bankruptcy filings by way of preliminary review or other conditions, including state prebankruptcy insolvency procedures.²⁵

Professor Tung gives a strong argument in favor of discretionary access to bankruptcy protection through use of a gatekeeper. Fundamental to his analysis is the potential effect that one municipality's bankruptcy may have on the borrowing power of other municipalities, supporting the conclusion that a city or county should not have sole authority to take advantage of Chapter 9 in disregard of the fallout for other public entities. Professor Tung concludes that discretion to approve municipal bankruptcy filings should be vested in the Governor, as the authority best situated to decide whether and under what conditions a municipality may file for bankruptcy.²⁶ Other possibilities exist, such as a committee of officials, like the procedure passed by the Legislature but vetoed in 1996.²⁷

Another well-argued proposal for reform has been presented to the Commission by Henry C. Kevane,²⁸ who agrees with Prof. Tung's reasons for early state involvement in the munic-

22. Freyberg, *supra* note 16, at 1009, 1016.

23. Tung, *supra* note 1, at 21-23; Freyberg, *supra* note 16, at 1009-10.

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

25. See Tung, *supra* note 1, at 23-25; Freyberg, *supra* note 16, at 1010-14.

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

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

28. See Kevane Memorandum, *supra* note 14; 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)).

ipal bankruptcy process, but believes quick access to bankruptcy protection from creditors is essential to local public entities. A trustee could be appointed by the Governor when a public entity had filed a Chapter 9 case and would have all the powers of the entity, including powers under Chapter 9. Mr. Kevane would limit the state government's function to helping formulate the adjustment plan and other post-filing issues, and argues that the correct focus is on shaping the adjustment plan and other fiscal matters (or dismissing the petition) once the factors can be better known.

CONCLUSION

The Commission has not found any consensus in favor of substantive reforms, whether providing for a gatekeeper or post-filing management. The Commission learned informally that the Governor's Office is not in support of accepting the gatekeeper function.²⁹ The Commission's study has engendered little interest from representatives of local public entities. The only written comment was received from the California County Counsels' Association, which expressed the view that substantive reform was not needed, particularly if it imposed a prefiling gatekeeper.³⁰

Although it has been nearly five years since Senator Kopp's SB 349 establishing the Local Agency Bankruptcy Committee was vetoed by Governor Wilson, the Commission has concluded that a gatekeeper or other substantive restrictions on local agency filings are not acceptable to state and local officials. Weighing the factors discussed by Prof. Tung and Mr. Kevane is largely a political exercise: what is the state's

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

30. 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)).

interest in controlling access as a gatekeeper, what is the risk to the fiscal soundness of the state and its subdivisions by unrestricted access to Chapter 9, and who can or should step in to remedy insolvency and when should they do it?

As we have seen in the Orange County crisis, the state can respond legislatively in serious cases. In other situations, such as school district insolvency, there are procedures in place for the state to use a trustee. Generally speaking, bankruptcy is not the only remedy, since there are a host of statutes governing municipal finance that also serve to avoid insolvency and promote sound credit.

In light of the political factors and the lack of a consensus, the Commission recommends only a technical statutory cleanup at this time. If conditions change dramatically in the future, the background study and other materials submitted to the Commission should be useful in helping to fashion an appropriate recommendation for substantive revision.

RECOMMENDED REVISIONS

The Commission recommends revision of Government Code Section 53760 with the goal of making the general authority of local public entities to file for Chapter 9 bankruptcy protection consistent with the scope and language of the federal Bankruptcy Code. The proposed statute authorizes local public entities to file a bankruptcy petition and exercise powers to the extent permitted municipalities under federal bankruptcy law. As revised, this section is intended to provide the specific state law authorization for municipal bankruptcy filing required under federal law.³¹

31. 11 U.S.C. § 109(c)(2) (Westlaw 2001). In discussing the specificity requirement, the court in the Orange County Investment Pool case suggested: "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 autho-

The proposed revision will reaffirm the likely original intent of the California statute to provide the broadest possible access to municipal debt relief permissible under federal law.

In addition, the Commission recommends a number of conforming amendments and repeals to modernize language and eliminate duplicative authority.³² These revisions would be technical, nonsubstantive changes in the statutes. Overlapping provisions, such as Government Code Section 53761, should be repealed as unnecessary and redundant.³³

rization “in its capacity as a municipality or by name.” Granting state authorization for “municipalities” as a class satisfies the Bankruptcy Code standard.

32. See proposed amendments and repeals *infra* 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). A number of other provisions relating to bankruptcy 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.

33. See proposed repeal of Gov’t Code § 53761 *infra*. See also Kevane Memorandum, *supra* note 14, at 2 n.1.

PROPOSED LEGISLATION

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

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

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

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

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

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

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

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

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

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

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

SEC. 2. Section 43739 of the Government Code is repealed. ~~43739. Any city authorized to refund its indebtedness pursuant to this article may file a petition under any bankruptcy law of the United States. If the refunding of the city indebtedness is authorized in the bankruptcy proceeding, the city may refund its indebtedness pursuant to this article.~~

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

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

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

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

Comment. Former Section 53760 is superseded by a new Section 53760. The substance of the grant of authority to file for municipal bankruptcy provided in this section is continued in new Section 53760, which modernizes references to federal bankruptcy law. The Bankruptcy

Act sections listed in former Section 53760 were repealed in 1978. See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598. The “taxing agency or instrumentality” phrase was drawn from the predecessor Bankruptcy Act of 1898, as amended in 1937. This language has been replaced by the more general term “municipality” in the Bankruptcy Code. See 11 U.S.C. § 101(40) (Westlaw 2001), as amended by the Bankruptcy Reform Act of 1994. To the extent that former Section 53760 could be interpreted in a more limited fashion (*cf. In re County of Orange*, 183 B.R. 594, 605 (Bankr. C.D. Cal. 1995)), that limitation is not continued in new Section 53760.

Gov’t Code § 53760 (added). Authorization for municipal bankruptcy

SEC. 4. Section 53760 is added to the Government Code, to read:

53760. (a) Except as otherwise provided by statute, a local public entity in this state may file a petition and exercise powers pursuant to applicable federal bankruptcy law.

(b) As used in this section, “local public entity” means any entity, without limitation, that is a “municipality,” as defined in paragraph (40) of Section 101 of Title 11 of the United States Code (Bankruptcy), or that qualifies as a debtor under any other federal bankruptcy law applicable to political subdivisions of the state.

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

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

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

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

Comment. Former Section 53761 is superseded by Section 53760. The substance of the consent to file for municipal bankruptcy provided in this section is continued in new Section 53760, which modernizes references to federal bankruptcy law. The Bankruptcy Act sections listed in former Section 53760 were repealed in 1978. See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598. To the extent that former Section 53761 could be interpreted to provide a more limited scope than federal law, that limitation is not continued.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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